

Fighting the Scourge of Audit Failures in Nigeria- the Search for Audit Quality

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Abstract

The objective of this conceptual study is to draw attention to the scourge of audit failures in Nigeria, its consequences for the capital market and suggest what is to be done to ameliorate the situation and enhance audit quality. Our literature search reveals that audit failure is a serious problem in Nigeria with dire consequences for the capital market and the auditing profession in Nigeria. We chronicle some of the suggestions made at various fora to tackle this problem. We recommend, among others, immediate mandatory introduction of Forensic audits for say every 5 years for public interest entities in Nigeria, strengthening of corporate governance institutions for more effectiveness, introduction of joint audits and tackling headlong cultural factors militating against audit quality in Nigeria.

Keywords: Audit failure, Audit Quality, Forensic audit, Culture, Joint audit.

1. Historical Perspectives of audit Failures in Nigeria and its Consequences.

Financial Statements' auditors are important gatekeepers in any corporate governance system. They attest to the financial statements prepared by the management of a company and thus lend credibility to the statements (Adeyemi & Olowokere, 2012).

Auditors are appointed by the shareholders although the Board of Directors has a say on the choice of the firm. The main objective of mandating the appointment of auditors, according to Company and Allied Matters Act, 1990 as amended, is to enable the auditors' report to the shareholders the position of the Financial Statements and activities of the firm, on whose behalf, and for whose benefit, the directors carry on the business(CAMA, 1990).

Each time an auditor used the term " True and Fair view" in his report, he is saying among others:

- a) As to his examination, that his independence is unquestionable; no limitation has reduced the scope of his audit below the level considered minimal, all records required by him were made available to and utilized by him, and he had exercised every professional care and skill throughout his examination.
- b) As to the client's internal control and accounting methods, that they are adequate
- c) As to the Financial Statements and appended notes that proper terminology had been employed and that no misstatement or misrepresentation is reflected in the system.
- d) As to statutory requirement, that the financial statements conform to the requirements of all existing statutes and regulations, and all disclosures required by law are made (Osisioma, 2004).

When audits fail, one or more of these assertions may turn out to be untrue. Audit failure is a global phenomenon and cuts across jurisdictions. Witness the recent collapse of such global companies as Enron and World Com. Earlier in the 1980's and 1990's such global giants as John Mathews Bank(JMB), Bank of Credit and Commerce International (BCCI), Barring Brothers, Nomura Securities, Brex and Long Term Capital Management (LTCM) all failed as a result of fraud related factors(Muraina et al., 2010). In such cases, the cry of the investing public has invariably been "Where were the Auditors?"

Nigeria is not spared either from incidences of audit failure. The case of five banks that failed the Central Bank of Nigeria (CBN) stress test in 2009, Afri-Bank, Fin Bank, Union Bank, Intercontinental Bank and Oceanic Bank is relevant as their external auditors had given them clean reports just before the CBN examination.

The banks had many things in common. Firstly, they were certified distressed by CBN barely few months after their auditors had given them a clean bill of health. For example, CBN declared Union Bank (Nig) Plc. distressed barely six months after it had received an unqualified audit report from its external auditors. Secondly, the banks were saddled with non-performing loans which were grossly understated in their Financial Statements. In a related development, it has been observed that there were red flags in the Financial Statements of some of the banks including Union Bank Plc which consistently posted losses in the preceding years just before CBN intervention. The going concern status of the banks was in doubt. Again the banks escaped going concern qualifications by their auditors, (Ande, 2011).

Perhaps, the greatest audit failure in Nigeria in recent times is that associated with the Cadbury (Nig.) Plc. accounting scandal which came to the fore in 2006 (SEC, 2006). This scandal which has since been euphemistically dubbed Nigeria's Enron equivalent(in terms of its magnitude) drew the ire of the Nigerian Security and Exchange Commission (SEC) on the auditors of the company. The auditors were accused, among other things, of failure to exercise due diligence and lack of professional skepticism in carrying out the audit of the company (Uwuigbe, 2013). Other cases of alleged audit failures in Nigeria include Ile-Oluji cocoa products, Standard Printing and publishing company, African Petroleum Company, Lever Brothers and Union Dicon Salt (Otusanya & Lauwo, 2010a; Bakre, 2007).

