Effect of Ethical Culture and Objectivity on Auditor Integrity among Nigerian Auditors

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Abstract

Past studies have suggested that the ethical culture within audit firms may have significant effect on audit decisions, auditor objectivity and integrity and ultimately audit quality. This study examines whether Ethical Culture and auditor objectivity influences integrity of practicing auditors in Nigeria. Using a cross-sectional survey, data was collected from 156 auditors in the private sector. The correlation results show ethical culture, auditor objectivity and integrity are positively and significantly correlated at 5% (.495, .375, .403). The multiple regression results show ethical culture and auditor objectivity predict variation in auditor integrity by 20%. The regression coefficients show all variables have t value above ±1.96 (3.466, 2.809) all significant at 5% (P=.001 & .006) indicating that ethical culture and auditor objectivity are significant predictor of auditor integrity. The study findings have implications to regulators, auditors and researchers. The findings will further benefit regulatory and professional bodies in structuring ethical guidelines and standards for practicing accountants and serve as a reference material for enhancing audit firm cultures. The limitations provide avenues for further research.

Keywords: objectivity, integrity, ethical culture, auditor independence

1. Introduction

Users of financial statements such as Financial markets, shareholders, potential investors, creditors and analysts rely on the credibility and reliability of financial reports to make investment decisions. The International Feaderation of Accountants (IFAC) professional codes charge auditors to be independent in fact and appearance by ensuring that they carry out audit assignments with integrity, objectivity and professional skepticism. Various factors have been inferred to impair auditor objectivity and integrity, some of which are still subject of much scholarly debate. Some of these include non-audit service provision (Dart, 2011; Quick & Warming-Rassmussen, 2009; Abdul Wahab, Gist and Abdul Majid, 2014), personal relationships (Irmawan, Hudaib & Haniffa, 2013), auditor tenure (Al-Ajmi & Saudagaran, 2011; Anis, 2014; Daugherty, Dickins, Hatfield & Higgs, 2013), audit market competition (Lee & Gu, 1998; Craswell & Francis, 1999).

The studies present conflicting results about the factors threatening auditor objectivity. Moreover, Abubakar (2011) and Tepalagul and Lin (2015) observe that rules and professional codes alone do not ensure ethical compliance nor deter auditors from objectivity compromises. There is therefore a need for further research to identify other avenues of reducing objectivity threats. This is because auditor objectivity, integrity and ethical culture are closely linked (Akter & D'Ambra, 2011; Brown, Stocks & Wilder, 2007; Colquitt, Scott & LePine, 2007).

This paper shows that ethical culture and auditor objectivity influence auditor integrity. Some studies (Svanberg & Ohman, 2016) have already linked auditor objectivity to ethical culture. However, the study did not examine the association between auditor integrity, objectivity and ethical culture. This is also very important because there are studies (Libby & Thorne, 2007; Fan, Woodbine & Scully, 2012) which show that integrity is significantly related to auditor objectivity and ethics. It is therefore expected that auditors in firms that have strong supportive ethical cultures will be objective and have high integrity.

Secondly, this study provides further evidence in line with prior research (Abubakar, 2011; Tepalagul & Lin, 2015) that professional codes and rules are insufficient in ensuring ethical compliance to principles of objectivity and integrity. The study will also reveal the relationship between ethical culture and auditor objectivity as they relate to auditor integrity. Thirdly, one way of tackling the unethical behavior is by understanding the association between auditor decisions and ethical culture in the audit firm. The findings from this study are expected to assist audit firms, auditors and regulators in developing viable suggestions on how to solve ethical non-compliance. The remaining part of this paper is structured into four parts; literature review and hypotheses development, research methodology, discussion of results and conclusions.

2. Literature Review and Hypotheses Development

This section reviews prior literature on ethical culture, auditor objectivity and auditor integrity in order to provide a basis for the research hypotheses.

