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Exploring the Relationship Between Audit Independence and Financial Performance of Listed Deposit Money Banks in Nigeria

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Abstract

A bank's efficiency and sustainability over the long term require strong internal controls and a clear strategic direction, both of which can be validated by a thorough audit performed by the bank's corporate parent. This study used an ex-post facto design, analyzing secondary data to predict current trends and investigates how audit independence affects financial performance. Secondary data was obtained from annual reports of the listed deposit money banks that were listed on the Nigerian Stock Exchange as of December 31, 2016. The data were examined using descriptive and inferential statistics (Pearson Product Moment Correlation and Regression). According to the findings, the coefficient of correlation (r) = 0.718 showed a positive relationship between financial performance and audit independence. As a result, more audit independence leads to better financial performance, and vice versa. There is a significant and positive correlation between financial performance and audit independence. The study gives management of listed deposit money banks with the strategic insight they need to make evidence-based decisions about audit independence and the resulting financial performance.

Keywords: *Audit independence, Financial performance, Management, Deposit money banks*

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Introduction

Many countries' economies may not have grown to their current levels without the banking sector's role as financial intermediaries between surplus and deficit economic agents. As a result, it remains a significant global phenomena for corporate organisations to continuously strive for improvement in corporate performance metrics such as return on asset and return on equity. Bank management fully recognizes the need of maximizing both as cornerstones of solid financial planning and reporting. For a bank to be efficient and sustainable over the long term, it must have strong internal controls and a clear strategic direction, both of which can be verified by a thorough audit conducted by the bank's corporate parent. However, according to industry report on banking sector review, the numbers of banks that have either been acquired or taken over by the asset management corporation of Nigeria between 2013 and 2022 have raised the question what the relevance of audit quality in is addressing this development (Opeyemi, Popoola & Yahaya 2020).

The global banking sector's performance in terms of earnings, scale, and resilience improved significantly between 2008 and 2018. According to The Banker's 2018 Top 1000 World Banks Ranking, total assets were $124 trillion, with a 0.9 percent return on assets (ROA) (Ahmad, Naveed, Ahmad, & Butt, 2019). The global banking sector outlook indicates that US banks outperform their European, Asia-Pacific, South American, and Middle Eastern and African (MEA) counterparts on a range of measures. Aggressive governmental interventions and strict controls has accelerated the recovery of US banks (Nattarinee, 2018).

The world's four largest banks in 2018 are Chinese; before 2007, none of the top ten global banks were Chinese, and they are also profitable (Akintola, Oji-Okoro, & Itodo, 2020). However, fears about economic growth and the tariff dispute with the United States are weighing on forecasts. Meanwhile, Japanese banks, which avoided the global financial crisis, have long suffered with poor domestic development and low or negative interest rates. Despite the overall favorable outlook for the global banking industry, difficulties are ahead. The International Monetary Fund's (IMF) real GDP growth forecasts show a decline in all areas, including China and emerging Asia. This study, therefore evaluated the effect of audit quality (audit independence, audit fees, firm size) and financial performance (earnings per share and return on asset) of listed deposit money banks in Nigeria.

Hypotheses

H_{01}: Audit independence has no significant relationship with the financial performance of listed deposit money banks in Nigeria.

Literature Review

Financial Performance

The correlation between the production of high-quality financial reports and the performance of a corporation is of great importance. The favorable influence on confidence levels within capital markets and potential reduction in financing costs for enterprises can be attributed to the reliability and correctness of financial reports (Babatunde, Adedeji, & Adegbite 2021). As a result, this has the potential to boost the overall performance of companies. In addition, the existence of investor confidence and dependence on the financial statements presented by management have the ability to result in heightened investments in the organization, thereby bolstering the overall performance of the firm (Ahmeti, Ahmeti, & Aliu, 2022).

On the other hand, if financial reports contain misrepresentations or mistakes, there is a possibility of negative impacts on a company's reputation and a consequent decrease in investor confidence, ultimately leading to harmful outcomes for the organization's overall effectiveness. Therefore, the guarantee of generating financial reports of exceptional quality is a crucial factor in achieving and maintaining strong organizational performance. The major goal of performing a financial statement audit is to address information asymmetry and defend the interests of diverse stakeholders. This is accomplished by providing a reasonable level of assurance of the absence of substantial misstatements in the financial statements provided by management. The study posits that auditors have a major impact on financial performance through their efforts to reduce the occurrence of serious misstatements and ensure adherence to existing rules and regulations during the compilation of financial statements (Owolabi, & Babarinde, 2020).

