

# **The Role of Auditors in the Recent Nigerian Banking Crisis**

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### **ABSTRACT**

In market societies people routinely have to transact with faceless corporations about whom they have little personal knowledge. In such societies external auditing and auditors are promoted as a trust engendering technology and watchdog with the capacity to promote a particular kind of social order. Investors and depositors in a number of banks in Nigeria have lost several billions of Naira due to the lack of implementing qualified audit report theory and practices of accountants and auditors, which has resulted in the distress of a number of banks. This research work has examined the contemporary auditing and the role of accountants and auditing firms in causing the collapse of banks. The paper locates the role of auditors within the broader dynamics of professionalism and the pursuit of profits to argue that major accountancy firms are becoming more and more willing to increase their profits by indulging in anti-social practices that show scant regard for social norms and even legal rules and regulations. Contrary to their claims to be protecting the public interest, accountants and auditors may be partly responsible for cases of distress and the collapse of banks in Nigeria, as they failed to qualify their reports when there were indications of financial difficulties in the banks. There is also evidence to show that auditors have collected large sums in audit and non-audit fees. Such events raise questions about the value of company audits, auditor independence and the quality of audit work. This paper argues that the basic auditing model is flawed since it makes auditors financially dependent on companies. The conventional approach to 'audit quality' is also inadequate as it pays little attention to the organizational pursuit of profits and the social

context of auditing. The paper encourages reflection on contemporary practices and on the role of accountants and auditing firms in corporate collapse, and offers some suggestions for reform.

**Keywords:** Accounting Firms, Accountants, Auditors, Banking Crisis, Professional Misconduct, Banks.

## 1. INTRODUCTION

Many organizations are required by law or by policy to hire an accountant to produce a periodic audit of the organization's financial statements. Auditors affix qualifications or warnings to an audit report that exposes defects within the organization's financial systems. This qualification serves as a protection to the auditor in that the auditor's opinion of the organization's fiscal policies is subject to the qualified item being corrected.

The qualified audit indicates that there are areas of concern in the presentation of financial data that may need to be addressed by an organization's management. These areas may be minor in scope. They should, however, be addressed as soon as possible to prevent abuse. In fact, a qualified finding may actually provide the road map to those who would commit malfeasance if any underlying practice of concern is not addressed. An audit report that does not contain qualification is a positive affirmation of organization management, Messier and Emby (2005)

A qualified audit report is issued when the auditor encountered one of two types of situations which do not comply with generally accepted accounting principles, however the rest of the financial statements are fairly presented. This type of opinion is very similar to an unqualified or "clean opinion", but the report states that the financial statements are fairly presented with a certain exception which is otherwise misstated. The two types of situations which would cause an auditor to issue this opinion over the unqualified opinion are:

Single deviation from GAAP – this type of qualification occurs when one or more areas of the financial statements do not conform to GAAP (e.g. are misstated), but do not affect the rest of the financial statements from being fairly presented when taken as a whole. Examples of this include a company dedicated to a retail business that did not correctly calculate the depreciation expense of its building. Even if this expense is considered material, since the rest of the financial statements do conform to GAAP, then the auditor qualifies the opinion by describing the depreciation misstatement in the report and continues to issue a clean opinion on the rest of the financial statements.

Limitation of scope – this type of qualification occurs when the auditor could not audit one or more areas of the financial statements, and although they could not be verified, the rest of the financial statements were audited and they conform to GAAP. Examples of this include an auditor not being able to observe and test a company's inventory of goods. If the auditor audited the rest of the financial statements and is reasonably sure that they conform to GAAP, then the auditor simply states that the financial statements are fairly presented, with the exception of the inventory which could not be audited, Marshall et-al (2008).

An unqualified audit report demonstrates that the audited entity appears to be in compliance with accepted accounting practices. An auditor writes this opinion after reviewing the financial statements and concluding that the evidence points to the organization's compliance with

these practices. An audit that results in an unqualified audit report is commonly referred to as a clean audit. An unqualified audit may assist the organization in securing future loans or attracting new investors.

Adverse opinion indicates serious problems with the audit, and can be very damaging in its effect on the firm's reputation and financial position. It also called accountant's opinion or audit opinion. The threat of an adverse opinion almost always motivates a business to give way to the auditor to doctor its accounting or disclosure in order to avoid getting an adverse opinion.

A fundamental feature of financial reporting is that an auditor is hired to attest to the quality of the financial statements prepared by management. The economic value of an audit opinion to users of financial statements is of great interest to academic researchers and accounting practitioners, especially in times when auditing is under considerable regulatory and public scrutiny Francis (2004); DeFond and Francis (2005).

The usefulness and reliability of the audited financial statements of banks depend on the quality of audit and the integrity of the auditor. One of the measures of audit quality is the auditor's report which contains important information for stakeholders about the quality of the financial statements as well as some indication towards the banks' performance. While the audit quality is difficult to measure, the extent to the auditor is willing to issue qualified opinion often provides some indication of audit quality, Chen et-al (2005).

In respect of the banking crisis, attention has focused on the role of accountants and auditors who have been involved. Accountants and auditors may be expected to report financial irregularities in company accounts by enhancing transparency and accountability and by developing techniques for fraud detection. However, an emerging body of literature argues that accounting professionals have increasingly used their expertise to conceal and promote anti-social practices (Sikka, 2008a; US Senate Permanent Sub- Committee on Investigations, 2005; Bakre 2007). For example, Akintola Williams and Deloitte (AWD) was indicted for facilitating the falsification of the accounts of Afribank Plc and for deliberately overstating the profits of Cadbury Nigeria Plc. It has been reported that between 1990 and 1994 the Nigerian economy lost more than N6 billion (\$42.9 million) to fraud within the banking sector alone (Bakre, 2007).