2.1 Auditor Objectivity and Auditor Integrity

The International Federation of Accountants Code of Ethics (IFAC) explain objectivity as avoiding compromising professional judgments because of pressures, influences or subordination of judgment, bias, conflict of interest or intentional misrepresentation of facts (IFAC, 120.1). Brown, Stocks and Wilder (2007) define objectivity as freedom from conflict of interest, impartiality, intellectual honesty and fairness in judgment. According to Svanberg and Ohman (2016) strong ethical culture in audit firms enhances auditor objectivity. Bamber and Iyer (2007) and Bauer (2015) found that auditors rely on their professional identities and ethics to enhance auditor objectivity. Trevino, Butterfield, and McCabe (1998) also report that ethical culture of an organization significantly influences the behaviour of its members to behave ethically.

There are a few studies on auditor objectivity and integrity. For example, Windsor and Ashkanasy (1996) report that auditor's ethical decisions are a function of existing organizational culture because acculturation processes in firms lead to outcome oriented values which determine behaviour. However, Douglas, Davidson and Schwartz (2001) showed that ethical judgements are influenced by individual values. Svanberg and O'hman (2015) found very similar factors causing poor audit quality and objectivity impairment when auditors had close ties with their clients. In fact, there is evidence to suggest that auditors are more likely to impair their integrity and acquiesce to clients choices by making biased judgment when time pressures and close bonds with client exist (Cianci & Bierstaker, 2009). Sweeney, Arnold and Pierce (2010) and Svanberg and O'hman (2015) report that the extent to which auditors remain objective is a function of the strength of audit firm culture (strong or weak) and their integrity in succumbing to management pressures. According to Shafer & Wang (2010) and Svanberg and O¨hman (2013) pressure put on audit staff to conform to authoritative rules sometimes impedes ethical behavior. Furthermore, Kaptein (2011) and Svanberg and Ohman (2013) observe that managers can encourage ethical behavior among employees by rewarding ethical behavior and punishing unethical behavior. In sum, empirical studies suggest that auditor objectivity and integrity are influenced by audit firm cultures. Despite the perceived effects of pressures to impair objective judgments, auditors are more likely to have integrity if they work in supportive ethical environments that enhances their objectivity. In line with this notion, the study proposes that:

H$_{01}$*: Auditor objectivity has no significant effect on Auditor Integrity*

2.2 Ethical Culture and Auditor Integrity

Examining ethical culture in the audit environment presents a peculiar challenge compared to other organizational settings in three major respects. Firstly, audit firms are in business to make profit. As such, they have to strike a balance between quality and audit cost considerations by managing pressures on cost and effectiveness (Sweeney & Pierce, 2010). These pressures are experienced right from engagement negotiation stage uptil audit execution and may undermine auditor judgment and ethical behavior (Barrainkua & Espinosa-Pike, 2015; Shafer & Wang, 2010; Svanberg & O¨hman, 2013). Secondly, balancing cost and quality presents an enormous challenge as quality improvements require greater investments in audit time and resources which translates to additional costs (Sweeney, Arnold & Pierce, 2010; Espinosa-Pike & Barrainkua, 2015). Thus, auditor judgement will then be based on ethical assessment of circumstances confronted as well as other factors affecting the cost-quality conflict. Thirdly, prior studies have presented different measures and proxies for audit quality (e.g. DeAngelo, 1981; Duff, 2004; Francis & Yu, 2009, Bedard, Johnstone & Smith, 2010). These differing yardsticks are subject to various limitations and yeild conflicting results. Depending on the definition employed, audit quality will be determined by the time spent on audit engagement and ethical values that result in the decision to disclose irregulaties when they are discovered.

Auditor independence requires auditors to act with integrity by avoiding situations that may be suggestive of impaired integrity. Mayer, Davis and Schoorman (1995) relate integrity to an individual’s strong perceived sense of justice. Lind (2001) assert that integrity refers to fairness and moral character which enhances trust and eliminates ambiguity. Gefen and Straub (2004) define integrity as a virtue that lessens unethical behaviors while Akter and D’Ambra (2011) explain it as adherence to moral and ethical principles. Brown et al., (2007) conceptualize integrity as honesty and fair dealings, observance of ethical and technical standards, maintaining client confidentiality and resisting pressures to acquiesce to client choices.

