AE-FUNAI JOURNAL OF ACCOUNTING,
BUSINESS AND FINANCE(FJABAF)
ISSN:2635-392X
www.fujabf.org

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ANALYSIS OF THE RELATIONSHIP BETWEEN AUDITORS' INDEPENDENCE AND AGENCY CONFLICT IN NIGERIAN DEPOSIT MONEY BANKS

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ABSTRACT

The paper examined the association of auditors' independence and agency conflicts in Nigerian Deposit Money Banks. The agency conflict depicted in agency theory, where principals lack reasons to trust their agents because of information asymmetries and differing motives, is critical in explaining the developmental process of auditing over the years and its usefulness. Auditing plays an important role in reducing information asymmetry by certifying the validity of financial reports as well as resolving agency problems. What is the aim and scope of the independent audit and what are the limitations and relationships around the audit role? This paper draws on agency theory to help consider such questions.The objective of the paper, therefore, is to analyse the relationship between auditors' independence and agency conflict in Nigerian Deposit Money Banks. To realise this aim, the study employed probit analysis to analyse the data collected from the annual reports of selected Banks.Fndings revealed an important positive association between agency conflict and auditors' independence. Also that non-audit servicesprovided by the auditor is a key factor which poses a threat to auditor independence, which by extension increases agency conflict. The paper recommends that further studies be conducted to confirm or disconfirm the association of poor earnings management and non-audit services provided by the auditor. Also, that a way out in reducing agency conflict is to restrict the auditor from providing non-audit services to existing audit client.

***Key Words**:* Analysis, relationship, auditors' independence, agency conflicts, Nigerian banks

Introduction

Financial reports remain the main means through which stockholders monitor directors' performance. However, as a result of the separation of ownership and control, problems with information asymmetries and different motives, there is likely to be tension in the shareholder – director relationship. Shareholders have limited access to information about the operation of a company and may believe that they are not getting the right information they need to make informed decisions or that the information provided in the financial reports is biased (ICAEW, 2005). As such, stockholders may lack trust in the directors and in such a situation, the benefit of an audit in maintaining confidence and reinforcing trust overweigh the cost..

Kabiru and Abdullahi (2012) explained that auditors play very important role in facilitating accountability and ensuring public confidence in financial reporting. An external auditor is expected to express an unbiased opinion on the financial reports of companies and to monitor managers' behavior. One of the major management responsibilities is to find external auditors with good reputation to reduce agency cost. Audit report adds value to the financial statements and may reduce cost of capital through the independent verification it provides.It is worthy of note that company failures connected to accounting scandals in this century raises questions about auditors' independence and the overall value of audits (Mohammad, Suzan &Madher, 2015). The objective of audit is lost when auditors' independence is compromised.

Agency relationship comes in when a principal engage another person as their agent to perform a service on his behalf. Performance of this service results in the delegation of some decision-making authority to the agent. This delegation of responsibility by the principal and the resulting division of labour are helpful in promoting an efficient and productive economy. However, such delegation also means that the principal needs to place trust in an agent to act in the principal's best interests. What happens when concerns arise over the motives of agents and cause principals to question the trust they place in them? As postulated by Kabiru (2012), the agency conflict, a situation wherebya principal losses confidence in his agents as a result of information asymmetries and different motivation is critical to understanding the developmental process of audits over the years and its aim. He maintained that the different motivations like economic rewards, market opportunities and relationship with other external parties can make agents to be more optimistic about the economic performance of a company. Therefore auditors as a third party are used to align the interests of agents with principals and to allow principals to gauge and manage the behavior of their agents and strengthen trust on agents. This, however, brings new concept of auditors as agents which leads to breach of trust, threats to objectivity and independence.

Auditing plays important role in reducing information asymmetry by certifying the validity of financialreports. By this, conflicts are abated. The question is: what is the purpose and scope of the independent audit and what are the limitations and relationships that surround the audit role? This paper draws on agency theory to help consider such questions.

The objective of this paper is to analyse the relationship between auditors' independence and agency conflict in Nigerian banks. To achieve this objective, the study employed probit analysis to analyse the secondary data. Accordingly, the work is arranged in five sections. Following this introduction is section two which deals with a review of literature on auditors' independence and agency theory. Section three explains the methodology while the fourth section provides discussion of findings. The fifth and final section draws conclusion and offers recommendations

AUDITORS' INDEPENDENCE

Auditors' independence is defined as auditors' unbiased mental attitude in making decisions throughout the audit and financial reporting process (Porter, Simon and Hartherly, 2008).Absence of independence on the part of an auditor increases the chances of being seen as not being objective. This means that the auditor will not likely report a discovered breach (Zayol, Kukeng&Iortule, 2017). Some factors that undermine auditors' independence are the fees receivable by the auditor for audit and non- audit services and the duration of the auditor - client relationship. The impaired independence of an auditor result in poor audit quality and allows for greater earnings management and lower earnings quality (Okolie, 2014). Auditor independence may be impaired by auditor tenure. As the auditor client relationship lengthens, the auditor may develop close relationship with the client and become more likely to act in favour of management, resulting in reduced objectivity and audit quality.