Financial performance can be characterized as the evaluation of firms' efficacy and efficiency in their internal and external operations (Arumona, & Nev, 2021). The attainment of a commercial entity is regarded as the fundamental aspect of the organization in modern society, as the success of a firm relies on its capacity to improve its expansion through favorable performance. The company's degree of quality can be deduced from its thorough and insightful financial statements. According to existing research, stakeholders play an important role in giving financial support for an organization's quality control activities, assuming that the organization performs well. To support the development of the organization, it is critical to analyze the organization's current performance, thereby revealing the degree of progress required to fulfill the objectives of the organization. The success of a firm is mostly determined by its outcomes, which are evaluated using various methods and strategies.

The implementation of corporate governance practices within a corporation exerts a substantial influence on its overall success. The achievement or lack thereof of a company is dependent on the efficient allocation and utilization of its resources. Hence, the adoption of rigorous corporate governance practices, such as the formation of an audit committee, empowers companies to improve their performance, optimize the allocation of resources, and ensure efficient management (Farooq, Noor, & Ali, 2022). The primary emphasis is placed on the performance of a company, which comprises the total wealth generated prior to its allocation among various stakeholders, rather than just on the accounting advantages obtained by shareholders (AlHares 2020). There exists a multitude of methodologies that can be employed to evaluate the financial performance. Categorization falls into two categories: accounting-based metrics and market-based indicators. Firm performance can be assessed using seven distinct dimensions: growth, profitability, market value, client happiness, employee satisfaction, social performance, and environmental performance (Gull, Abid, Hussainey, Ahsan, & Haque, 2023). Numerous academics utilize a number of financial performance assessment tools, whereas the prevailing strategy among investors is depending on accounting ratios to analyze a company's financial success. Nevertheless, this particular study utilized profits per share (EPS) as an innovative measure to evaluate the financial performance of companies (Alsmairat, Yusoff, Ali, & Ghazalat, 2019).

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Financial performance refers to the extent that a corporation meets its financial goals through the use of numerous measurements and performance indicators, the most popular of which are accounting ratios. The study of a company's financial performance is crucial in establishing its overall health and allows for comparisons between sectors, industries, and even within the same organization. This approach helps with the evaluation of business lines. The topic is around the impact of contributions on financial performance. This refers to the long-term trust of the market and the general public in the financial statements of listed firms, which is established by the certification of their reliability by the auditing firm (Aikpitanyi, & Idemudia, 2020).

Audit Independence

The term "independence" in auditing and financial data reporting refers to the auditor's ability to think and behave objectively at all times (Enekwe, Nwoha, & Udeh, 2020). Lack of independence is a significant factor that contributes to a substantial decline in the quality of the audit service and audit report (UgwuChukwuma, Aikpitanyi, & Idemudia, 2020). The absence of influence, persuasion, or bias is the definition of independence. If an auditor is not completely independent, there is a greater chance that they may be perceived as being less than unbiased. Because of this, it is less likely that the auditor will report discovering a security problem. If it is required that public disclosure of audit fee and non-audit fee be made, the auditor may be willing to issue a qualified audit opinion, regardless of how financially significant the client is to them. An independent auditor is one who does not have a vested interest in the outcome of their work (which would go against the norms of impartiality and honesty). An auditor who has a vested interest in the outcome of their work would not be independent. Since the purpose of an audit opinion is to enhance the credibility of financial reports as a management assertion, the lack of independence between a public accountant and their client renders the view meaningless (Ogbodo, & Akabuogu, 2018).

The public's trust in a company's financial accounts is predicated on the impartial opinion of the company's external auditor. The mental condition of being objective and free from bias is the essence of what we mean when we talk about independence. Because of this, the level of auditor independence is dependent on the policies and procedures of the audit business as well as the attitudes of the personnel who are doing the audit's stated tasks (Ehiedu, & Toria, 2022). The auditor's capacity for objectivity in the performance of his duties as an auditor is what we understand by the term "independence." The most convincing evidence of auditors' independence is the candor and objectivity with which they approach their work, along with that of their audit teams.