The social cost of the banking crisis is difficult to estimate, but huge amounts of public money are being used to bail out distressed banks (Sikka, 2009). In 2008, almost every Reserve Bank across the globe, in collaboration with finance ministries, was forced to adopt extraordinary measures to stave off the collapse of the financial institutions and to restore confidence in the banking system. Some countries, such as the UK, took direct stakes in their banks as a temporary measure in order to ensure that they kept lending. The German and French governments offered to guarantee inter-bank deposits to achieve the same purpose, while the US government rolled out the Emergency Economic Stabilisation Act authorising the US Treasury Department to spend up to \$700 billion to purchase distressed assets from sick banks and to make a direct capital injection into those institutions (*The Guardian*, 30 August 2009).

While the global recession was biting hard on advanced economies, the governors of the Central Bank of Nigeria (CBN) had stated that 'what the rest of the world is now trying to do as the bailout option was what Nigeria did about four years ago, through a pro-active initiative,

the result of which we are celebrating today' (*ThisDay*, 16 October 2009). Less than a year later, however, Nigerians were awoken to the reality that the Nigerian banks were not so stable after all (*The Guardian*, 21 August 2009). The audit conducted by the CBN into the activities of the 24 registered banks in 2009 revealed that they were experiencing huge financial difficulties in their operations. As a consequence, in August 2009, CBN injected N420 billion (\$2.8 billion) into the first five banks (Afribank, Finbank, Intercontinental Bank, Oceanic Bank and Union Bank) which had failed the CBN audit. Two months later, an additional N200 billion (\$1.33 billion) was injected to stimulate the liquidity of four other banks (BankPHB, Equitorial Trust Bank, Spring Bank and Wema Bank) (*Nigerian Tribune*, 8 December 2009; *ThisDay*, 12 December 2009). This injection of money was done in order to stabilise the banks and to ensure that they remained going concerns after their former managers had been sacked for reckless lending and for lax corporate governance which had rendered the institutions undercapitalised (*Nigerian Tribune*, 17 August 2009; *ThisDay*, 12 December 2009).

The investigations launched by the financial regulators and other stakeholders into the Nigerian banking industry revealed that accountants and auditors have not done their work properly; because the nature of qualified audit report practice in Nigeria does not conform to qualified audit report theory. Despite the distress, some banks have opened new branches in some parts of the country while others have ceased operations and changed names to Keystone bank, Mainstreet bank, Enterprise bank and some were acquired. What factors attributed to the distress, change of names and acquiring of those banks? Could it be as a result of the inability of auditors to give qualified audit opinion that conform to theoretical framework; about the capital structure, unethical management practices, customers' patronage, loss of goodwill or just to change the names? Faith in the audit that is essential to auditor's job diminished because of severe crimes left undetected in Nigerian banking industry, until billions of naira were lost through the Chief Executive Officers' (CEO). Insider trading abuse of some Nigerian commercial banks such as Afribank Plc, Intercontinental bank, Oceanic bank International Plc, Union bank, and First Inland bank as reported by Waziri (2009).

As a result of the questionable role of auditors, this study's main objective therefore, is to assess the economic role of the qualified audit report by investigating how a qualified audit opinion practiced in Nigeria has affected the Nigerian banking industry and the adequacy of two years audit report of some selected distressed banks aforementioned as well as to find out the party (ies) responsible for the problems encountered by the distressed banks, in order to ascertain the reliability of qualified audit report theory and its practices in the Nigerian banking industry.

The paper is organized as follows. Part II examines the literature on the nature of audit report received by Nigerian banking industry and the collapse of banking sector in Nigeria. Part III considers statement of the methodology of data collection. Part IV describes the nature of result and its discussion and Part V concludes the paper by providing the findings and recommendation.

## **2. LITERATURE REVIEW**

The need for external party to verify financial statements' credibility is required due to the agency problem. Auditing role as intermediary and assurance provider of information could help to reduce the agency problem arising from the separation between management and

ownership. The theory suggests that as agency cost increases; there is a demand for higher quality audit either decided by manager or enforced by shareholders and creditors. Audit report is a medium of communication and one way to measure audit quality that the users of information is expected and it considers the crux process of audit process.

Although there are several theories relating to what economic role auditing plays, the type of audit opinion issued is presumed to further such a role. Specifically, auditors' choice of modified opinions (e.g. explanatory notes, qualified with "except for", disclaimer and adverse opinion) can be important because they may convey different warning signals to users of the financial statements. Thus, research on what factors influence auditors in arriving at their decision on the type of report (unqualified or some degree of modified opinion) and their predictive value in anticipating the ultimate outcomes are worthwhile. Lam and Mensah, (2006)

The concept 'audit' has been defined by several authors. Tandon, Sudharsanam, and Sundharabahu (2006) opines audit to mean a critical and intelligent examination of facts-financial and otherwise, to give in the form of certificate or report an attestation, an expert opinion or an expert advice. This definition view audit beyond the examination of financial statements only but also includes non-financial events of an organization and goes further to portray explicitly that the exercise is carried out by one who is a professional as in terms of being a certified accountant. In another definition, the concept is viewed as a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users Messier, (2003). This shows that audit is both an investigative and reporting process.

Similarly, Beatline (1992) states audit as an examination by an independent expert—the auditor (who can be either an individual or a professional firm) of a set of financial statements and of the underlying books and records, which results in the auditor providing an opinion on the financial statements. However, the most widely accepted definition of audit is that provided by the International Auditing Guidelines (IAGs) issued by the International Federation of Accountants Committee (IFAC) cited in Dandago (2002). Audit according to the guidelines is an independent examination of, and the expression of an opinion, on the financial statements of an enterprise, by an appointed auditor, in accordance with his terms of engagement and the observance of statutory regulation and professional requirements. In another vein, Kantudu (2004) defined audit as an exercise that involves evaluation of the relevance, reliability and adequacy of evidence in support of verifiable information. The general definition of an audit is an evaluation of a person, organization, system, process, enterprise, project or product.

