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Financial Statement Insurance: Restoring Investor Confidence in Nigerian Banks

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Abstract
Nigerian banks are the driving force of the economy and are important players in the financial market. Their healthy existence is very key to the survival of all other industries while their failure or lack of liquidity will lead to a drastic decline in economic activities. Over the past few years, The Nigerian banking industry has experienced a massive wave of failures, which has led to the continued lack of confidence in the banking system. The problem identified was the auditors' lack of independence as shown in the provision of false or misleading financial statements to investors. In order to provide investors with the assurances that they can rely on financial statements issued to them, this research aims at identifying a mechanism that can restore investors' confidence in Nigerian banks. It posits that, to depict the true and fair view of the affairs of the banks, auditors must be removed from the employment of the corporation. The study expatiates on how Financial Statement Insurance (FSI) concept is effective in eliminating the problem of auditor's independence and the inherent conflict of interest between the management and auditor. The underlining idea is that audits of corporate financial statements must be completed and paid for by an outside third-party entity which may be an insurance company that can manage and control entire audit process and protect shareholders, customers and investors in the event that they suffer a loss as a result of misrepresentation in the financial statements. Hence, FSI is a process whereby a company, instead of appointing and paying auditors, purchases financial statement insurance that provides coverage to investors against losses suffered as a result of misrepresentation in financial reports. Both the insurance coverage that the companies obtain and the premiums paid for the coverage are made public. The insurance companies would then appoint and pay the auditors who ascertain and testify to the accuracy of the financial statements of the companies (insurance clients). This study finds that the benefits of FSI outweigh its inherent limitations and that the adoption of Financial Statement Insurance will eliminate the problem of auditors' lack of independence and give reasonable assurance that financial statements have been prepared fairly, therefore restoring investor's confidence in Nigerian banks. Thus, it concludes that there is a need to introduce a market-based financial statement insurance scheme designed to eliminate conflicts of interest that are inherent in the auditor-client relationship and, at the same time, credibly signal the quality of financial statements. It therefore recommends that Nigerian banks and all concerned stakeholders should promote their level of awareness and application of Financial Statement Insurance as this would help engender not only better communication with stakeholders but also greater investor confidence and trust.
Keywords: Insurance; Financial Statement; Banks; Investors.

1. Background of Study

The noble profession of accounting has been under pressure due to rising public expectation (Adesina, 2003). This is a result of a series of financial failures and the distress especially in the banking sector in Nigeria. Bank managers were sacked because they acted in a manner detrimental to the interest of their depositors and creditors as the banks were said to have given out huge amount of loans without following adequate measures or precautions.

The Enron Corporation saga of 2001 which was the largest corporate bankruptcy filed in the United States of America was as a result of a series of disclosures about the restatements of the company's financial statements. The presence of such errors that required the financial statements be restated brings into focus the importance of financial statements. Financial statements present quality information on the company's position which will be useful to a wide range of users to make economic decisions. They are formal records of the financial activities of a business, person or other entity. Financial statements provide an overview of a business or person's financial condition in both short and the long term. Even if it is assumed that the financial statements provided are not misleading and are relevant and reliable to the management and other users, it follows that the certainty of their quality is pursued. Auditors are the main gatekeepers for financial probity, and audit failure is one of the most important reasons why financial errors occur. Although nominally speaking, shareholders appoint auditors, this is actually up to the public company's management, who also structures the fees and assignments of auditors. This sort of relationship between the auditors and the management brings about a conflict of interest. The perception of the auditor's conflict of interest (lack of independence) started with a host of high profile, highly publicized corporate failures and near failures like the Enron's, WorldCom's etc.

The public auditor is a shareholder's first line of defence to protect the shareholder's interest from corporate wrongdoing and financial mismanagement. Historically, however, this has been a false perception of protection. One of the major corporate rating agencies, Weiss Ratings, Inc., has completed an exam of just how false this protection has been. A key finding of the Weiss study is that auditing firms almost universally failed to warn stockholders of accounting irregularities. In fact, audit firms gave a clean bill of health to 94% of public companies that were subsequently involved with accounting problems. These accounting problems ultimately cost the shareholders involved $1.276 trillion in market losses. The results of the Weiss study highlight a well-documented problem within the audit community: that of auditor independence. Most industry experts realize that it is extremely difficult for an auditor to walk the fine line between being paid by the public company client, and watching out for the shareholders' best interest. The conflict of interest that this business practice creates is undeniable; and it has been at the centre of the most corporate failings.