Auditors' tenure can be seen in two areas. These are: the tenure of the person engaged in the audit, and the tenure of the audit firm. Empirical evidence regarding the effect of auditor tenure on audit quality supports both arguments, with finding that audit quality both increases and decreases as audit firm tenure increases (Meyers,Ringsby& Boon, 2007; Ghosh and Moon, 2005). Some studies on audit tenure find a positive relationship between audit partner tenure and audit quality measured by discretionary accruals (Ye, Carson &Simnett, 2011; Quick, Satltler&Wieman, 2013). Therefore, the imposed compulsory partner rotation, which limits auditor tenure, can result in reduced audit quality. On the other hand, other studies find negatierelationship between audit quality and long audit partner tenure (Dechew, et al, 2012; Jekins&Veluny, 2008). In all, the impact of rotating audit partner on quality of audit is yet to be conclusive.

Since an auditor can provide services other than auditing to his 'audit client', the discussion was enlarged toaccommodate the non-audit fee aspect. French (2006) noted that consulting services were an integral part of non-audit services in the 1970s. Subsequent discussion was split into twodimensions: First when an auditor provides services to his current audit client and secondly when the service is provided to a non-auditclient. The non-audit service can be arranged by the client to be conditioned on the outcome of the audit report (Babatolu, Aigienohuwa, &Uniamikogbo, 2016).). In circumstances of this nature, managers could influence the contents of audit report by awarding non-audit services to an existing auditor inexchange for a favorable audit report. Dechew*et' al.* (2012) associated poor earnings management with the provision of non-audit services,although other studies did not reveal this association (Causholli,, Chambers, & Payne,2015; Adeyemi, & Olowookere,2012; Jong-Hang, 2008). The possible way out is to restrict auditorsfrom the provision of non-audit services to existing clients. However, such restrictionwould result in lowering of the potential for knowledge-sharing between theauditing and non-audit services, and therefore leads to a reduction of economy ofscale benefits to both the auditor and its clients.Also, there is the possibility of enhanced audit quality due to additional income from non-audit services which assist auditor to hire competent staff.

Agency Theory and Attendant Agency Conflict

Agency theory postulates that as a result of information asymmetries and self-interest, principals lack reasons to trust their agents and will seek to resolve this concern by putting in place mechanisms to align the interest of agents with principals and to reduce the scope of information asymmetries and opportunistic behavior. The theory evolved in response to conflicts between agents and principals resulting from: information asymmetry; The actual aim of the principal is to enhance the maximization of the company's value while agents try to enhance their remuneration and boost career development. To ensure the synergy of principals' and agents' goals, principals have to bear the agency costs (.Okolie, 2014). Sylwia&Piotr (2016) opined that a principal enters into an economic contract with an agent in order to run the business entity. If there is large discrepancy between the agent's and the principal's goals, or if high agency costs exist, the agency conflict is in place.

The theory models the relationship between the principal and the agents**(**Kabiru, 2012**).** The owner engages an auditor to produce information used in contracting with the manager. In this circumstance, auditors are seen as agents and can be modeled as such. The auditor is assumed to behave as if he tries to maximiz expected utility while carrying out his professional duty and issuing reports under conditions of moral hazard. Adeyemi&Olowookere(2012) argued that auditors are provided with more and better information about audit quality which is not completely observable by the client. Consequently, a moral hazard exists. The auditor could decide to compromise his independence and accept side payments from management for not truthfully reporting in line with the expectation of the owner. By accepting such side payments, the auditors' independence is impaired. In the opinion of Kabiru (2012), consultancy services could be used to give side payments a legitimate character. Different motivations and information asymmetries decrease reliability of information, which cause breach of trust that principals will have on their agents. Therefore auditors as a third party used to try to align the interests of agents with principals and to let principals to gauge and manage the behavior of their agents and strengthen trust on agents ((Mohammad, Suzan &Madher, 2015). When auditors perform an audit they are acting as agents for principals and this liaison therefore arising similar issues of trust and confidence as the director-shareholder relationship, prompting questions about who is auditing the auditor. Agents (either directors or auditors) may be trustworthy without further incentives to align interest or monitoring strategies such as audit or increased regulation. However, the simple agency model would recommend that agents are untrustworthy because managers and auditors will have their own interests and motives.

