AUDITOR INDEPENDENCE AND EARNINGS QUALITY OF LISTED COMPANIES IN NIGER IA (2006-2013)

Mary Kehinde SALAWU
B.Sc. (Hons) Accounting, Ife, MBA Ife, M.Phil. Ife, ACA, ACIT
ADP12/13/H/1315

A Ph.D. THESIS SUBMITTED TO THE DEPARTMENT OF MANAGEMENT AND ACCOUNTING, FACULTY OF ADMINISTRATION, OBAFEMI AWOLOWO UNIVERSITY, ILE-IFE, NIGERIA, IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF DOCTOR OF PHILOSOPHY (Ph.D.) IN ACCOUNTING

2016

CERTIFICATION

I certify that Mary Kehinde Salawu carried out this research work under my supervision in the Department of Management and Accounting, Faculty of Administration, Obafemi Awolowo University, Ile-Ife, Nigeria.

....

Prof. T.O. Asaolu **Date**

(Supervisor)
Department of Management and Accounting Obafemi Awolowo University Ile-Ife, Nigeria

....

Prof. A.A. Agboola **Date**

Head of Department
Department of Management and Accounting Obafemi Awolowo University Ile-Ife, Nigeria

OBAFEMI AWOLOWO UNIVERSITY, ILE-IFE, NIGERIA

HEZEKIAH OLUWASANMI LIBRARY

POSTGRADUATE THESIS

AUTHORISATION TO COPY

AUTHOR: SALAWU, Mary Kehinde

TITLE: AUDITOR INDEPENDENCE AND EARNINGS QUALITY OF LISTED COMPANIES IN NIGERIA (2006-2013)

DEGREE: Ph. D. (Accounting)

YEAR: 2016

I, SALAWU, Mary Kehinde hereby authorize the Hezekiah Oluwasanmi Library to copy my thesis in whole or in part, in response to request from individual researchers and organizations for the purpose of private study or research.

-------------------- ------------------------

Signature Date

ACKNOWLEDGEMENTS

My heart-felt gratitude goes to my Heavenly Father, the Living and the Holy God; He is from Everlasting and the Great God of wonders. He declares the end from the beginning. He knows the way that I go and He directs my path. Without Him, I am nothing and I can do nothing, so through Him, this work was done and I return the Praises to Him. "TO YOU BE GLORY OH MY GOD FOR EVER AND EVER".

I acknowledge and appreciate the tremendous role of my supervisor, Professor T.O. Asaolu in bringing my dream to fruition. Only God knows how best to reward you for your sacrifice of time, advice, encouragement and timely intervention at every challenging instance in ensuring the success of this thesis; I cannot thank you enough sir. "You are one in thousands". To my Head of Department, Professor A.A. Agboola, a man who is highly interested in the success of his subordinates: Sir, "You are a blessing to this generation" God Almighty will reward you and your generations to come. I am very grateful to Prof. P. O. Jegede, Dr. A. A. Adegboye, Dr. A. G. Aremo, Dr. A. Adedokun, Dr. O. B. Obembe, Mr. Awe O. O. and Mr Mobolaji J. W for their timely contributions to the success of the work. My appreciation also goes to all academic and non-academic staff of the Department.

A friend in need is a friend indeed. Dr. & Pastor E.A Olajubu, Pastor and Mummy T. F. Ojo, Pastor O.O Olatokun, Pastor and Mummy Olagunju, Pastor and Mummy Adeoye, Pastor and Mummy Atolagbe, Pastor and Mummy Famakinwa, Pastor and Mummy Adedeji, Pastor and Mummy Adewole, Mr. and Mrs M. Salawu, Olabisi Prudence, Mary, Joshua, Yinka and my project students, 2014/2015 Session, all contributed practically and tremendously to the successful completion of this work. My God shall not forget your labour of love which you all

bestowed on me. I cannot but appreciate the prayer support of all my brethren in the DLBC, Ife-Region and the other brethren whose names are known to God. "How sweet and how pleasant is it for brethren to dwell together in unity".

I thank God for the shepherd-heart of my Region Overseer- Pastor Fola Ajala and our Mummy in the Lord, Mummy Ajala who prophesied Academic Excellence in to my life. They are always very supportive and happy seeing their children in the faith advancing in their chosen career. Sir and Ma, the godly seed you have planted shall not wither and your generation shall continually enjoy the supply and the support of God and of men in Jesus name.

