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# The Relevance of Statutory Audit in Evaluating Performance in Nigeria

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**ABSTRACT**

This research work examined the relevance of statutory audit in evaluating performance in an organization**.** The researchers adopted survey research method. Questionnaires were designed and administered. Chi-square ($x^2$) was used to analyze the data and test the hypothesis. From the analysis of data, it was discovered that the charges paid as fees are not adequate; the need for the review of the Act and Auditors to be appointed by the regulatory bodies; and the implication of these findings have resulted in fraud; abuse of office and corruption by the auditors and management of various entities. It also led to lack of confidence and accuracy on the financial report and the problem of independence of the auditors. The researchers recommended establishment of financial reporting council, encouragement of joint audit competition and proper training of audit staff. In conclusion, audit committees of public companies in Nigeria should rise to the challenge of strengthening the independence of their auditors.



## Introduction

Auditing is simply a 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 citeria and communicating the results to interested users (Rittenberg and

Schwieger, 2005). The Nigerian Companies and Allied Matters Act (CAMA) 1990 (as amended), section 359(1) states that "the auditors of a company shall make a report to its members on the account examined by them, and on all group financial statements, copies of which are to be laid before the company in a general meeting during the auditor's tenure of office". The responsibility of the auditor in examining the financial statement is to enable him express an opinion on the truth and fairness of the financial statements.

For the owners to be satisfied and even for the managers to be justified to establish and maintain their integrity, it becomes necessary to invite an auditor to examine the stewardship report for the purpose of expressing an opinion as to the truth and fairness of the report. The independent party's study not just mere examination of the account from which the financial statements are prepared rather, it includes collection of all relevant information, that are necessary to be able to form an opinion on truth and fairness of the report by the management (Oladipupo, 2005).

The fundamental responsibility of the auditor is to scrutinize the accounts and records of all business entities, including charities, trusts, professional firms as well as governmental establishments, in such details as well as enable the auditor to form an opinion about its accuracy and reliability. However, in order that the auditor will do his work effectively, he requires a degree of independence necessary for a wholly objective audit (Izedonmi, 2000) and Oladipupo (2004) aptly puts it "the general principles is that the auditors must approach his work an independent outlook and must do nothing which would impair that independence".

This paper therefore examines the relevance of statutory audit in evaluating performance in Nigeria. In this regard, the paper has been divided into five sections. Section one is an introduction. Section two literature review. Section three focuses on methodology. Section four is about discussions of results. Section five contains the findings conclusion and recommendations.

## Research Methodology

A survey research method was employed in collection of data for this study. Primary and secondary sources of data were used. The secondary data were generated from journals, magazines, newspapers and textbooks. The primary data was mainly obtained from field survey using a questionnaire.

## Research Hypothesis

**$H_0$:** The spate of audit failures in recent times in organization has not diminished the relevance of an audit.

**$H_1$:** The spate of audit failure in recent times in organization has diminished the relevance of an audit.

## Literature Review

Adopting an historical approach, the word audit is a Latin word known as "he hears". This arose from the practice whereby the accounts of the estate, domain or man were checked by those in authority having called them out by those who had prepared or compiled them in an attempt to ensure accountability. Hence an audit in the modern sense refers to a process whereby the accounts of business entities are subjected to scrutiny in such detail as will enable the auditor to form an opinion as to their truth and fairness (Odion & Lawani, 2009).

Okolo (1988) also defines an audit as a conscientious and objective examination of, and inquiring into any statement of account relating to money or money worth, the underlying documents, and the physical assets where possible as will enable the auditor to form an opinion as to whether or not the statement of account present a true and fair view of whatever it purports to represent, and to report accordingly. It is a view of a statement of account prepared by the appointed financial officer of an organization by some other independent person(s).