To understand the crux of this issue, a quick review of the prior literature is necessary. Lam and Mensah (2006) categorized the literature related to audit opinion into three categories. The first category consists of those studies concerned with determining factors which appear to influence auditors in the decision of whether to issue a modified opinion or not. The second category consists of studies which have examined the capital market relevance of modified opinions. The third category of studies focused on whether the modified opinions impacted the decisions of financial statement users.

Based on the above classifications, the concern of this study is the first category of those studies regarding the factors that may have an influence on auditor decision weather to qualify

his opinion or not. These studies include e.g. Ballesta and Meca,(2005); Caramanis and Spathis, (2006); Farrugia and Baldacchino,(2005).

There were several models have been developed in those studies to predict the audit qualifications in the auditor's report. The general consensus of these models has been that financial and non financial factors influence the audit opinion decision Caramanis and Spathis, (2006).The users believe that audit qualifications are useful warning signal to bankruptcy.

Earlier study conducted by Dopuch et al.(1987) investigated the extent to which models based on the financial and market variables predict auditor decision to issue qualified reports in situation involving contingencies and uncertainty. The model includes five financial variables which are: leverage; ratio of receivables and inventories to total assets; total assets to measure size and if there is any operating loss in the year of qualifications. In addition to financial variable Dopuch et al. (1987) include market variables in their study. Market variables such as time listed, change in beta, change in residual standard deviation and industry return could explain part of audit qualifications. In general the findings state that in addition to financial information power to explain the qualifications, the market variables have explanatory power in explaining the opinion decision. They believe that the model should be useful for the auditors because the auditor's decision is much related to financial and market variables. The auditors can use the model to identify the clients that are more likely to receive qualified opinion or to screen potential clients. The researchers argued that the models can be used as benchmark to represent the probability that the auditor would issue a qualified opinion in similar situations. The investors also can use the model as a proxy to predict the qualified opinion.

Keasey et al. (1988) in a similar approach with Dopuch et al. (1987) examined 12 financial and non financial factors that may explain audit qualifications in audit report. Using multivariate logistic regression, the result of their study showed that auditor is more likely to issue qualified audit report in the case of existence of certain variables such as the large type of audit firm, the a few non director –shareholders in the board, declining earnings, secured loan and the time lag of audit report.

In later study, Hopwood et al. (1989) examined the relation between bankruptcy and audit qualifications using one univariate and two multivariate models. The opinion variables were tested in conjunction with the financial ratio variables. The results indicate that there is association between bankruptcy and qualified audit opinion and they provide credence to the financial statements users' insistence that the qualified opinion has the ability to serve as an early-warning signal for the entity failure.

Taking different approach, Ireland (2003) investigated the determinants of audit report in the UK by examining the association between published audit report and observable company characteristics in UK's public and private companies. Unlike previous studies in UK which investigated the association between audit qualifications in UK's small companies and going concern opinion, Ireland (2003) took another way of expanding and examining data in large companies with different types of audit qualifications. Explanatory factors tested in this study were auditor size and fees as auditor characteristics and size, gearing, liquidity, profitability, and company type as a proxy for company characteristics.

The results indicated that large companies, highly-g geared companies, and companies that have received prior years audit modifications are more likely to receive modifications. Large companies, companies with good liquidity and those paying dividends are less likely to receive

going-concern modifications. Finally, companies paying high audit fees are also more likely to receive going-concern related modifications.

Similarly, Bell and Tabor (1991), examine the usefulness of financial statements and other data (industry) for modeling the auditor's decision process leading to the modification of audit reports for uncertainties. They developed the model that could be applied early in the audit when the auditor forms an expectation of engagement risk and again at the final stage when making the reporting decision. The model can be useful as an expectation model for studying the information content of qualified audit report. It could be also used as evidence against auditor when there is a failure of issuing qualified opinion. The model is quite similar to the Dopuch et al.(1987) model. However, they include new additional variables that capture the short term liquidity measure and return on investment in their model. They found that the short term liquidity, return on investment, financial leverage were significant in all models.

Laitinen and Laitinen (1998) developed a statistical logistic model based on financial statements information to explain qualifications in audit reports. The analysis of results showed that the qualifications of an audit report are mainly associated with poor profitability, high indebtedness and low growth. The logistic model showed that the likelihood of receiving a qualification is larger, the lower the growth of the firm, the lower the share of equity in the balance sheet and the smaller the number of employees. The results of the study indicated that the model is efficient to explain qualifications in the audit reports of Finnish publicly-traded companies can be constructed

Extending the previous literature on the association between qualified audit opinion and financial and market variables, Krishnan and Krishnan (1996) extend those models by incorporating economic tradeoffs that arise in the auditor's qualification (modification) decision. The economic tradeoffs could influence the auditor decision to whether qualify his opinion. Dopuch et al. (1987) argued that qualification decision involves economic tradeoffs because auditors who qualify too frequently risk losing clients and those who seldom qualify are expected to litigation risk and loss of reputation.

This study incorporated the auditor's risk of litigation, the type (big Six or not) of auditor, the extent of outsider ownership, the share of public debt in total debt, the relative importance of the client in the auditor's portfolio, and the future growth rate of the client. The results provide evidence that the greater the likelihood of auditor's litigation risk, the extent of outsider ownership, the relative importance of the client in the auditor's portfolio, and future growth are important factors in the audit opinion decision to consider as a trade offs.