Again, Mrs. B. Ojo (Mummy Mary), you are a neighbour closer than a blood-brother. You played a significant and dignifying role in my life. My Great God of Heaven shall engrave your good work upon the platter of Gold which shall not be blotted out and shall reward you and your family hundred-fold. You are to me "THE LOVE OF GOD EXEMPLIFIED"

I sincerely appreciate the true love and labour of my Husband through thick and thin. He is a true representative of God to me. I cannot quantify his effort, absolute support, words of encouragement and inspiration before and during the time of putting this thesis together. He is the man behind the curtain of this achievement. You will live to eat the fruit of your labour in Jesus name. My beloved children are not the least on the list. I am happy for all their prayers for me and their immeasurable love and support in my life and career till this moment. You shall not die but live to declare the glory of God in the land of the living in Jesus name. (Amen).

Mary Kehinde SALAWU

DEDICATION

I dedicate this work to God the Father, God the Son and God the Holy Spirit.

TABLE OF CONTENT

CHAPTER THREE: METHODOLOGY

CHAPTER FOUR: APPRAISAL OF AUDITOR INDEPENDENCE REGULATION IN NIGERIA

LIST OF TABLES

LIST OF FIGURES

ABSTRACT

The study appraised the effectiveness of auditor independence regulations in Nigeria; examined the trend of earnings quality and analysed the factors influencing auditor independence. It also investigated the influence of audit fees on earnings quality and analysed the influence of audit committee characteristics on earnings quality of listed companies in Nigeria. These were with a view to providing information on the impact of auditor independence on the earnings quality of listed companies in Nigeria.

The study employed both primary and secondary data. The population for the study consisted of 194 firms; Finance Director/Chief Accounting Officers of quoted firms; Statutory Auditors and Financial Analysts. Purposive sampling technique was used to select 65 financial and non-financial firms quoted on the Nigerian Stock Exchange (NSE). These comprised 15 financial firms and 50 non-financial firms selected on the basis of continuity in transaction and availability of complete data during the study period. Primary data, with the aid of structured questionnaire, were sourced from Finance Director/Chief Accounting Officers of quoted firms (150); Statutory Auditors (110) and Financial Analysts (90) on the effectiveness of auditor independence regulations and factors influencing auditor independence in Nigeria. The respondents were purposefully selected on the basis of their professionalism in corporate and financial matters. Secondary data on control variables, auditor independence, audit committee characteristics and earnings quality were sourced from the audited Annual Reports and Accounts of the sampled firms and from the NSE factbooks. Data were analysed using content analysis, mean, relative importance index, mean index score, percentages, graphs, tables and Generalised Methods of Moments.

The results of the effectiveness of auditor independence regulations showed that; restriction on advertising with mean index score (MIS) of 4.08; the number of statutory auditors performing the audit (MIS = 3.78); installation of audit committee (MIS = 3.78); restrictions on the unsolicited offering of service (MIS = 3.57); restrictions on the length of audit mandate (MIS = 3.56); approval of the appointment of a statutory auditor by any party other than the appointing party (MIS = 3.54); and limiting auditors from becoming financially dependent on an individual client (MIS = 3.53) were considered effective. The trend analysis results showed that earnings quality improved between 2006 and 2007 (42.15%) but declined in 2008 (46.47%). However, there was consistent improvement in the earnings quality in year 2009, 2010 and 2012 (37.46%, 79% and 97.28%), with a decline in 2013.

The results of the factors influencing auditor independence revealed that BIG4 ($t = -1.981$, $p<0.05$); audit tenure ($t=-1.78$, $p<0.05$); profitability ($t=-2.26$, $p<0.05$); leverage ($t=-1.49$, $p<0.05$); and inventory with account receivable ($t=-2.10$, $p<0.05$) had negative significant influence on auditor independence, while size of the firms ($t=2.36$, $p<0.05$); and loss ($t=2.45$, $p<0.05$) had positive influence on auditor independence in Nigeria. Furthermore, the results of the effect of audit fees on earnings quality showed that, audit fees ($t=-3.25$, $p<0.05$) had negative significant impact on earnings quality, while previous year earning quality ($t=-5.62$, $p<0.05$); size of the firm ($t=3.58$, $p<0.05$); and growth of the firm ($t=13.62$, $p<0.05$) had positive significant impact on earnings quality, unlike leverage (capital structure) with negative significant impact ($t=-8.23$, $p<0.05$). Finally, the results showed that audit committee meeting had a negative significant impact on earnings ($t=-6.19$, $p<0.05$), while audit committee size ($t=0.175$, $p>0.05$) and management ownership ($t=0.055$, $p>0.05$) had positive but insignificant impact on earnings quality. Also, audit committee independence (t=-0.86, p>0.05) and board size (t=-1.06, p>0.05) were found to be negatively related to earnings quality but not significant.

The study concluded that auditor independence and audit committee characteristics were major factors to be considered in the determination of earnings quality among listed companies in Nigeria.