Audit failures are costly to investors, the auditors themselves and even the wider society as a whole. Enormous sums of money are lost every year by investors to fraud and corporate collapse. Nigerian investors have lost several billions of dollars as a result of companies that falsified and deliberately overstated their accounts and consequently failed or got into serious trouble. For example at the height of the Cadbury (Nig.) Plc. Accounting scandal, its share price pull meted from an all -time high of ₦65.52 in December 2005 to ₦8.65 as at October, 2009. In 2008, the world witnessed economic and financial crisis of an unprecedented

proportion resulting primarily from over extended credits by American commercial banks, insurance companies and mortgage institutions. This crisis was marketed across the globe via a highly inter-connected global and financial network. Nigeria was not spared and soon its capital market took a plunge (Osisioma, 2010). As a result of the plunge market capitalization of the Nigerian Stock Exchange dropped from an all-time high of ₦13.5 trillion to a mere ₦4.6trillion. At the same time about ₦2billion of pension assets were lost by pension fund administrators. The effects of the capital Market collapse in Nigeria in which some banks and their auditors have been blamed for unbridled granting of margin loans and manipulation of share prices of the banks include the following:

- i. Loss of confidence in the Nigerian capital market by investors.
- ii. Investors and stock brokers lost billions of Naira of their investments virtually overnight.
- iii. Investors became exposed to the risk of bankruptcy as they had obtained investment and margin loans from the banks and were no longer in a position to repay.
- iv. Depositors' funds were seriously eroded from loans extended by banks for share speculation and sometimes manipulative purposes.
- v. Credit crunch as banks became wary of extending further credits to the productive sectors of the economy.
- vi. Capital flight ensued as foreign investors sought safer climes for their investments (Osaze, 2011).

The auditors, on the other hand, have had their reputation sullied. Audit clients switch from firms that have reputation for low audit to other firms, (Skinner & Srinivasan, 2010).

The development of accounting profession in Nigeria was influenced by UK practices and company law. The debut of the Association of Accountants in November 1960 heralded the birth of Accountancy profession in Nigeria. This metamorphosed into the Institute of Chartered Accountants of Nigeria (ICAN). Another professional accounting body in Nigeria- the Association of National Accountants of Nigeria (ANAN) came into being in 1993. The association is also responsible for ensuring the best practices in the profession and also undertakes the regulation of accountancy practice in Nigeria. In 1982, the Nigerian Accounting Standards Board was established to promulgate accounting standards to narrow areas of differences in preparation and presentation of financial information by publicly quoted companies (Adenola, 2011). The Nigerian Accounting Standards Board (NASB) has since metamorphosed to the Financial Reporting Council of Nigeria (FRC) with the promulgation of the Financial Reporting Council Act of 2011(Financial Reporting Council Act, 2011). The Professional Accounting bodies in Nigeria, namely ICAN and ANAN contributed in the development of the auditing profession in Nigeria. Auditing standards were developed, particularly, by ICAN to guide auditors in their work, (Ojo, 2012).

Self- regulation of accountancy profession has come under severe attack as critics doubt the ability of the profession to enforce regulation directed against some misbehavior of its members. Self- regulation raises the issues of openness, transparency, accountability and acceptability of the process. Additionally, the rules written by the self -regulators are adjudged to be capable of being self- serving and may be difficult to be shown to have been contravened, (Iyoha, 2011).

Following the consolidation of the banking industry in Nigeria, the Central Bank of Nigeria (CBN) introduced in 2006 mandatory rotation of auditors of banks as a way of further sanitizing the sector. In the same vein CBN barred Nigerian bank auditors from providing certain non-audit services to their audit clients. However, in spite of spirited efforts to stem

the tide of audit failures, the problem has persisted as evidenced by the recent pension and fuel subsidy scams in Nigeria where auditors have again been fingered as accomplices, (Adoke, 2012).