During every stage of the auditing and reporting process for financial records, maintaining audit independence is a crucial concern. It is the auditor's capacity to develop objective evaluations that is being looked at here. If the auditors are truly independent, they won't have to worry about being influenced, swayed, or biased in any way when they go about their auditing duties. If an auditor is not completely independent, then they have a greater propensity to be biased and a lower propensity to be objective (Osevwe-Okoroyibo, & Emeka-Nwokeji, 2021). A non-independent auditor has a lower probability of reporting a violation, which is a strong indication that a breach has taken place. Auditors are expected to uphold the standard of maintaining their independence, which indicates that they should not allow their own personal interests to impact the manner in which they carry out their duties. Because increasing the dependability of accounting records is one of the primary purposes of an external audit, a public accountant's perspective may be subjective and misleading if the public accountant is not independent from the client. This is because one of the primary goals of an external audit is to raise the trustworthiness of accounting records as a management claim (Saidu, Miko, & Zubairu, 2021).

Theoretical Framework

Resource Dependence Theory

The resource dependence theory (RDT) asserts that companies have a high risk of failing due to the unpredictability of the settings in which they operate. Organizational theory is a theoretical framework that clarifies the ways in which businesses use and are formed by their external contexts. It does this by focusing on the relationships between these two factors. It gives the impression that in order for businesses to be successful, they require resources from outside the firm such as money, data, and knowledge. According to the Resource Dependence Theory, a firm must have the ability to alter the external environment in which it operates in order to maintain a long-term competitive edge. The organization's influence is dependent on things outside of it, such as its supply chain, customers, and board of directors. These are all important to the organization. The corporation is able to deal with unforeseen events and reduce its dependency on external factors by utilizing a variety of different strategies (Lawal, Agbi, & Mustapha, 2018).

The Resource Dependence Theory is comprised on three primary ideas or principles. To begin, one cannot ignore the importance of the wider world. Two things are abundantly clear: (1) the social environment in which a firm operates has the potential to influence resource allocation, and (2) businesses might develop ways to increase their autonomy in acquiring and distributing resources in order to improve their overall performance. The pursuit of autonomy can reduce a company's dependency on other sources of funding, and market domination is essential to understanding both the company's internal and external actions. The resource dependence theory focuses on market power, which distinguishes it from other theories that aim to explain the activity of the company, in particular.

Methodology

The study used an ex-post facto research design, which uses secondary data to predict current trends and looks into how audit quality affects financial performance. This study's population comprised of deposit money banks that were listed on the Nigerian Stock Exchange as of December 31, 2016. At the time of the study, 11 Nigerian banks were classed as deposit money banks. Secondary data was obtained from annual reports of the listed deposit money banks that were listed on the Nigerian Stock Exchange as of December 31, 2016. To evaluate the hypotheses, statistical tests can be performed on the independent variable coefficients and their interaction terms with Firm Size. The study will use descriptive statistics and inferential statistics (Pearson Product Moment Correlation and Regression) as its analysis techniques. To explain the trend of the obtained data, descriptive statistics will be employed, defining its central tendency, variability, and dispersion.

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Results and Discussion of Findings

Table 1: Descriptive Statistics

	FNP	AUF	AUI	AFS
Mean	0.453	0.134	1.479	7.683
Median	0.337	0.067	0.367	7.464
Maximum	1.294	0.995	119.150	9.109
Minimum	0.156	2.855	0.019	6.577
Standard Deviation	0.308	0.633	10.770	0.688
Skewness	1.559	1.761	10.823	0.695
Kurtosis	4.857	8.447	118.737	2.296
Jarque Bera	66.992	213.925	704.17	12.361
Probability	0.000	0.000	0.000	0.002
Sum	53.384	16.413	180.538	937.355

Source: Authors' Computation, 2023

This is done to summarize the fundamental characteristics of the data. Table 1 shows the results based on summary statistics; it is evident that all of the variables have positive mean values. Audit firm size has the highest mean value of 7.683, while audit fees have the lowest average value of 0.134. The table also illustrates that variables exhibit a significant variance in their maximum and minimum values.

Except for audit independence, the standard deviation value is relatively low when compared to the average points. The table also shows the results of other statistics, such as the skewness, Kurtosis, and Jarque-Bera tests. Skewness measures the asymmetry of the series' distribution around the mean. A normal distribution has zero skewness, whereas positive and negative skewness result in long right and left tails, respectively. The skewness test shows that all variables are positively skewed. The kurtosis test detects the existence of outliers in a dataset. The results reveal that the majority of the variables are not normally distributed and do not match the Kurtosis statistic standard of 3.0.

