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INFLUENCE OF AUDITOR INDEPENDENCE ON AUDIT QUALITY: EMPIRICAL EVIDENCE

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Abstract

The objective of this paper is to examine the impact of auditor independence on the quality of audits. A survey was carried out on employees from 14 banks under consideration, and the results indicated a correlation between auditor independence and audit quality, based on the perspectives of the bank employees. This study provides evidence from a relatively under-researched region that adds to the crucial discussion on auditor independence and audit quality.

Keywords: *Audit Quality; Financial Statements; Audit Independence*

JEL Code : *L21, F21, M41*

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1. Introduction

According to **Porter, Simon & Hatherly 2014,** external audit is an examination of a company's financial statements, to find out whether the information contained in such statements is correct **(Arens et al., 2012).** Auditing is described as the collection and evaluation of informational evidence, to establish and communicate the degree of concordance between the information and predetermined criteria. In the same vein, **Messier (2008)** also defined auditing as a systematic process of gathering and objectively assessing evidence regarding claims about economic actions and events, to determine the degree of correspondence between those claims and established criteria and communicate the results to interested users of financial statements. The auditor must be perceived as being independent of the entity, its management, and all other

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factors. According to **Bahram Soltani, 2007**, the work must be completed with proper regard for audit quality, that meets the reasonable expectations of users of audited financial statements. As a result, "auditor independence" refers to the external auditor's ability to operate honestly and impartially while carrying out his auditing obligations **(Akpom & Dimkpah, 2013)**. In this context, independence refers to the technique by which an auditor demonstrates his competence to carry out his duties objectively. According to some scholars, an auditor's independence influences the quality of the audit. But **Wahyuni et al., 2019** opined that auditor independence had reported only a minor impact.

Researchers, regulators, and even members of the general public maintain that the independence of auditors does have considerable effect on the quality of audit. The critical importance of the independence of auditors to the quality of audit, has spawned a lengthy debate among academics, legislators, and market observers **(Yakubu & Williams, 2020)**. According to **Dattin, 2017; Tepalagul & Lin, 2015,** the Sarbanes-Oxley (SOX) Act of 2002 was enacted in response to industry professionals' reactions to the Enron scandal and the demand for the integrity of audit reports to check accounting irregularities in publicly traded corporations.

The failure of large corporations such as Enron, WorldCom, Satyam, and Cadbury in Nigeria, Olympus in Japan, and the repercussions of the global financial crisis, prompted market regulators and practitioners, to demand auditor independence **(Wood & Small, 2019)**. Yemen had undergone a crisis of accountability, credibility, and loss of confidence, as a result of the bankruptcy and collapse of multiple companies and many potential investors and owners wondered why auditors did not send warning signs about these companies' economic conditions, indicating a lack of audit quality. The National Bank, one of Yemen's largest banks, was audited by one of the top four auditing companies, Deloitte and Touche, which establishes the need for audit quality **(Jubran, 2010)**.

2. Review of Literature

Many studies describe audit quality as the auditor's capacity to find and report flaws in the accounting and reporting system of the audit client **(De Angelo, 1981)**. The most critical aspect is that the auditor should be objective and have the necessary technical ability to achieve this capacity. The auditor's ability to detect fraudulent statements, would influence the quality of the audit. This relates directly to the auditor's expertise (competence). The auditor's ability to uncover a mistake, which is directly related to the auditor's level of independence, is the second component of audit quality. Auditing standards and the ethical code of auditors, clearly state that the auditor should maintain his independence, which essentially means that the auditor should always be neutral and the auditor's independence is a critical factor in ensuring audit quality.

Given that auditors do their jobs in the public interest, **Ardillah & Chandra, (2022)** believe that they should not be easily influenced. As a result, the auditor is not justified in promoting anyone's interests. After all, the auditor has extensive knowledge, but if he loses sight of the importance of autonomy, the auditor will rapidly lose motivation to pursue possibilities for evaluation that would increase audit quality **(Ariningsih & Martha, 2017)**.

The credibility of the financial reports, presented by executives, depends upon audit quality **(Aljaaidi, 2023)** and therefore, the auditor should be able to keep a free mental attitude **(Darmayanti et al., 2015)**. Users of

financial statements rely on auditors' independence and hence more an auditor's independence, the higher the audit quality provided **(Iskandar & Indarto, 2015)**. Independence has positive and significant impact on the quality of audit **(Deli et al., 2015; Wiratama & Budiartha, 2015; Haryanto & Susilawati, 2018; and Joseph & Fidiana, 2020)**.

3. Statement of the Problem

Financial scandals such as WorldCom (US), BCCI (UK), Parmalat (Italy), Polly Peck (UK), and Enron (US) have demonstrated that financial crises naturally diminish confidence in the auditing quality. The financial scandals in Yemen cannot be overlooked. The bankruptcy of Yemeni National Bank in 1998 eroded investors' trust and as a result, auditors' position, obligations and performance have been challenged. In other words, the problem with auditor independence could lead to poor audit quality.