2. Conceptual Framework of Audit and Audit Quality.

An audit must be of sufficient quality if audit failures will be reduced to the barest minimum. According to Tackett, Wolf and Claypool (2006), auditing failure occurs when management grossly misrepresents their financial statements and auditors through negligence or incompetence fail to discover and report these misrepresentations to the public. Quality audit enhance the credibility of financial statements. A classical definition of audit quality is that it is the market-assessed joint probability that a given auditor will both: (i) identify a breach in the client company accounting system and (ii) report that breach, that is that the auditor has both the technical competence to detect any material errors during the audit process, and the independence to ensure that material errors and omissions are corrected or disclosed in the auditor's report (De-Angelo, 1981). It follows that an audit fails if all or any of the above two conditions are not met.

Two main factors distinguish audit product from other professional services. In the first instance auditors are hired and paid by the client but their product is usually used by third parties (the investors) to whom they owe a duty of care. Secondly, the quality of an audit cannot be directly observed prior to contracting and in general not even after the audit is conducted. The only observable outcome of the audit process is issued audit report which in its present form may not contain much information about audit quality(Zerni, 2009). Audit quality is a multi -dimensional construct and is made up of both service quality issues and the need to deliver technical quality. Service quality includes responsiveness, provision of non-auditing services, empathy and client services. Technical quality usually conceptualized as the competence and objectivity of the auditor is described by reputation, capability, independence, expertise and experience. Technical quality and service quality though different constructs are, however, linked by factors which describe the two facets of audit quality (Duff, 2004)

Certain fundamental characteristics are worth noting in respect of any audit engagement. These are:

- i. An audit is an economically motivated response to risk, i.e., incentives matter.
- ii. The output of an audit is a report but the outcome is uncertain and unobservable, i.e. uncertainty matters.
- iii. Each engagement is different. The idiosyncratic nature of an audit arises due to variations in client characteristics, audit teams, timing of work, and assessed risks and procedures used, i.e. uniqueness matters.
- iv. The audit is a systematic activity, i.e. process matters.
- v. The execution of the audit process depends on appropriately leveraging the knowledge and skills of experts, i.e. professional judgment matters

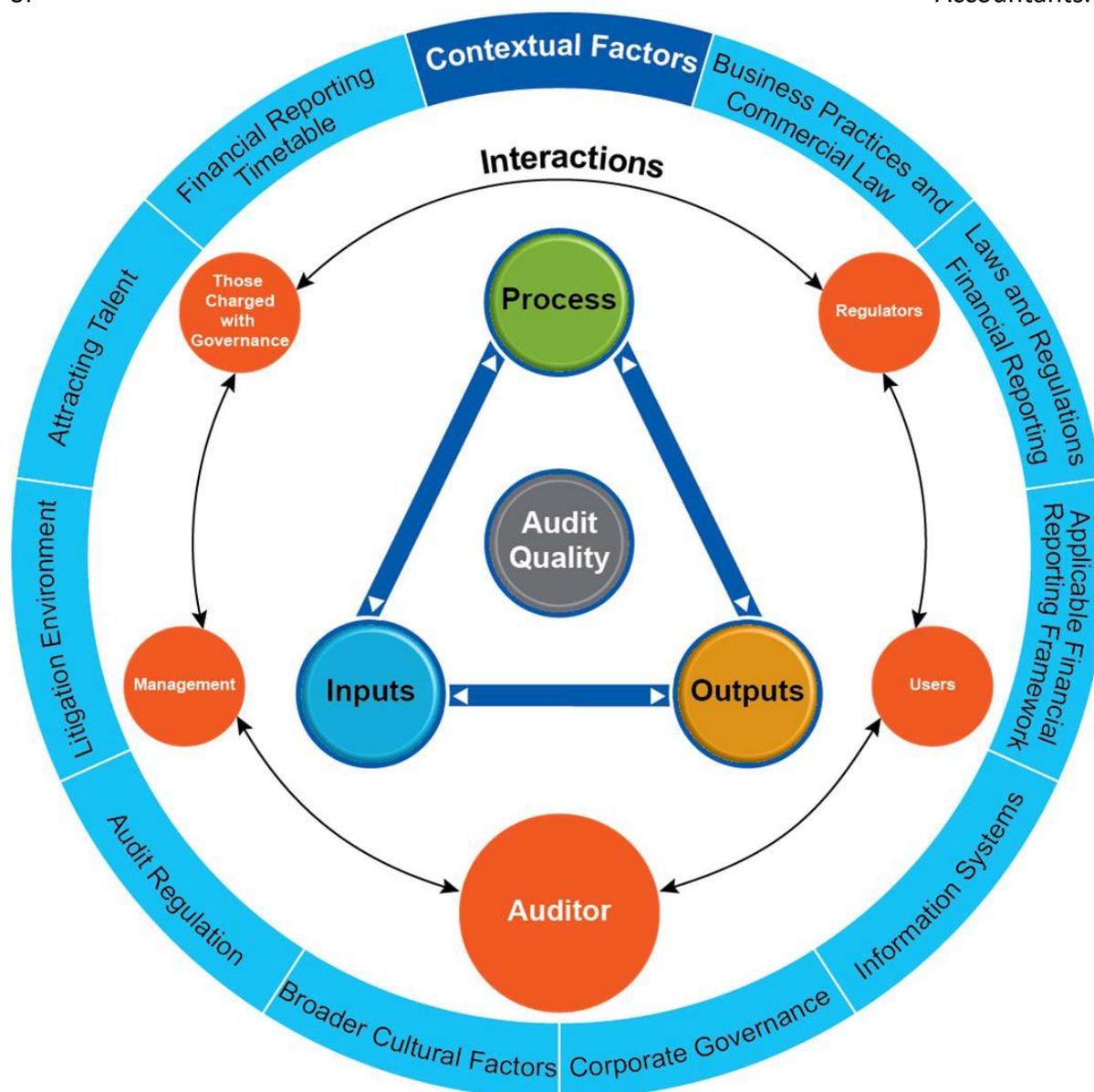
Audit quality depends on how these fundamental characteristics manifest in any given engagement, (Knechel, Krishnan, Pevzner, Shefchik, & Velury, 2012).The United Kingdom Financial Reporting Council identifies five factors that impinge on audit quality. These are audit firm culture, reliability and usefulness of audit reporting, skills and personal qualities of partners and staff, effectiveness of audit process and factors outside the control of auditors(Beattie & Hines, 2010). The model though a welcome development has been assailed by stakeholders as being insufficient.