Table 2: Correlation Matrix for the relationship between audit quality measures and financial performance for listed Deposit Money Banks in Nigeria

Variables	FNP	AUF	AUI	AFS
Financial performance	1			
Audit fee	0.621**	1		
Audit independence	0.718**	0.683**	1	
Audit audit firm size	-0.683**	-0.576**	-0.657**	1

**Correlation is significant at the 0.01 level (2-tailed)

Source: Authors' Computation, 2023

Table 2 shows the results of the correlation analysis, which have dual implications. First, it reveals the correlation between the individual measures of the independent variables and the dependent variable, yielding the results of Hypothesis one. The second implication is that it helps to determine the presence or absence of multicollinearity in the estimated model for the analysis, which looked at the effect of audit quality on the financial performance of Nigerian listed DMBs.

Discussion of Findings

According to the findings of the test of hypothesis one, which assessed the connection between audit independence and the financial performance of selected publicly traded DMBs in Nigeria, audit independence was shown to have a positive and significant relationship with financial performance (Ananzeh, Al Amosh, & Albitar, 2022).

Independence of audits is another essential criterion which has a substantial impact on audit quality and, indirectly, the financial performance of deposit money institutions. It is anticipated of audit firms that they would preserve their independence from their clients in order to guarantee impartial and objective evaluations. When a bank's auditors' independence is called into question, there is a greater chance that they may fail to spot errors or omissions in the institution's financial statements. It is absolutely necessary to conduct an audit that is rigorous and independent in order to guarantee the correctness of financial reports. This, in turn, can strengthen investor trust and improve the financial performance of deposit money institutions (Wang, Abbasi, Babajide, & Yekini, 2020).

The scale of the auditing company is an important consideration with regard to the quality of the audit. Larger auditing firms typically possess a greater quantity of resources, as well as greater levels of experience and a reputation to uphold, all of which can translate into superior audit quality. It's possible that these companies are in a better position to entice and keep the best employees, as well as invest in cutting-edge auditing techniques and technologies. Therefore, deposit money banks that have their financial statements audited by larger corporations have a greater tendency to gain from the increased credibility and reliability of their financial statements, which ultimately leads to superior financial performance (Connelly, Certo, Ireland, & Asquith, 1986). There is a definite link between audit independence and the overall impact on the financial performance of deposit money institutions. In most cases, increased audit costs are related with greater audit quality, which can reduce the possibility of financial misstatements and improve financial performance. It is essential to keep auditing independent in order to guarantee impartial judgments and maintain investor confidence. Furthermore, the size of the audit firm can have a significant impact on how thoroughly the audit process is carried out, contributing to improved financial performance. Both academics and regulatory bodies continue their research into these connections and place a strong emphasis on them since they are aware of the vital role they play in preserving the reliability and consistency of the banking sector (Brigham, Eugene, Joel, & Houston, 2006).

This descriptive and cross-sectional study is based on secondary data obtained from five randomly selected publicly listed consumer products companies' annual reports over a five-year period. Except for audit firm size, the analysis discovered that all other independent factors had a significant and cumulative effect on the financial performance of the selected firms. This suggests that audit quality (as evaluated by audit independence, audit tenure, and audit firm size) has a significant and positive impact on Nigerian consumer product companies' financial performance. However, the study discovered no statistically significant relationship between

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the size of the audit organization and the results of the financial audit. The study's conclusions are supported by the fact that the quality of audits has a significant impact on the financial performance of consumer products companies in Nigeria (Ahlers, Cumming, Günther, &Schweizer 2015).

Conclusion and Recommendations

The empirical findings of this study suggest that audit independence impact the financial performance of Nigerian listed DMBs. As a result, management of DMB must recognize the importance of quality audit engagement in maintaining their company's long-term viability. Furthermore, high-quality audits can boost a company's connections with consumers, suppliers, and business partners. These stakeholders may be more likely to build long-term relationships with a company that they regard as trustworthy and transparent, which can lead to a variety of strategic advantages and improved financial performance in the long run. The study offers the management of listed DMBs with the strategic information they need to make evidence-based decisions about audit quality and the resulting financial performance.

Based on the findings, the study offers the following recommendations:

1. Management of DMBs must ensure that audit fees, audit independence and the audit firm size does not cost the bank so much that it takes away the financial performance.
2. There is need for a stringent measure in monitoring the process that leads to audit engagement for this listed DMBs. Audit process activities must ensure that audit fees, audit independence, and audit firm size are in alignment with its financial resources.

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