4. Need of the Study

By clarifying the character of audit quality in Yemen, this study would add to the auditing literature. In addition to expanding one's knowledge, the Researcher thinks that the findings of this study will assist policy making by regulators as well as researchers and academics. Further, this study was conducted in countries that differ from the Republic of Yemen in terms of their economy, politics, social structures, cultural norms, and educational systems.

5. Objective of the Study

To investigate the impact of auditor independence on the audit quality.

6. Hypothesis of the Study

H1: The independence of auditors has a favorable impact on audit quality.

7. Research Methodology

7.1 Sample Selection

Data for this study were gathered from Yemeni banks' Financial Affairs and Accounting Employees. The research relied on primary data. Respondents to the study, including those working in the financial department and internal auditing in Yemeni banks, were given questionnaires to complete. The study's primary focus was on any differences in these groups' points of view.

7.2 Sources of Data

The research data were extracted from primary data. The statements in the questionnaire had five possible responses on a Likert scale of 1 to 5, which included Strongly Agree, Agree, Neutral, Disagree and Strongly Disagree as options. It was designed to gauge respondents' perception of the auditor's independence and audit quality.

7.3 Period of the Study

The data were collected for the study during the year 2022.

7.4 Tools Used in the Study

To assess the dependability of the study's instruments, Cronbach's alpha and the Spearman-Brown half-segmentation factor were used. The internal consistency reliability of the research tool was evaluated using the Pearson correlation coefficient. The Kolmogorov-Smirnov test, which employs the Wilcoxon non-parametric test for normal distribution, was used as an alternative to the single-sample parameterized t-test.

8. Data Analysis

8.1 The Independence of the Auditor Influences the Audit Quality

The apparent validity of the questionnaire (the validity of the judgment), which the Researcher distributed to a panel of accounting,

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measurement, and assessment professionals, was used to validate the study instrument. The questionnaire was stabilized, in its final form of 10 items, by taking into account the referees' notes and making the required deletions, additions, and amendments in the light of the given suggestions. The internal consistency validity was confirmed by calculating the Pearson correlation coefficient between each questionnaire item and the overall degree.

Table-1 shows that the correlation coefficients were both positive and statistically significant. By using the Cronbach Alpha and Spearman-Brown coefficients for half-segmentation, the study instrument's reliability was verified and it was discovered that the questionnaire was reliable. To evaluate if the data had a normal distribution, the Kolmogorov-Smirnov test was employed as a suitable statistical procedure. When the data were distributed normally, parametric approaches were employed and when they were not, nonparametric methods were employed. The analysis revealed that the data in the current investigation did not follow a normal distribution. **Table-1** summarizes the most essential facts necessary to answer the research question-whether the auditor's independence influences the audit's quality. The Researcher found that all the test significance level Sig values were below the 0.05 significance level employed in this investigation.

The mean and standard deviation of the study instrument items were calculated by the Researcher. The Wilcoxon Test was then used to examine the significance of the mean differences calculated, by using the fictional study of mean three (the level of neutrality). The test result was considered significant if the test significance level (Sig) value was less than the 0.05 level of significance chosen for this investigation. If the computed mean was greater than the hypothetical study mean of three and the differences between them were statistically significant, there would be strong agreement among respondents, regarding the impact of the auditor's independence on audit quality. The respondents differed on the impact of the auditor's independence on audit quality if the computed mean was lower than the fictional study mean of three and the differences between these two means were statistically significant. If the mean value for an item or the overall study instrument score was three, or higher or lower than three, and the difference between it and the study's fictitious mean was statistically insignificant, it indicated that respondents were unsure how the auditor's independence affected the audit's quality. According to **Table-1**, study instrument's item means ranged from 3.22 to 4.24, which was more than the study's three-point hypothesis mean (the degree of neutrality). At first glance, it seemed that the respondents agreed on these points. However, to boost the level of agreement, the Researcher used the Wilcoxon test, which showed that the respondents agreed with the study instrument's components and overall score (all the items). For example, all the test significance level Sig. values fell below the 0.05 significance threshold used in this study. In each of the following items, there were similarities between the values of the items' means and the respondents' perspectives.

The independence of the bank's external auditor is one of the most important pillars of the auditing profession's reputation and caliber. Since the means of these items were 4.24 and 4.12, respectively, raising the risk of the auditor losing his independence may result in lower audit quality. They were at the top of the list of questionnaire items. The two items (the external auditor's long-term stay with the bank erodes its independence and impartiality, affecting audit

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quality) and (if the bank auditor stays for a long time, this means that the external auditor is more in agreement with the bank management regarding important decisions related to the preparation of financial reports) were placed in the last among the questionnaire items, with a mean of 3.24 for both, indicating the respondents' high acceptance of them. This was confirmed by the Wilcoxon test. The increasing length of stay of the external auditor may lead to the formation of invested interests, which would reduce audit quality. With a mean of 3.22, this item was ranked last among the research instrument items. The study's findings revealed that respondents were almost unanimous in their belief that the auditor's independence influences the quality of the audit. In other words, auditor's protracted presence has a significant impact on the auditor's independence.