The Board of Directors has oversight responsibility over management and engages the auditor to audit the financial statements and prepare an independent opinion on the fairness of the financial statements. Management has responsibilities for managing the organization, safeguarding the assets entrusted to it, and preparing financial statements that portray the economic condition of the company and the results of its activities over a period of time. The financial statements are provided to third parties who have, or who might, invest in the company, lend the organization resources, or who otherwise have a vested interest in the organization. Auditors gather evidence to determine whether the financial statements are fairly presented in accordance to **GAAP (Generally Accepted Accounting Principles)** and prepare an independent opinion that is shared with third-party users, management, and the Board of Directors.

## Types of Audit

In looking at types of audits, it is better to know the basis so that we can better appreciate the distinguishing features of the respective types of audit, which are grouped into four main categories:

i. Financial statement audits: This determines whether the overall financial statement is presented fairly in accordance with the established criteria.
ii. Compliance audits: This determines the extent which rules, policies, laws or regulations are complied with by the enterprise under audit. For example, a company may have an auditor determine whether company's rules and policies are being followed by the respective departments within the organization. In this example, the rules and policies serve as the criteria for measuring compliance of departments.

iii. Operational audits: This type of audit evaluates the efficiency and effectiveness of any part of an organization's operating procedures and methods. The purpose of operational audit is to assess performance, identify areas for improvement, and develop recommendations that will put the company back on a smooth level. This audit is sometimes referred to as performance audit or management audit.

iv. Forensic audits: The main purpose of this type of audit is the detection or deterrence of a wide variety of fraudulent activities among client's staff. Audits of this nature have grown significantly in recent times especially where the fraud involves financial issues. Forensic audit might be conducted in the following circumstances:

a. Business or employee fraud (e.g. tracing funds or assets identification and recovery, investigating the existence, nature, extent and identification of an employee who misappropriates assets, (etc).
b. Criminal investigations (e.g. investigating white collar crime).
c. Shareholder's or partners' disputes (e.g. investigating disputes between shareholders).
d. Matrimonial disputes (e.g. tracing and locating assets in a divorce proceeding).

## Audit Failure and Relevance of Statutory Audit in Nigeria

Auditors in common with other professionals are subject to legal and other sanctions as a consequence of audit failures; that is, failure to meet professional standards in the performance of their work. Unlike some other professionals whose liability is limited to their clients and patients, independent auditors are also liable to a growing numbers of non-clients third parties mainly investors and creditors who rely on audited financial statements in making decisions that expose them to substantial potential loss. As a result, auditor's exposure to possible loss is great and the amount of potential loss is usually determined at the time the audit is performed.

The exact legal position of auditor is one of considerable complexity and difficulty the various statutes dealing with auditor's appointments do not define in clear terms and details the auditors responsibilities and liabilities, and this is where case law and professional pronouncements help to determine the work to be performed.

Whatever the position is, proper understanding of the auditor's legal responsibilities and liabilities is of utmost importance to every professional accountant. The fundamental duty of company auditors is statutory reports to its members on the accounts. Sometimes, the duties may be wider but statutory duties cannot be restricted except in non-statutory audits. Both the law and professional standards impose the duty on auditors to act with reasonable skill and care at all times. Auditors perform audit and sign audit reports. These reports are the auditors' opinions on the truth and fairness of financial statements where auditors endorse financial statements as showing a true and fair view, the readers of such financial statement will have faith in them because of the faith they have in the auditors. However, the heavy reliance placed on the auditors, impose heavy responsibility on him to carry out his duties honestly and carefully. This was emphasized in the case of London and General Bank case (1895) where the judge said that "He must be honest – that is, he must not certify what he does not believe to be true and he must take reasonable care and skill before he believes that what he certifies is true". Where the auditor falls short in his duty, he may be liable for negligence which accounts for audit failure (Adeniyi, 2004).

The problems are:

(i) To whom those auditors own this duty of care in the performance of his professional work?
(ii) Who are those that have the legal right to claim from the auditor's negligence and/or duty failure?