CHAPTER ONE
INTRODUCTION

1.1 Background to the Study

The financial scandals around the world and the collapse of major corporate companies at the end of the 1990s and the beginning of the 21st century, in the USA, South East Asia, Europe and Nigeria have shaken investors' faith in the capital markets and also put in doubt, the efficacy of audited financial statement in promoting transparency and accountability (Salawu, 2011). The collapse of companies like Enron, Adelphia, Tyco and Xerox and particularly Worldcom in 2002 has been linked with audit failure as the audit firms failed to take proper step in detecting significant accounting irregularities.

Audit failure resulting from the failure of professional firms in exercising due care is a global phenomenon that cuts across jurisdictions. The issue is a major concern among the policy makers and investing public across the globe. The incidence of financial crisis witnessed by many nations particularly the developing economy and the attendant loss of confidence by the economic actors, has raised many questions about the expected roles of auditors in corporate financial reporting. For instance, the cry of the investing public had invariably been "Where were the Auditors?" (Akinjobi and Omowumi, 2010). Nigeria is not spared from incidences of audit failure. Notable corporate scandals in the country include Cadbury Nigeria Plc in 2006, African Petroleum Plc, Savannah Bank, African International Bank, Wema Bank, Nampak, Spring Bank, Intercontinental Bank Plc in 2009, Afribank Plc, Bank PHB, Fin Bank, Union Bank and Oceanic Bank all in 2009 etc (SEC 2006, Bakre 2007, Otusanya and Lauwo 2010, Uwuigbe 2013). The case of the five banks that failed the Central Bank of Nigeria (CBN) stress test carried out in 2009, revealed one thing in common; the banks were certified distressed barely few months after their auditors had given them a clean bill of health (Okoye, Okaro and Okafor 2015).

In October 2006, the Board of Cadbury Nigeria Plc notified the world, its stockholders and regulatory bodies of the discovery of "overstatements" in her accounts, which according to it, has spanned many years. The financial scandals prove to show that the auditors have fallen below expected standards. If a company fails within certain months after being audited, the auditors should be blamed for their failure to alert stakeholders of an impending business failure. Thus, the most commonly question asked whenever there has been a financial scandal is, whether the auditors carried out their duties and obligations properly (Reilly, 2006). Audit failures are costly to investors, the auditors themselves and the wider society as a whole.

External audit is an external governance mechanism that reviews and evaluates client's internal controls and audits the financial statements in order to prevent material mis-statements. The major role of external auditors is to express an opinion on whether or not an entity's financial statements show a true and fair view and are free of material misstatements. The external auditor's report in corporate financial statements is seen as providing key assurance to the shareholders' interests (Gallegos (2004). Auditors of higher quality are less willing to accept doubtful accounting methods and are more likely to report errors and irregularities revealed during the audit work. Thus, the external auditor is considered to have an impact on the efficacy of the firm's monitoring function (Murya, 2010). Also, stakeholders rely upon external auditor to provide some assurance that the financial statements of a firm are not misleading.

Prior to corporate governance reforms in many countries, the pressures mounted on the external auditors by the directors in many organisations constituted the focus of several major issues. Also, "creative accounting" practices were widespread. As a response to the devastating collapse of major corporations, the US passed the Sarbanes-Oxley Act (SOX), which aimed at cleaning up the auditing process (The Economist, 2002). The SOX, for instance, prohibits the offering of non-audit services to audit clients and requires rotation of the lead auditor or coordination partner and the reviewing partner every five years to avoid becoming close to management at a personal level and dependent on the company and the audit fees for advancement within the firm.

The accounting and auditing regulatory bodies in Nigerian such as Stock Exchange Act (1961), Institute of Chartered Accountants of Nigeria Act (1965), Nigerian Deposit Insurance Corporation Act (1988), Companies and Allied Matters Act (1990), Banks and Other Financial Institutions Act (1991), Association of National Accountants of Nigeria Act (1993), Investments and Securities Act (1999), Securities and Exchange Commission Rules and Regulation (1999), Nigerian Insurance Act (2003), and Nigerian Accounting Standards Board Act (2003) (now Financial Reporting Council for Nigeria (FRCN, 2011), and other interested parties, such as institutional shareholders, have taken steps to ensure that financial information is accurate and free from management influence. Thus, as part of mechanisms to ensure sound and reliable corporate reporting, the Companies and Allied Matters Act (1990) had made the audit committee, a body whose function is to oversee the financial reporting process, as well as, the audit of financial statements.

The Audit committee is expected to assist the board of directors in enhancing the transparency and integrity of financial reporting. It is also expected to enhance financial reporting quality by fulfilling its numerous responsibilities including, commenting on and approving accounting policies, reviewing the financial statements and maintaining and reviewing the adequacy of internal controls. Audit committees assumes responsibilities for the appointment and remuneration of external auditors, and discussing the scope of, and reviewing the auditors; reviewing the financial reporting process and facilitating the flow of information