Farrugia and Baldacchino (2005) used two methods to investigate the relationship between audit qualification and firm specific characteristics. They employed the annual reports of small Maltese's companies to give them some insights about the factors that may affect auditor opinion. Thereafter, they conducted interview with auditors to give further evidence regarding the relationship between firm specific variables and auditor type and audit qualifications in small Maltese's companies. They found no association between the size of company and the issued shares of company and audit qualifications. However, there are other factors may influence the type of report such as industry type and the type of company (i.e. multinational or local). Furthermore, the results indicated that there was a significant association between type of auditor and audit qualifications. The explanation for the relationship between audit size and audit qualifications as they believe is that the big auditors are well established and well

qualified which enable them to discover any breaches and problems in the company accounts. It is also suggested the big auditors are more likely to resist for management's pressure to issue clean opinion because their reputation is the first concern for them to be considered.

In a different way from previous literature, Ballesta and Meca (2005) take a new approach to study the factors that affect audit opinion. They examined the corporate governance factors and its role in enhancing audit quality and in turn the likelihood of receiving qualified audit report. Using logistic regression and matched pair design they tested the influence of ownership concentration, board ownership, board size and number of family member in the board.

The results of study, in one hand support that higher insider ownership provides better corporate governance leading to higher financial reporting quality. Thus, the less likelihood to received qualified opinion. It is because the degree of alignment between shareholders and managers' interest which motivate managers to act in the interest of company and prepare financial statements that are less likely to attract audit qualifications. On the other hand the result show that increasing in family members on board lead to increase the likelihood of receiving qualified audit report because the degree of transparency is small in such company.

In further study, Spathis et al. (2003) examine the extent to which combination of financial and non- financial information can be used to enhance the ability between the choice to qualify audit report or issuance of clean report. They examined the financial statements and auditor opinion and notes on financial statements. They applied discriminate and logit analysis to developed their model. From a set of 20 variables 10 variables selected, eight of them financial variable, one variable is a dummy variable (i.e.litigation risk) and Z-score. The possible indicators to predict audit opinion are: the receivables/sales ratio, net profit, total assets ratio, the sales/total assets and the working capital/total assets ratio

Following Dopuch et al.(1987) in recently study, Caramanis and Spathis(2006) developed a model to explain audit qualifications, however in their model they consider another indicator which is audit firm characteristics. Using logistic and OLS regression models to compare between two groups, the analysis point to a number of findings: (1)the existence of negative relationship between audit opinion and profitability (2) no significant explanation between audit fees and number of qualifications (3) In contrast to Farrugia and Baldacchino (2005), there is no association between type of auditor and receiving qualified audit report.

Chen and Church (1992) examined the use of default status in auditors' decisions to issue a firm a going-concern opinion and the usefulness of default status in explaining the weak association between the issuance of going-concern opinions and the occurrence of bankruptcies. Their findings suggest that auditors consider default status in making going-concern decisions. Furthermore, they also found that default status provides a reasonable explanation for this weak association.

All the above mentioned studies have been conducted in developed countries which have different environment which make the validity of the study. Thus to make the topic is suitable in the emerging market like Malaysia, it is worthwhile to review the literature on this topic in those countries to All literatures that have been conducted indicate that there is influence on the auditor decision regarding whether to qualify his opinion or not. This influence can be explained by two groups of factors either financial or other qualitative factors.

Fan and Wong (2004) examine whether external independent auditors are employed as monitors or as bonding mechanisms, or both, to alleviate the agency problems. Using a broad sample from eight East Asian economies, they document that firms with agency problems embedded in the ownership structures are more likely to employ Big 5 auditors and more easily to trigger audit modified opinion. They tested different variable in relation to audit opinion such as size, return on assets, leverage, account receivables to total assets, inventory to total assets and ownership concentration.

In general, the results showed that East Asia firms subject to greater agency problems, indicated by their high control concentration, and they are more likely to hire Big 5 auditors, report that Big 5 auditors. Particularly, with respect to audit opinion decision, they found that auditor in those countries take into consideration auditees' ownership structure when making opinion decisions. Also, they found that poor earnings can more likely cause auditors to issue a modified opinion of their clients with large agency problems, examine whether independent external auditors can serve a corporate governance role in safeguarding accounting information in eight East Asian economies including Malaysia

Teoh and Lim (1996) investigated the effects of five selected variables on the perceptions of auditor independence of Malaysian public and nonpublic accountants. The variables tested in this study size of audit fee, management consultancy services, rotation of audit, firm audit committees and non audit fee disclosure. The results of this study showed that all independent variables significantly affect perceptions of independence. In relation to this study audit committees as a means of enhancing auditor independence are perceived being important in Malaysia. In this case if the audit committee has an impact on auditor independence, thus logically should be on audit report as outcome of auditor decision. It is because auditor independence could affect the auditor decision on whether qualifying his report or not.

Abu Bakar et al. (2005) examined the perception of Malaysian loan officers on independence by examined these variables tenure, size of audit fees, size of auditor, management audit services, existence of audit committee and level of competition between auditor. Even though this study investigated the perception of loan officers, it can give insights from the main group of users on the auditor independence. Among the reported result, there was positive relation between independence and audit committee and the type of auditor. As it mentioned before that audit committee effectiveness play important role in enhancing auditor independence by reducing the pressure from management upon him. Therefore, enhancing auditor independence will lead to enhance and improve the quality of audit report. Regarding the auditor size and independence, the researchers found that big four more independent than other firms which suggests that big four are more likely to resist the management pressure to issue clean opinion. Since 2007, major Western economies have been experiencing a deepening banking and financial crisis arising from subprime lending practices by banks, which in turn has restricted the availability of credit and has led to what has been described as the 'credit crunch' Sikka *et al*, (2009). Some commentators have attributed this economic crisis to the unethical practices of corporate bank managers and to the inability of auditors to expose such anti-social practices from previous audits *Broad Street Journal*, 21 October (2009); Sikka, (2009). Some auditors may have failed to comply with expected standards. If a company fails shortly after being audited, the auditors may be blamed for conducting an inferior audit Dopuch, (1987). Thus, whenever

there is a financial scandal, it must be questioned whether the auditors carried out their duties and obligations with due care and diligence.