Prior studies indicate that integrity is significantly related to objectivity, moral and ethical behavior. For example, Libby and Thorne (2007) developed a model of auditor virtue which report that the most important auditor virtues are honesty, independence and objectivity. Fan, Woodbine and Scully (2012) also report that auditor independence is measured in terms of integrity, objectivity and ability to resist client pressure. Akter and D'Ambra (2011) also provide evidence that users of mobile health information perceived ability and integrity as very important qualities that determine trustworthiness. Literature on the concept of integrity is sparse. Brown et al. (2007) explain that this may be because of difficulty in conceptualizing and measuring the concept. However, regulatory frameworks require auditors to conduct their work with professionalism and high integrity so that informed users identify them as persons of integrity and their work credible and reliable.

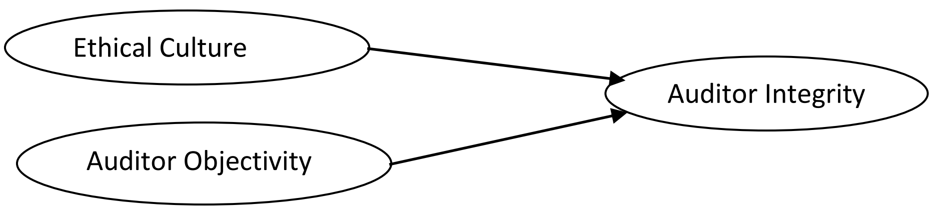
According to Thoms (2014) ethical integrity is a measure of how leaders enshrine morality and define right and wrong behavior in line with organizational rules and code of conduct. Consequently, organizations demonstrate their integrity by making integrity manifest in its core values which employees emulate and other stakeholders perceive. Thus, when leaders effectively communicate and imbibe ethical behavior, other employees will commit themselves to safeguarding that ethical culture (Graf, 2005). This role modeling is in line with social learning theory (Bandura, 1977; Schein,1985) which relates people's behavior to learning from superiors, role models and mentors. As such, subordinates copy their superiors' ethical and unethical behaviors because they are their role models (Kaptein, 2011).

Although some studies (e.g. Windsor & Ashkanasy, 1995; Lord & DeZoort, 2001; Libby & Thorne, 2007) associate auditor ethical behavior with resisting client pressure and meeting stakeholders' interests, there is evidence to suggest that organizational integrity seeps into employees through acculturation. For example, Windsor and Ashkanasy (1995) assert that auditors make ethical decisions when clients present them with conflict situations by relying on organizational culture and integrity. Ethical culture in organizations shape personal ethical behavior of members. This is also in line with findings by Morris (2009) that ethical culture significantly influences auditor professional behavior. Furthermore, Azis, Subroto, Rosidi and Subekti (2016) provide evidence that auditors' ethical behavior regarding respect and integrity is influenced by strong ethical cultures that are enshrined in the organizational code of conduct. Sweeney et al. (2010) also found that ethical culture significantly influenced auditor's ethical decisions and ethical pressure influenced auditor's intention to behave unethically. In addition, Apriliani, Anggraini and Anwar (2014) showed that self-efficacy moderated the relationship between ethical culture, ethical climate and auditor decisions.Webb (2012) reported that when senior management and supervisors' have integrity and commit to ensuring ethical behavior, unethical malfeasance is reduced. Kaptein' (2011) showed that employees were more likely to behave ethically and correct wrongdoing by reporting to management rather than ignore wrongdoing. Huhtala, Kaptein and Feldt (2016) assert that even the appearance of unethical behavior needs to be prevented as it can have an adverse effect on stakeholders' perceptions and undermine reputation of the organization.