It should be noted that audit quality is not primarily about auditing standards, but about the quality of people, their training and ethical standards.(Arezoo, 2011).

The following propositions about audit quality, among others, have been made in order to further clarify the concept:

- 1) How to define and measure audit quality is still not known
- 2) Zero risk cannot be the goal of audit quality
- 3) Audit quality as an outcome cannot be completely divorced from reporting quality
- 4) Any definition of audit quality must take cognizance of the fact that audit is a professional service
- 5) Audit quality is uncertain and idiosyncratic
- 6) Audit failure from the perspective of the auditor can be grouped into two. Calibration failure refers to the variance of planned assurance from targeted assurance. Execution failure, on the other hand, refers to the variance of achieved assurance from planned assurance.
- 7) The primary cause of execution failure are misdiagnosis and inappropriate treatment of risk
- 8) The quality of auditing is inherent in the nature and execution of the activities that diagnose and treat risk in the audit process(Knechel, 2009)

A more comprehensive model of audit quality is provided by the International Federation of Accountants.



Source: IFAC (2014)

The framework sees audit quality as output from a system that first involves input and processing. In doing his work, the auditor interacts with Regulators, Users, Management and Those charged with Governance. This interaction is done in the broader context of factors that include Corporate Governance, Broader Cultural factors and Audit Regulation

3. Enhancing Audit Quality in Nigeria.

Our review of Nigerian literature in respect of restoring audit quality reveals the following dominant suggestions.

- 1) Strengthen self-regulation machinery of the Accounting profession in Nigeria
- 2) Encourage short audit client relationship or mandatory rotation of auditors
- 3) Ban, on a selective, basis the provision of certain non-auditing services (NAS) to an audit client.
- 4) Encourage joint audits

- 5) Strengthen Board effectiveness
- 6) Strengthen Audit Committee effectiveness
- 7) Discourage cultural factors that circumscribe auditor performance.
- 8) Encourage Forensic Auditing.