In Nigeria the spate of corporate failures witnessed in the financial sector in the early 1990s brought auditors into sharp focus and caused the Nigerian public to question the role of accountants and auditors Okike, (2004); Bakre, (2007); Ajibolade, (2008). Furthermore, the investigations launched by the regulators and other stakeholders into the cases of distress and disclosure revealed that accountants and auditors were implicated NDIC, (1995). With the recent banking crisis in Nigeria members of the auditing profession in Nigeria are once again in the limelight, as the banking crisis and the revelation of unethical practices by bank executives and board members has raised many questions about the ethical standards of the accounting profession and about the integrity of financial qualified audit reports issued by professional accountants *ThisDay*, 9 December (2009). The question has been raised as a result of the failure on the part of accountants and auditors to alert regulators when they have discovered fraud and other irregularities in company records, Bakre, (2007); Ajibolade, (2008); Okike, (2009); Neu *et al*, (2010). A number of scholars have shown that many accountants, particularly members of the Institute of Chartered Accountants of Nigeria (ICAN), have been responsible for the crisis in the banking and manufacturing sectors in Nigeria Okike, (2004); Bakre, (2007). These studies show that the regulatory framework in Nigeria is weak, because members of the professional firms implicated in a number of anti-social practices in Nigeria have not yet been sanctioned Okike, (2004); Bakre, (2007). The studies have suggested that the accounting profession in Nigeria and other regulators (such as the Central Bank of Nigeria, the National Deposit Insurance Corporation, and the Nigerian Accounting Standards Board) must continue to monitor developments in both the external and internal reporting environments.

### **3. RESEARCH METHODOLOGY**

To understand the role of qualified audit report theory and practice in Nigerian banking industry and how practicable has this opinion helps banking sector with all these incessant distress in the industry, this paper relies primarily on archival records which include press reports, regulator and government reports on the banking crisis, annual reports, evidence of falsification of accounts and evidence on the role of auditors. This evidence is used to compile case studies. Although this evidence may be incomplete and somewhat biased, it nevertheless provides evidence of anti-social financial practices. There are considerable problems in collecting data because unethical behavior is masked with secrecy and because it is extremely rare for participants or auditors to volunteer details of their practice. For this reason it is only possible in this paper to refer to publicly available evidence which provides only a Glimpse of the bigger underlying problems. Information on ethical practices by regulators who have conducted investigations on the activities of the banks may, however, shed light on the role of qualified audit report theory and practice in the recent banking crisis in Nigeria.

Although a comprehensive investigation and critique of the politics and problems of auditing in Nigeria is beyond the scope of this paper because of the reasons given above, the paper nonetheless seeks to explore some basic practices which are deeply embedded in current auditing practices. These relate to the appropriateness of the basic auditing model, the quality of audits and the variability of financial statements. An analysis of documentary reports is

particularly useful in this respect in that it not only serves to highlight the role and value of qualified audit report theory and practices, but also helps to frame and contextualize the active role of professionals and auditors in facilitating unethical practices in Nigeria.

#### **4. RESULTS AND DISCUSSION**

Although professional accountants and accounting firms claim to act in the public interest, they have been implicated in various acts of professional misconduct and in falsification and deliberate financial engineering in Nigeria, *ThisDay*, 16 October (2009); *The Punch*, 14 December (2009); Bakre, (2007). The 'big four' accounting firms in Nigeria are KPMG, Ernst and Young, PricewaterhouseCoopers, and Akintola Williams and Deloitte. These four accounting firms have been implicated in falsification and financial engineering scandals in Nigeria. Paradoxically, this suggests that the way in which professional firms conduct their audit has financial implications for the financial sector and the capital market in Nigeria which has not been under public scrutiny in recent years. The cases below provide evidence on the role of auditors in corporate scandals in Nigeria.

##### **CASE 1: Akintola Williams Deloitte and Afribank Plc and Cadbury Plc**

Akintola Williams Deloitte (AWD), one of the big four accounting firms in Nigeria, was external auditor to Afribank Plc. AWD has about 40 partners and audits the accounts and serves as reporting accountants to many big companies in the capital market, SEC Administrative Proceedings Committee, (2008). In 2006 AWD was in two different cases accused of account falsification and financial engineering during its audit of Afribank Plc. In the case of Afribank Plc, AWD was exposed by the former Managing Director of Afribank Plc who alleged that the accounts of the company had been manipulated by the Afribank board and the external auditor AWD *ThisDay*, 16 October (2009). However, AWD denied their involvement in any unethical practices:

*'In our thirty years of existence, this is the first time someone would accuse us of modifying our report. We apply the rule 100 per cent; we do not bend the rules at all. Our firm has a world renowned in-house audit approach system called Deloitte audit that ensures our audits are carried out in full compliance with all applicable audit and accounting standards both local and international'. ThisDay, 16 October (2009.)*

At the completion of the audit exercise by the external auditor, AWD, the draft accounts for the period under review showed that Afribank had recorded gross earnings of N16 billion, a before tax loss of N6.3 billion and an after tax loss of N6.9 billion, total assets of N127.5 billion, and the shareholders' fund dropping to N17.85 billion compared with the 2005 amount of N21.4 billion *ThisDay*, 16 October (2009). According to the former Managing Director, the main reason for the wide difference between the management figures and the audited figures was simply as a result of huge non-performance risk assets in the previous year, which the bank had been carrying erroneously as performance risk assets. This account manipulation occurred with the knowledge of the Board of Directors and on the professional advice of the external auditors, AWD *ThisDay*, 16 October (2009). Despite evidence of irregularities and unethical practices in the accounts of Afribank Plc, the Chief Executive of AWD claimed that its audit report on the Bank's accounts was a 'true, fair and accurate' representation of its financial position for the year under review. He also claimed that the Central Bank of Nigeria (CBN) had certified the

audit as being satisfactory *ThisDay*, 16 October (2009). While the auditor, AWD, claimed that the CBN had given the audit a clean bill of health, the CBN, due to public demand, sent its examiners to re-investigate the accounting books of Afribank Plc. The Nigerian Stock Exchange and the House Committee also launched separate investigations into the alleged financial malpractice by the Bank's directors and its auditor. The Board, management and external auditors of the Bank were asked to confirm to the Committee whether the recently published account had taken into account all material facts, such as Director-related loans and full provisions for bad loans. Despite the scale of the alleged irregularities and unethical practices perpetrated by the Board of Afribank in collaboration with the company's auditor, AWD continued to claim that their audit represented an accurate representation of the Bank's financial position.