Put together, empirical studies suggest that ethical culture is associated with ethical integrity of organizations. It then follows that organizations having stronger and supportive ethical cultures are more likely to be associated with higher organizational ethical integrity and employee integrity. In line with this thinking, the study propoes that:

H$_{02}$*: Supportive Ethical Cultures have no significant effect on Auditor Integrity*

3.0 Reasearch Framework



The research framework shows that supportive ethical cultures and auditor objectivity are proposed to affect auditor integrity. This is in line with prior studies that have established a link between ethical culture and auditor objectivity (e.g. Bamber & Iyer, 2007; Bauer, 2015; Svanberg & Öhman, 2016) and auditor objectivity and integrity (Akter & D'Ambra, 2011; Fan, Woodbine & Scully, 2012). The variables were measures were adapted from prior studies; ethical culture measured using Trevino *et al.* (1998) instrument as modified by Shafer and Wang (2010), auditor objectivity and integrity measured using Brown *et al.* (2007) scale.

3.1 Methodology

The study employed a cross sectional survey to obtain data from auditors about their perceptions and assessment of objectivity and integrity in relation to ethical culture of the audit firm. The instrument was pilot tested using two practicing accountants in Maiduguri. Next, the instruments were administered to auditors in the North Central Zone (Benue, Kwara, Nassarawa, Plateau, Kogi, Niger states and Abuja FCT). Respondents were members of the Association of National Accountants of Nigeria (ANAN) and Institute of Chartered accountants of Nigeria (ICAN). From the ANAN registered practicing professionals on the ANAN website, all 88 practicing accountants in the north central zone were given a copy of the instrument. Due to the absence of a sampling frame for the ICAN firms on the ICAN website, 150 practicing ICAN members were purposely selected and surveyed.

3.2 Data Analysis and Results

Data collected was analyzed using descriptive and inferential statistics. A total of 81 instruments were retrieved from the ANAN members and 75 from the ICAN memebers summing up to a total of 156 representing a response rate of 65.5%. Of the 156 respondents, 62% were male and 38% female while 88.4% were above 31 years of age. In terms of experience, 80% of the respondents had over 11 years of experience as auditors. About 72.6% of the respondents have very good-excellent knowledge of auditing practices and 83.3% were aware of the existence of an ethical code of conduct in their firms.

3.3 Correlation Analysis

The pearson product-moment correlation was run with using the mean of the three variables coded as Metc, Maobj and Maint for ethical culture, auditor objectivity and auditor integrity. Two demographic variables coded as Mexp and Maknw (auditor knowledge and experience) were also used. Table 2 shows the results of the pearson correlation coefficients for variables. The correlation between Metc and Maobj (.495) is significant (P<.01). In addition, Maobj is also correlated to Maint (.375) and significant (P<.01). Metc is also correlated to Maint (.403) and is significant (P<.01). Auditor knowledge was also found to be correlated with ethical culture (P<.05). Auditor experience was also found to correlate with auditor knowledge (.400) significantly (P<.01). This shows there is a high degree of association between the variables as shown in table 2.

Table 2 Pearson Product-Moment Correlations

		Metc	Maobj	Maint	Maknw	Mexp
Metc		1				
Maobj	Pearson Correlation	**.495****	1			
	Sig. (2-tailed)	0.000				
Maint	Pearson Correlation	**.403****	**.375****	1		
	Sig. (2-tailed)	0.000	0.000			
Maknw	Pearson Correlation	**.160***	0.148	0.028	1	
	Sig. (2-tailed)	0.046	0.064	0.729		
Mexp	Pearson Correlation	0.127	0.148	0.017	**.400****	1
	Sig. (2-tailed)	0.113	0.065	0.831	0.000	

**. Correlation is significant at the 0.01 level (2-tailed).
*. Correlation is significant at the 0.05 level (2-tailed).

3.4 Regression Analysis

The regression results on Table 3 show an R square of 20% meaning that ethical culture and auditor objectivity predict variation in auditor integrity by 20% and other variables outside the scope of this study account for the 80% of the variation. Furthermore, the F statistic (19.548) is positive and significant at 1% (P=.000) indicating that the model is fit and reliable.