8.2. Relationship between Auditor Independence and Audit Quality

According to **Table-2,** there is a favorable association between auditor independence and audit quality. The regression coefficient was 0.47 and it implied that, increasing the influence of auditor independence by one unit of measurement, increased audit quality by 0.47 units. While the correlation coefficient was 0.69, it is a highly significant direct correlation coefficient, which means that the bigger the impact of auditor independence, the higher the audit quality, and vice versa. These are two coefficients - the regression coefficient and the correlation coefficient - that were significantly different, as shown by the T-test. Concerning the explanatory ability of the regression model represented in the coefficient of determination, it amounted to 0.47, which indicated that 47% of the changes and effects that occur on the audit quality, were due to the effect of the independence of the auditor, with all other factors remaining constant, while 53% of the effects on audit quality were due to other factors. The F test suggested that the regression model was significant in this investigation since the significance level (F) was 0.00, which was less than the significance level used in this study (0.05). Based on these findings, the study hypothesis **H1: Auditor Independence has a Positive Effect on Audit Quality,** was accepted.

9. Findings of the Study

- Auditor independence has a positive impact on audit quality.
- The results of this study agreed with the results of other studies, conducted in environments different from the Yemeni environment.
- This study found that respondents were almost unanimous in their belief that the auditor's independence influenced the quality of the audit.
- Further, the auditor's protracted presence has a significant impact on the auditor's independence.

10. Suggestions

According to the conclusion of this study, the Yemeni Government should promote awareness of the importance of developing and following suitable laws and regulations, in both the accounting and auditing professions, to meet Yemen's current needs. In other words, reforming and improving Yemeni laws, governing both professions, is vital.

11. Conclusion

The purpose of this study was to investigate the relationship between auditor independence and audit quality in the Republic of Yemen. The findings revealed that there was direct and strong association between auditor independence and audit quality. Based on the data used, the

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consequence of this result is that increased audit fees will motivate the auditor to reject external influence and focus on work performance, thereby promoting audit quality.

12. Limitations of the study

The study's limitation was that it was only conducted in Yemen, with no comparisons to other developed or poor countries.

13. Scope for Future Research

Future studies could compare Yemen's situation to that of any developed or growing country. This comparison should provide new insights into the impact of auditor independence on audit quality.

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Table-1: The Independence of the Auditor Influences the Audit's Quality

Items	Mean	Standard Deviation	Wilcoxon (Z-value)	Sig.	Degree of approval
The external auditor's long tenure with the bank erodes its independence and impartiality, lowering audit quality.	3.24	0.90	3.29	0.00	High
Increasing the period of stay of the bank's external auditor and forming personal relationships with the bank's employees and management make him lose his independence, which affects the audit quality.	3.92	0.96	2.59	0.00	High
The common interests between management and the auditor make it difficult for the auditor to be independent, which affects audit quality.	3.69	0.92	2.52	0.00	High

The length of the external auditor's contract with the bank may lead to a gradual decrease in his integrity and honesty.	3.52	1.07	1.97	0.00	High
If the bank auditor stays for a long time, this means that the external auditor is more in agreement with the bank management regarding important decisions related to the preparation of financial reports.	3.24	0.84	3.14	0.00	High
The length of the external auditor's contract with the bank may lead to his agreement to waive his reservations in his report, which affects the audit quality.	3.63	0.98	2.03	0.00	High
Failure to change the auditor after some time may lead to his inability to resist the pressures exerted on him by the bank management, which affects the audit quality.	3.59	1.05	2.41	0.00	High
Increasing the period of stay of the external auditor may lead to the formation of investment relationships, which reduces audit quality.	3.22	1.11	2.01	0.00	High
The independence of the bank's external auditor is one of the most crucial cornerstones of the auditing profession's reputation and quality.	4.24	0.80	2.42	0.00	High
Increasing the risk of the auditor losing his independence may lead to lower audit quality.	4.12	0.85	2.70	0.00	High
The overall score for all axis items	3.71	1.02	2.48	0.00	High

Source: Primary Data computed using SPSS

Table-2: The Relationship between Auditor Independence and Audit Quality

Independent Variable	**Transactions**	**Trans-action Values**	**Correlation Coefficient R**	**The coefficient of Determi-nation R2**	**T-Value**	**F-Value**	**Sig.**	**Hypothesis Result**
Auditor Independence	Regression Constant a	**1.92**	0.69	0.47	**9.70**	79.90	0.000	Accept the Hypothesis
	Regression Coefficient b	**0.47**			**8.94**			
Y = 1.92 + 0.47x								

Source: Primary Data computed using SPSS

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