The role of accountants in the Afribank Plc case was shaped by an organizational culture which prioritized high profits and in which accountancy firms put the best interests of their client above their own professional code of practice. As a result, Akintola Williams Deloitte (AWD) was ordered to pay a fine of N20 million for its failure to handle the accounts of the bank with due professional diligence. Although AWD was strongly reprimanded and warned to desist from engaging in acts that might affect the investing public's confidence in the capital market, the penalty seemed light compared with the damage such anti-social practices have on Nigerian society.

A number of accountants and auditing firms have been implicated in the crisis in banking industry in Nigeria Bakre, (2007). Thus, it has been argued that, despite qualified audit reports, a number of banks still collapse, thereby raising the specter of unethical behavior on the part of professional accountants. The recent pronouncement by the Central Bank of Nigeria (CBN) on the state of Nigerian banks has been a cause of concern for regulators, depositors and shareholders. The role played by accounting firms in the recent banking crisis in Nigeria is examined in the following cases.

### **Case 2: The Big Four and the Recent Banking Crisis**

Regulators and investors have traditionally relied upon corporate financial statements to make sense of bank liabilities, risk and economic exposure, but this has been highly problematic Stiglitz, (2003). In the process of constructing a regulatory environment, accountants and the auditing profession were enlisted to provide the necessary assurance of 'fairness in the conduct of banking business' Nue *et al*, (2010). However, despite the enlistment of auditors as corporate watchdogs, Nigeria has witnessed a number of bank failures since independence in 1960. The spate of banking distress experienced in the 1980s prompted the introduction of the regulatory framework for the Nigerian banking industry. In 1995 another bout of distress occurred in the banking industry when 57 commercial and merchant banks went into distress in the first three months of that year. Their illiquidity was put at N47.9 billion (\$383.2 million), constituting 24.6 per cent of the total deposits in the banking sub-sector at that time, and out of the reach of their depositors *Newswatch*, 24 August (2009).

As a consequence of inadequacies, the liquidity problems often experienced by banks in Nigeria led to the raising of the minimum capital base of banks to N25 billion (\$167 million) in 2004. The re-capitalization led to there being 25 banks in 2006, a considerable reduction from the 89 which existed in 2004. Nigerian banks saw explosive balance sheet growth in the wake of consolidation four years ago, and they went on massive capital raising sprees which increased their capacity to lend to companies and to individuals. Risk management, however, did not keep pace *Nigerian Tribune*, 17 August (2009). The evidence shows that, out of the 25 big banks operating in Nigeria after recapitalization, three international accounting firms have been the major auditors of the banks (see Table 1) showing the intense competition among them. The audit monopoly has provided them with stability of income and a springboard for selling other services. Their income runs into hundreds of millions, and yet audit stakeholders have no way of checking the efficiency and standards of audit work. Cousins *et al* (1998) have drawn attention to this lack of accountability:

*'In the absence of a 'duty of care' to individual stakeholders and public accountability, the auditing industry does not have a strong economic incentive to improve the quality of audits. If by hook or by crook a company survives, no external party knows that audits were botched. . . . The auditing industry is pre-occupied with fees and client appeasement'.* (p. 9.)

Cousins *et al* (1998) argue that auditing firms are concerned only with mechanical compliance with auditing standards rather than with audit quality; and that the whole emphasis is on covering up deficiencies.

**Table 1 Banks Audited by the Big Four Accounting Firms**

KPMG Professional Services	Akintola Williams Deloitte & Touche	PriceWaterhouse Coopers	Ernst & Young
Access Bank	Afribank	BankPHB	Skye Bank
Guaranty Trust Bank	Fidelity Bank	Diamond Bank	
Wema Bank	First Bank	EcoBank	
Nigerian Int. Bank	First Inland Bank	FCMB	
Sterling Bank	Union Bank	IBTC Stanbic	
Standard Chartered	Unity Bank	Intercontinental Bank	
	United Bank of Africa	Oceanic Bank	
	Equitorial Trust Bank	Zenith Bank	
	Spring Bank	Stanbic Bank	

**SOURCE:** Extracted from the *Audited Reports* of the various banks.

Table 1 shows that KPMG Professional Services audited six banks, Akintola Williams Deloitte and PricewaterhouseCoopers nine banks, and Ernst and Young one bank since the post-consolidation period. There has been discontent with the development and quality of audits produced by the big accounting firms, and it has been stated that 'the crash of financial institutions in the Western countries has shown that foreign auditors are no better than their local counterparts' *The Guardian*, 9 August (2009).