Table 3 Multiple Regression Analysis Results

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Sig F
1	0.451	0.204	0.193	0.119	.000

a.Predictors: (Constant), Maobj, Metc
b. Dependent Variable: Maint

Table 4 shows the t value of ethical culture (3.466) is significant at 1% (P=.001). This result shows that supportive ethical culture is a significant predictor of auditor integrity and provides the basis to reject H01. Therefore, the alternate hypothesis that Supportive Ethical Culture has significant effect on auditor integrity is accepted. Additionally, auditor objectivity t value (2.809) is also significant at 1% (P=.006) suggesting that auditor objectivity is a significant predictor of auditor integrity. Hence, H02 is rejected and the alternate hypothesis that auditor objectivity has a significant effect on auditor integrity is accepted. This result is also in line with Svanberg and Ohman (2016) findings that ethical culture influences auditor objectivity.

Table 4: Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics		Durbin - Watson
		B	Std. Error	Beta			Tolerance	VIF	
1	(Constant)	2.019	0.388		5.198	0.000			1.798
	Metc	0.304	0.088	0.288	3.466	0.001	0.755	1.324	
	Maobj	0.246	0.088	0.233	2.809	0.006	0.755	1.324	

a. Dependent Variable: Maint

In assessing the robustness of the model, the tolerance value (.755) and Variance Inflation Factor (1.32) are reasonably within limits and rules out the existence of Multicollinearity in the model (Tabachnick & Fidell, 2007). Similarly, the Durbin-Watson statistic of 1.798 indicates no auto correlation. Overall, the results show that the model is fit and robust.

4.0 Discussion and Conclusions

The study adds to existing knowledge in several respects. Firstly, the study extends Tahir (2017) and Svanberg and Ohman (2016) study by establishing empirically how ethical culture and auditor objectivity are associated with auditor integrity. This is significant because if audit firms are able to nurture firm cultures, the benefits will extend to influence not only auditor ethical decisions but auditor and firm integrity as well. Secondly, the finding that auditor objectivity significantly affects auditor integrity is also important and concurs with prior studies (e.g. Libby & Thorne, 2007; Fan, Woodbine & Scully, 2012) that auditor objectivity and integrity are important auditor virtues in addition to independence. Thirdly, the study results concur with prior studies (e.g. Abubakar, 2011; Tepalagul & Lin, 2015) that rules and codes alone do not ensure ethical compliance nor do they deter auditors from compromising on objectivity and integrity. However, supportive firm cultures are more likely to encourage and instill objectivity and enhance auditor integrity. Fourthly, the study results show association between ethical culture and auditor integrity and auditor objectivity and integrity. The association between ethical culture and auditor objectivity was also significant at 1%. (P=.495). This concurs with the finding of Svanberg and Ohman (2016).

In sum, the results show that audit firms with supportive ethical cultures are more likely to have auditors that are more objective and have integrity. The fact that items measuring ethical culture loaded highly on aspects of reward and punishment system shows respondents' perception and acceptance of monitoring system to ensure ethical compliance. This is also supported by some studies that Nigerians often respond to reward-punishment systems because punishments are perceived to check unethical behaviour (Nwanyawu, 2010; Ajila & Omotayo, 2002). Thus, the paper concludes that supportive and re-enforced systems are more likely to enhance auditor integrity and objectivity.

Even though the study has contributed to knowledge, it also has some limitations. Firstly, the study relied on data generated from a cross-sectional survey which is prone to respondent bias. Additionally, the study did not also examine differences in perception among the two groups of professional accountants nor test for non-response bias among the respondents sampled. Furthermore, perceptions of Nigerian auditors may differ from those practicing in other countries because contextual factors in countries shape how citizens perceive certain relationships. Moreover, the study focused on professional accountants in the North Cental Zone comprising six states and the federal capital territory. As culture and environmental factors may influence and make perceptions differ even across a country, results may not apply to other zones with differing cultures and environmental practices. Despite the limitations, the study results have important implications to audit firms and Accounting regulatory bodies. The study limitations also provide avenues for further research on ethical culture in the audit firm.

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