Independent auditor from the board of directors is of huge importance to shareholders and key factor to deliver high audit quality. However, an audit obliges a close working relationship with the board of directors of a company. The fostering of this close relationship has left question mark on the independence of auditors and ultimately question mark on audit quality (ICAEW, 2005).Different motives and information asymmetries lead to concern about the reliability of information, which impacts on the level of trust that principals will have in their agents (Patrick, 2001) There are several mechanisms that may be used to align the interests of agents with principals and to allow principals to measure and control the behavior of their agents thereby reinforcing trust.

It should be noted that no generally accepted measure of agency conflicts.Therefore, researchers use several variables to proxy for its existence in a firm on the basis of findings from previous studies. In a study by kabiru (2012), firm size, organizational complexity, volatility in operational environment, ownership structure, leverage and free cash flow have been identified to increase agency conflicts.

METHODOLOGY

Data were collected from quoted banks listed in the Nigerian stock exchange within the period 2013 – 2016. Stock exchange report for the period covered revealed that, 24 banks were listed in the exchange within the period. Five deposit money banks were sampled from the 24 banks for investigation. The study employed probit analysis in estimating the association of the variables.. The justification for adopting linear probability model lies in the fact that the regresand, auditors independence proxiedby non-audit services is dichotomized into binary codes 1 and 0

The model is as follows:

$A1 = \beta_0 + \beta_1$ size $+ \beta_2$ complex $+ \beta_3$ growth $+ \beta_4$ risk $+ \beta_5$ ownership $+ \beta_6$ lev $+\beta_7$ff $+ \varepsilon$

Where:

SIZE = Bank Size,

COMPLEX = Complex nature of organisation

GROWTH, RISK = Volatility in Operating Environment

OWNERSHIP = Ownership Structure

LEV = Leverage,

FF = Free Cash Flow

β_0 = Constant

$\beta_1, \beta_2, \beta_3, \beta_4, \beta_5, \beta_6, \beta_7$ = linear regression coefficients

ε = Standard error

Discussion of Results

The results of the probit Regression are as follows:

Binary Probit Regression

VARIABLE	Coefficient	Std Error	Z- statistics	probability
SIZE (log)	-2.08796	0.21987	2.00564	0.0098
COMPLEX	0.00867	0.09867	0.09867	0.9499
GROWTH	0.98113	0.90654	0.06289	0.0900
RISK	-0.65749	0.24368	1.69532	0.0016
OWNERSHIP	-0.00897	0.56445	0.54556	0.0502
LEV	-0.90877	0.77654	0.76875	0.0064
FF	-0.09008	0.32458	0.31121	0.0565
C	3.00453	0.97054	3.15758	0.0018
Mean dependent variable			0.810811	
S.E. of regression			0.365217	
Sum squared resid.			9.336826	
Log likelihood			-130.0714	
Restr.log likelihood			-135.8933	
LR statistics			15.64371	
Probability (L R stat)			0.007509	

Source: E view output run by the author (2017)

Above results show a multivariate binary probit regression convergence achieved after iterations. Auditors' independence proxied by non-audit services were explained with the explanatory variables: Bank Size, (SIZE), Organisational Complexity (COMPLEX), Volatility in Operating Environment (GROWTH; RISK), Ownership Structure (OWNERSHIP), Leverage (LEV) and Free Cash Flow (FF). The soundness of the model as revealed in the probability was good enough to interpret the individual contribution of the regressors. On the overall, the model fit the data at less than 1% level of significance. This means that the variables explained in full the regressand. It is inferred therefore that agency conflicts have significant positive association with auditors' independence.

CONCLUSION AND RECOMMENDATION

Agency theory stipulates that as a result of information asymmetries and self-interest, principals could not see reasons to trust their agents and will seek to resolve this concern by putting in place mechanisms to align the interest of agents with principals and to reduce the scope of information asymmetries and opportunistic behavior. Within this framework, conflicts arise from divergences of interest between any two parties to a contract within anorganisation. This paper couldn't fullycover the entire scope of agency conflicts. However, what is dealt with is some of the main studies which have been conducted into the area.Auditing plays an important role in reducing information asymmetries by certifying the validity of financial reports as well as resolving agency problems.

The results show a significant positive relationship between agency conflict and auditors' independence. It can be concluded that the level of auditors' independence depends on the size of the bank, growth, risk, ownership, leverage and free cash flow available. This implies that those variables make the auditor to engage in non-audit services thereby compromising his independence. Furthermore, rendering non-audit services by the auditor remains a key factor that serve as a threat to the independence of the auditor which by extension increases agency conflict.

The paper recommends that further studies should be conducted to confirm or disconfirm the association of bad earnings management and the provision of non-audit services by the auditor.

Also, that a way out in reducing agency conflict is to restrict the auditor from providing non-audit services to existing audit client.

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