The attention of stakeholders has focused on auditors worldwide because of the belief that an auditor's qualified or unqualified report signifies that a company is healthy. Before the CBN announced its findings on the state of affairs of the banks and their activities in the Expanded Discount Window (EDW), the external auditors to these banks were unable to properly scrutinize and bring into the public domain the true state of these reports including their loan portfolio which CBN put at N2.8 trillion (\$18.67 billion). In 2007, the Nigerian Deposit Insurance Corporation (NDIC) annual report showed signs of insolvency amongst Nigerian banks which indicated that four banks were sound, 17 were satisfactory, two were marginal and one was unsound *NDIC Annual Report, (2007)*, and yet the audit report of these banks had shown that they were sound *Daily Sun, 22 August (2009)*. As part of the statutory requirements of the Companies and Allied Matters Act 1990, CAMA (1990) and the Banks and Other Financial Institutions Act 1991, BOFIA (1991), external auditors of quoted companies are required to state that their financial statements of companies give a true and fair view of the state of the companies' financial affairs (in this case the troubled banks) and that their profits and cashflows are in accordance with CAMA 1990 and BOFIA 1991 and the Nigerian Statement of Accounting Standards. In contrast, however, accounting has become a new exercise in creative fiction, with the result that banks are including many unreported non-performing interests in the statements of their financial position. As a consequence, the Deputy Chairman of the House of Representatives Committee on Drugs, Narcotics and Financial Crimes has challenged the regulatory framework governing the relevant institutions charged with the responsibility of auditing and supervising the commercial banks *ThisDay, 18 August (2009)*.

Table 2 below shows that the distressed banks received qualified audit reports on their financial statements published immediately prior to the regulatory pronouncement of their financial difficulties. The evidence shows that audit opinions as contained in the banks' annual reports were provided by the 'big four' accounting firms in Nigeria: Akintola Williams Deloitte (AWD); PricewaterhouseCoopers (PwC); KPMG Professional Services; and Ernst & Young (E&Y). Despite the deepening financial crisis in Nigeria in 2009, auditors did not express any reservations about the value of non-performing loans or of any scenarios under which a company might not be able to honor its obligations. However, just some few months later the regulators declared these banks to be distressed. The list of banks in Table 2 is useful for highlighting a number of issues. Thus, for instance, the Nigerian auditing standards require auditors to consider an 'entity's ability to continue in operational existence for the foreseeable future', which 'necessitates consideration of both the current and the possible future circumstances of the business and the environment in which it operates' Dandago (2004). How the auditors constructed the audits to satisfy themselves that the banks below were going concerns is open to conjecture, because the financial difficulties of many banks became publicly evident only months after they had received qualified audit reports.

**Table 2 Auditors and Distressed Banks**

Bank	Year end	Auditor	Date of last Audit report	Audit Opinion	Auditor's Remuneration (N'millions)	
					2008	2007
Afribank	31/3/2008	AWD	Mar. 2008	Unqualified	N/A	N/A
Finbank	31/4/2008	AWD & AI	Dec. 2008	Unqualified	67	63
Union Bank	31/3/2009	AWD & BTN	Oct. 2009	Unqualified	<b>118</b>	<b>113</b>
Intercontinental	29/2/2008	PwC	May 2008	Unqualified	<b>208</b>	<b>112</b>
Oceanic Bank	31/12/2008	PwC	May 2009	Unqualified	<b>168</b>	<b>100</b>

**Source:** Extracted from the *Annual Reports* of the various banks.

The nature of the recent banking crisis in Nigeria, which has resulted in concerns being voiced about the apparent lack of independence or technical incompetence of the auditors involved, has cast doubt on the functional capacity of audit technologies. Table 2 above shows the financial institutions which failed the Central Bank of Nigeria (CBN) audit in 2009, even though they had all received unqualified audit reports in the previous accounting year. For example, Oceanic Bank International Plc received an unqualified audit opinion on its annual accounts on 31 December 2008, followed by a 'clean bill of health' in respect of its annual accounts on 28 May 2009. The external auditor of Oceanic Bank International Plc, one of the banks which were bailed out, was reported to have asserted that:

*'We have audited the accompanying consolidated financial statements of Oceanic Bank International Plc 'the bank' and its subsidiaries (together 'the group') which comprises of the consolidated cash balance sheet as at 31 December 2008 and the consolidated profit and loss account and consolidated cash flow statements for the period ended and a statement of significant accounting policies and other explanatory notes. . . . In our opinion, the financial statement gives a true and fair view of the state of the financial affairs of the banks and group as at 31 December 2008 and of their profits and cash flows for the period ended in accordance with the Nigerian Statement of Accounting Standards, the Companies and Allied Matters Act 1990 and the Banks and Other Financial Institutions Act 1991.'* (Annual Report, 2008, p. 31.)

The CBN's findings on Oceanic Bank International Plc appear to give a contrary view and raise questions on the credibility of the auditors especially on the disclosure of debt exposure *Business Day*, 15 October (2009). Oceanic Bank's annual report for the 2008 financial year shows that it had N5 billion (\$40 million) non-performing loans in 2007 and N36 billion (\$288 million) in 2008 (*Annual Report, 2008*, p. 53). However, by 14 August 2009, just three months later, the Central Bank of Nigeria had declared the bank unhealthy with N278.2 billion (\$2.2 billion) non-performing loans representing 37 per cent of the total non-performing loans of the first five distress banks which was put at N747 billion (\$5.98 billion) *ThisDay* 25 August (2009);

*Newswatch*, 24 August (2009). This was against the bank's 2008 figures for non-performing loans which stood at N36 billion (\$288 million) (*Annual Report, 2008*, p. 53). In the case of Intercontinental Bank Plc, PwC did not qualify the audited report of the bank as at 14 May 2008 with about N16.6 billion (132.8 million) nonperforming loans, and yet the CBN report showed that the bank had N210.9 billion (\$1.69 billion) in non-performing loans representing 28 per cent of the total bad loans *This Day*, 25 August (2009). The length of time it takes an external audit team to verify the complex operating activities of a bank with its networks of branches and to produce a statement of a bank's financial position is in stark contrast to the length of time it has taken regulators to investigate and determine the financial inadequacies of the banks concerned. Such a comparison of the time taken and the depth of work involved questions the level of assurance which is provided by standard audit investigations and also the source of evidence on which audit opinions are based. This suggests that an auditor's assessment of the truth and fairness of a bank's set of financial statements is influenced by assurances from the corporate manager.