According to Odion and Lawani (2009); says it is clear that audit failure arises when auditors as professional men incurs liabilities from duties they own to their clients both in contract and tort concurrently and under statutes which bring about the relevance of statutory audit in Nigeria.

According to Izedonmi (2000) liabilities of auditors under statutes are as follows:

(a) Auditors Civil Liabilities
(b) Auditors Criminal Liabilities

(A) **Auditors' Civil Liabilities:** Civil law is described as private law which seeks to compensate the impaired party at the expense of the wrong-doer. The auditors civil liabilities in respect of his duties may be examined under the following headings:

(i) **Contract:** Liability arises where the auditor wholly or in part, by act or omission fails to properly fulfill his contract. The date of any breach will generally be taken as the date of auditors reports. The only parties who can sue on a contract are those who are parties to it. No third person can sue to enforce a contract or seek damages out of it. There is, the distinction between an action based on contract and an action based in negligence may not be material. There is need that the company auditor must under contract report to the members of the company they have audited and not to the directors even if they are the same set of people. Failure of auditors to report fully will render them liable for any breach (Re-London and General Bank). Under contract, an auditor may become liable if he does not deliver the audited report (accounts by the agreed date or violates the clients' confidential relationship.

(ii) **Libel:** This refers mainly to the content of an auditor's report. In the absence of malice, the auditor will not be held liable for his adverse comments on any person mentioned in his reports. Lawless Vs. the Anglo-Egyptian Cotton and Oil Co (1869) IV G.B.262. Here, the plaintiff sought to bring libel proceedings against the Directors for circulating account bearing auditor's report, which contained adverse comments on him. The plaintiff was held not entitled to succeed as the publication by the Directors was on a privileged occasions and there was no evidence of malice. Malice in this sense, in libel means deliberately printing an untruth or printing it from an evil motive.

(iii) **Company's Act (CAMA):** Section 507 of CAMA provides that if in the course of winding up a company, it appears that an officer of the company has misapplied or been quilt of any misfeasance or breach of duty in relation to the company, the court may on the application of the official receiver, liquidator, creditor etc examines into the conduct of such officer and compel him to repay or restore the money or property or to make such contributions of the company's assets as the court thinks just. An auditor for this purpose has been held to be an officer of the company of appointed property – London and General Bank 1895, 2ch 166 and Western Countries Steams Bakeries (1897) 1ch 617.

(iv) **Negligence:** An auditor is presumed to bring reasonable skill and diligence to bear upon the work which he is employed to do and if he is guilty of negligence in the execution of his duty, he may be held liable to make well and damages resulting from that negligence. The liability arises from the general principle of law that when a person under a legal duty to take care, whether imposed by a specific contract or otherwise, the failure to exercise a reasonable standard of care will make that person responsible for any resultant damages or loss to those whom the duty is owed.

(v) **Third Party:** Liability to third parties in respect of physical injury has a long and well-established legal history. The case of Donoghue Vs Stevenson (1932) in which damages were awarded in favour of the young lady who consumed the contents of a ginger-bear bottle in a seaside café only to be made aware, too late that such content included the decomposed remains of as snail. Although the contractual relationship was between her and the vendor of the bottle damages were awarded against the manufactures with which there was no positive of contract.

Similarly, in Grant Vs Australian knitting Mills, the plaintiff was awarded damages in respect of a skin irritation suffered due to a defect in the underwear which he had acquired from a retailer, the damages were awarded against the manufacturer and not the retailer.Legal cases relating to third party liability for financial injury is by no means as consistent.