Randle (2004), reports that the self-regulatory machinery of the accounting profession in Nigeria was frustrated by rivalries among the accounting firms. There have been recent attempts to reactive the machinery of self- regulation by the Institute of Chartered Accountants of Nigeria. The establishment of the Financial Reporting Council (FRC) of Nigeria in the wake of the adoption of international Financial Reporting Standards by Nigeria has further strengthened the regulation of the accounting profession and indeed all the professions involved in financial services as all such professionals are now required to register with the Council for monitoring(Financial Reporting Council Act,2011)

Perhaps the most controversial suggestion for restoring audit quality in Nigeria is the issue of mandatory rotation of auditors. While the Institute of Chartered Accountants of Nigeria is opposed to the idea of mandatory rotation of auditors, the Association of National Accountants of Nigeria (ANAN), the only other recognized professional accounting body in Nigeria, welcomes the idea. In the wake of the Cadbury (Nig) PLC accounting scandal, it was discovered that the external auditors had stayed with the company for 40 years! Perhaps the issue should be the optimum time an auditor should stay before a change is made. The Central Bank of Nigeria at the moment requires a change to be effected when a bank auditor stays for 10 years in a bank audit (Ujah,2006)

The Central Bank of Nigeria (CBN) has mandated selective ban on some non-audit services provided by bank auditors to their bank clients. Also many empirical studies in Nigeria lend support to outright or selective ban. There is a need for all publicly quoted companies' auditors' to also follow suit mandatorily. The empirical studies include (Adeyemi,Olowokere,2012) and(Adeyemi, Dabor and Okpala, 2012).

Joint audit has been touted as the elixir for the problem of audit market concentration in Nigeria. The president of the Institute of Chartered Accountants of Nigeria (ICAN) is upbeat about this(Ajaegbu,2014). In addition to helping to adress the issue of audit market concentration, it will also help shore up audit quality as two heads are certainly better than one.

Corporate board effectiveness in Nigeria will place the audit function in good stead as it will reduce the information assymetry that normally arises in principal agency relationships. Many factors make for board effectiveness including independence, diligence and size.(Ogbechie,2012).

In a similar fashion, audit committee effectiveness will strengthen the hands of the auditors in their dealing with corporate management and thus enhance audit quality. At the moment many stake holders are dissatisfied with the performance of the average audit committee in Nigeria.(Owolabi,Dada, 2011); (Olayiwola, 2010). Reasons adduced for the apparent ineffectiveness of the committee include dominance by members of the committee appointed by members of management, lack of remuneration for members, short tenure of members and members inability to ask relevant questions as a result of poor technical knowledge(Okoye&Akenbor,2010). The Financial Reporting Council may do well to extend the requirements for appointments into corporate boards and audit

committees as it plans to introduce a mandatory corporate governance code for companies in Nigeria.

Perhaps the most important issue in enthroneing audit quality in Nigeria is the issue of cultural factors which circumscribe effective performance of the Nigerian Auditor. These include slow and tardy judicial process, low litigation culture (Berg and Eskinazi, 2008) fear of loss of live by auditors, acceptance of bribes by auditors in the course of their duties (Bakre, 2007); (Kida, 2013), excessive respect for elders that results in unquestioning obedience to instructions some of which may be detrimental to an organisation's welfare (Oghojafor & Owoyemi, 2012). There are also some issues like lack of professional skepticism and negligence by some Nigerian auditors (SEC, 2006). There is also the issue of lack of whistle blowing culture (Egbiki, 2006)

The benefits of forensic audit in Nigeria have become real with the results of forensic audits of Cadbury (Nig) Plc, the Nigerian Stock Exchange and lately the NNPC. It will be appropriate if legislation is introduced mandating forensic audit of public interest entities say once every 5 years to complement the traditional audit with its limitations. A stakeholders conference in 2010 recommended immediate introduction of forensic accounting in 2010 (Azinge, 2010). Okunbor & Obaretin (2010) has also recommended introduction of forensic audits in Nigeria.

4. Conclusion

We set in its historical perspective some incidents, causes and consequences of audit failures in Nigeria. This was followed by situating audit and quality conceptually. We then discussed some suggestions that are capable of reducing the scourge of audit failures in Nigeria by improving audit quality. Our findings have implications for regulatory authorities in Nigeria, the professional accounting bodies in the country and indeed all the members of the public. A holistic approach to tackling audit failures and enthroneing audit quality in Nigeria is thus envisaged.

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