The increased commercialization of the accounting profession and of the big four accounting firms and their emphasis on non-audit work has clear implications for auditor independence. Company auditors, the private 'police force' of capitalism, make millions of Naira in fees from company audits; and company audits are used to obtain easy access to senior management and to sell a variety of consultancy services. The fear of diversification of audit firms into other services areas compromises their independence and may result in the audit being sold as a 'lost leader' in the hope of selling the more profitable management consultancy services, with subsequent implications for audit quality. The Nigerian Economic and Financial Crimes Commission (EFCC) Chairman, Farida Waziri, alleged that the auditors conspired with the managing directors of the erring banks to defraud those banks. She stated that:

*'During our investigations, we found that all the erring bank chief executives were given a clean bill to operate by both the external and the internal auditors who are paid to do so. It was gathered that these auditors connived with the chief executives to cook the books and cover the tracks while the frauds were being perpetrated.'* (*Saturday Tribune*, 22 August 2009; *ThisDay*, 22 August 2009.)

Table 2 above also shows that the auditors received a considerable income from their audit clients. Fee dependency and career advancement exert pressure on auditors to acquiesce with management, which can create a conflict of interest. PwC received N112 million (\$896,000) (in 2007) and N208 million (\$1,66 million) (in 2008) in audit fees from Intercontinental Bank Plc (*Annual Report, 2008*, p. 82). During 2007, PwC collected N100 million (\$800,000) and N168.4 million (\$1.35 million) in 2008 from Oceanic Bank International Plc. In 2009 PwC had global gross revenue of \$26.2 billion with the Middle East and Africa, including Nigeria, contributing \$704 million (*PwC Global Annual Review, 2009*, p. 43). The scale of fees raises questions about auditor independence. This suggests that auditors are too close to companies and that they 'cannot bite the hand that feeds them'. How can one group of commercial entrepreneurs audit another group of commercial entrepreneurs? According to Sikka (2009) that model is broken and cannot work. In the case of Afribank Plc, Union Bank Plc and Finbank Plc, their accounts

were audited by Akintola Williams Deloitte (AWD), another giant accounting firm, with a global revenue of nearly \$26.1 billion in 2009, with auditing contributing \$11.9 billion and Europe, the Middle East and Africa, including Nigeria, contributing \$10.2 billion. It was reported in Union Bank Plc's annual report that the joint auditors, AWD and Baker Tilly Nigeria, received N146 million (\$1.17 million) in 2009, N118 million (\$944,000) in 2008, and N113 million (\$904,000) in 2007 as fees for audit and accountancy services from Union Bank Plc. On April 2009, AWD gave the accounts a clean bill of health, but barely six months later was the bank declared distressed. The contemporary auditing model makes auditors dependent on companies and their directors for fees and profits. As a result, auditors may become too Subservient to directors and even 'bend the rules' in order to accommodate directors Sikka, (2008a). Audit opinions are akin to a financial mirage Sikka, (2008).<sup>5</sup> It has been argued that the basic audit model is faulty Sikka, (2009); Sikka *et al*, (2009). Private sector auditors cannot be independent of the companies they audit. The auditing model in practice is further complicated by the fact that auditors are permitted to sell other accountancy services to their audit clients. This increases auditor fee dependency upon companies and can impair their perceived and actual independence.

## **5. CONCLUSION, FINDINGS AND RECOMMENDATION**

In conclusion, this paper has sought to stimulate debate on contemporary qualified audit report theory and practice in Nigerian banking industry and the role of accountants and external auditors in the recent banking crisis in Nigeria. It has been argued that the deepening banking crisis poses questions about the purpose and value of external audits. Shareholders, depositors and even regulators do not seem to have been assured by qualified and unqualified audit opinions; and a number of banks have either had to face management restructuring or have had to be bailed out by the Central Bank of Nigeria even after receiving clean audit reports by their external auditors. The evidence shows that auditors lack their acclaimed expertise to conduct an independent and objective reporting of corporate affairs. An inquiry into the activities and involvement of accountants and external auditors in the falsification of company accounts in the recent banking crisis in Nigeria would help to draw public attention to the unethical practices of professionals and the shortcomings of current practices in Nigeria. Although audit reports are the public and visible evidence of an audit, little is known about the processes and organizational values associated with their production Sikka, (2009). Such processes involve the management of labor, economic incentives and the image of clients, the public and regulators. It has been argued in the literature for example, Halon (1994) that audit staffs are inculcated to appease clients and to neglect wider social interests. As has been argued in this paper, in the pursuit of profit accountancy firms exert time and budget constraints and place pressure on audit personnel with the result that some have responded by adopting irregular practices and have even resorted to the practice of falsifying audit reports Bakre, (2007).

Our findings revealed that, although it is common practice for companies and their directors to select and remunerate auditors, it has been argued that such an audit model is fundamentally flawed and cannot deliver an independent or searching audit. The flaws are further compounded by permitting auditors to have a direct economic interest in corporate transactions through the sale of accounting services. There is evidence to show that the

commercialization of professional firms enables them to act as a 'watchdog' on profits and, on occasions, appease and even collude with directors. Their professional independence is indeed compromised because auditors are dependent on executive directors for their nomination, appointment and the determination of their fees, and, as such, they cannot easily go against the interests of executive directors rather they will prefer to doctor the report in favor of the management at the expense of professionalism.

We therefore, recommend that, to strengthen corporate reporting and auditing there should be corporate democracy in that stakeholders in our banking industry should have the power to determine who should be the auditor and how the auditor is to be remunerated. Further reforms could include imposing personal accountability for wrongdoing on all executive directors and finance directors of the banks, and barring accounting firms involved in anti-social financial practices from auditing and conducting other accounting related assignments and services.

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