It was formally thought that in the absence of a contractual or fiduciary relationship between third parties, auditors owed no duty to third parties in the execution of their professional duties. The case of Candler Vs Crane Christmas and Co. (1951) 1 all E 426, in this case, the audited prepared and audited an account knowing that they were wanted by the managing director for the purpose of showing to the plaintiff to induce him to invest money on his client business. Relying on the accounts, the plaintiff invested in the company which later got liquidated and the plaintiff lost his investment. It was found that the accounts relied on, did not show the true and fair view and the plaintiff sued the auditors in negligence but they were held not liable with one of the judges Lord Denning dissenting when he said that Accountant are "under a duty to use reasonable care in the presentation of their accounts and in the making of their reports". He went further to also hold that they owe the duty or course to their employer or client and also thinks to any third person to whom they know their employer is going to show the account so as to induce him to invest money or take some other action on them".

(B) **Auditor Criminal Liabilities:** Criminal law is the code of conduct demanded from a person (individual or corporate body) by society as a whole and championed by the government of the day. A breach of this standard or code is referred to as commission of a crime and results in prosecution either by the state i.e. police or an appropriate agency e.g. Corporate Affairs Commission. If convicted, the person breaking the law may be fined or imprisoned or both.

An auditor may become criminally liable under the course of his audit assignments if he commits offences which under the statute law constitute a crime. Most cases of liability under this heading arises from errors in the performance of audit duties involving criminal neglect or actual fraud or conspiracy in which intention to do what is known to be illegal is an essential element.

Company's Act, Section 643 of CAMA provides that if any person willfully makes a material false statement in any return, certification, balance sheet or other document for purpose of CAMA provisions, he shall be guilty of an offence and liable to imprisonment, fine or both as prescribed for that breach.

There is need to observe, however, that in any proceedings for negligence, or each of duty or trust against any officer, auditors, the court may under CAMA (Sec. EH) relieve the accused either wholly or partly from any such liability, if satisfied that he has acted honestly, reasonably having regard to all the circumstances and other such reaction at the court may deem fit. There is an impending litigation for negligence, breach of duty or trust etc the officer auditor concerned can apply to the court for similar relief above.

Auditors may be penalized under tax acts if their clients' accounts as audited by them are found to be defective thereby leading to loss of tax revenue to government.

**Relevance of Statutory Audit in Nigeria**

Statutory audits do help to assist organizations to improve their internal audit functions by measuring the effectiveness of existing internal audit process and advancing on the development of enhanced internal audit methodologies.

It helps the account to be regarded as authentic, correct and vehicle as a true and fair indicator of the state of affair of an organization. The rationale behind this is that auditors do not partake in the preparation of an account and his opinion as an independent one arrives at after an objective examination of all the relevance evidence relating to the financial statement.

Statutory audit helps the financial statement audit frequently and have a favorable effect on the employee's efficiency and honesty. Knowledge that an independent audit is to be carried out results in fever errors in the accounting process and reduces the likelihood of misappropriation of assets by employees, that fact its financial statement assertions are to be verified increases that probability that management will be more truthful and fortnight in its representations.

Statutory audit enhances the amount a purchaser is willing to pay for a business would depend among other things on the earning capacity of the business and the trend over a number of years. This will be revealed in the profit and loss account for the past number of years decided upon five or ten years example. Negotiations will be easier if the accounts for these years have been audited and certified by a qualified accountant. After all, it is quite possible for a man intending to sell his business in five years time to fabricate accounts that will show high profit at the end of each year until he is ready to sell. Such fabricated accounts cannot have a certificate of an auditor and will certainly be a contentious basis for negotiations.

Statutory audit brings important benefits to companies themselves, as well as for regulators, shareholders and other stakeholders. The statutory requirement for an audit is a major contributor to efficient management of companies, a significant disincentive to fraud, a stimulus to openness and transparency and a highly effective driver for the promotion of good corporate governance.

Statutory audit of the financial statements in Nigeria is to provide reasonable assurance that the accounts have been prepared in accordance with the Generally Accepted Accounting Principles (GAAP) and are free of any misstatements errors and discrepancies. It also helps the client to monitor organizational ethics, conducting effective reviews of operational and financial performance, assessing the quality, economy and efficiency of their operations and suggesting continuous improvement strategies.

The relevance of statutory audit in Nigeria also helps to provide claims with valuable information and benchmarking on the effectiveness of controls in the procure-to-pay process. Independent auditors identify weak systems or procedures that drive financial leakage and recommend practical solution to protect clients and firms from future financial leakage.

Statutory auditing helps to minimize loss of value and further enhances optimum controls of financial statements. The relevance of statutory audit in Nigeria helps today to reduce the level of corruption and embezzlement in almost all the financial firms and all other relatives firms is too astronomical such that without statutory audit, most of these firms are suppose to be at their collapsed stages. Recent example is the the discovering of fraudulent actors who are being tormented by the EFCC and other related governmental bodies. It takes the intervention and introduction of statutory audit to get this secret revealed and traced up to its climax (Igbokwe, 2004).

## Results and Discussion

The following data extracted from the questionnaires were used to test the hypothesis.

| | **Yes** | **No** | **Total** |
|---|---|---|---|
| Audit failure diminishes relevance of audit | 17 | 13 | 30 |
| Audit information enhances investor’s confidence | 29 | 1 | 30 |
| **Total** | **46** | **14** | **60** |

The expected values are calculated as follows:

$$X^2 = \frac{\sum (0-e)^2}{e}$$

$$= \frac{(17-23)^2}{23} + \frac{(29-23)^2}{23} + \frac{(13-7)^2}{7} + \frac{(1-7)^2}{7}$$

$$= \frac{36}{23} + \frac{36}{23} + \frac{36}{7} + \frac{36}{7}$$

= 1.57 + 1.57 + 5.14 + 5.14

$= 13.42$

$X^2 = 0.95.1 = 3.84$

**Decision**

Since the calculated value (13.42) is greater than $X^2$ 0.95.1 = (3.84), we reject the hypothesis that the spate of audit failure has not diminished relevance of audit and concluded that the spate of audit failure has diminished relevance of audit.

**Findings**

The following are discovered in the course of this research work.

(i) It was discovered that the charges paid as fees to the auditors who are made to audit the financial statement are not adequate compared to the nature of the job and the credibility that it adds to financial statements.
(ii) Audit failure has contributed immensely to the decline in relevance of an audit which must have been as a result of negligence in carrying out the audit process, ethical factor and environmental and cultural influence.
(iii) That the Act has overstayed for a long time, so there is the need for the review of the Act on statutory report with respect to auditor's responsibilities.
(iv) There is no strict penalty in place for the non-compliance with the current code of best practices and where the penalties are, they are not effective and efficient.
(v) That auditing and investigation are not taken as a consultant job in order to make the accountants more accurate who are the preparer of the financial statements.

**Conclusion**

The issue of audit failure is a complex issue. Since professional accounting service has implications for the public interest, the intention of external auditors should be determined chiefly by satisfactory performance on the job defined in terms measured reliability of report, quality of service and cost efficiency. The spate of audit failure has diminished the relevance of audit in the country. This is because the country is replete with incidents of corruption and where hired assassins are always on the prowl for whistle blowers, do not provide an enabling environment for auditors and auditing to thrive. That is why the anti-graft war to bring about a disciplined country must continue.

**Recommendations**

There is urgent need for establishment of financial reporting council in conjunction with the Nigerian accounting standards board in line with the World Bank model with strict rules on auditing and accounting standards and monitory and sanctions. Therefore, it will be the duty of the council to promote auditing and accounting standards among other duties.

There should be proper training of audit staff. This is because professional excellence comes with education and practical experience. While these are the hallmarks of professionalism, such knowledge becomes obsolete with the passage of time and hence has to be renewed on a continuous basis. Auditing in a computerized environment requires special skills which training can provide.

There is need for the appointment of a government oversight body from the National Assembly and the Federal Executive body to conduct inspection of all registered accounting on a continuous basis. This is to complement the activities of professional regulatory bodies.

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