The current expose on the fraudulent activities of Nigerian banks clearly states that the auditors have deliberately or through manipulations by the bank managements, ignored the presence of such activities and have provided false opinions on the financial statements. The key problem facing banks in Nigeria today is traceable to the problem of auditors' independence or the lack thereof. Auditors are meant to be independent of management and attest that financial accounts based on information provided by management are in accordance with generally accepted accounting principles or disclose promptly if otherwise so that adequate actions can be taken to prevent any loss. There is the knotty problem of aligning management's interests with those of shareholders.

The large amount of recent audit failures has given rise to a regulatory initiative, the Sarbanes-Oxley Act of 2002 (SOX). The failure of auditors to fulfill their role as independent gatekeepers formed the focus of much attention in the Sarbanes-Oxley Act. The United States Sarbanes-Oxley Act 2002 sought to offer a partial solution by prohibiting some non-audit services. The Act seeks to address the auditor independence problem by increased regulation and penalties, empowerment of audit committees, and reduction of the auditor's involvement with the client. All of these efforts were directed at reducing the pressure that auditors may feel to compromise their audits in order to retain the corporation's non-audit work. But the Act does not untie the auditor/management knot: auditors continue to be hired and paid by the firms they audit. Without going in depth about the effectiveness of the Act, there is a need to introduce a market-based financial statement insurance scheme designed to eliminate conflicts of interest that are inherent in the auditor-client relationship and, at the same time, to credibly signal the quality of financial statements.

The banking profession, like any other profession in a civilized society, requires people of verifiable character and impeccable integrity- individuals who are transparently honest and dedicated to uphold professional ethics. Nigerian banks are the driving force of the economy and are important players in the financial market as they provide funds. Their healthy existence is key in sustaining all other industries while their failure or lack of liquidity will lead to a drastic decline in economic activities. Unfortunately, the banking industry in Nigeria is peopled by most individuals who are lacking honesty and integrity. According to the Central Bank of Nigeria (CBN), the management members of the banks were sacked because they acted in a manner that was detrimental to the interest of their depositors and creditors. The CBN said these banks have liquidity challenges arising from their "huge" exposure to the capital market, petroleum marketing sector, specific large-ticket transactions and consequently "massive" Non Performing Loans (NPL). These left nine of the banks being either "technically insolvent" and/or undercapitalized. The CBN reforms aimed at sanitizing the industry and protecting innocent depositors have been described as being long overdue. Most of the Chief Executive Officers (CEOs) had overstayed their effectiveness and should have left on their own volition considering the tendency for worsening funding gaps (arising from poor credit/risk management).

The extent of banks' exposure to margin loans is a critical issue. Nigerian banks were said to be giving out huge amount of loans without following the adequate measures such as establishing the banks' credit capacity, their liquidity, the extent to which the client's collateral security will recover debt etc. The bank managers were operating in their own personal interest as reflected in cases where clients were relations or personal friends. These events or transactions that should have been disclosed by the auditor were deliberately omitted from the financial statements of these banks. Auditors' intentional misstatement of certain financial values such as the amount of excessive debt and reduced cash flow in order to enhance the appearance of the company performance brings to focus the issue of auditor independence. Bank CEO's engaged in fraudulent abuse of credit process, insider trading, capital manipulation and money laundering running into billions of Naira. Consequently, it became obvious that ignoring immediate intervention will eventually lead to the banks' collapse while investors and private customers will suffer great loss.

This paper takes cognisance of the fact that Nigerian banks operate in a very complex, competitive, and regulated environment and attempts to make a contribution to the need to maintain a strong, stable and reliable financial system in which investors, private customers, government, and regulatory agencies can be provided financial statements of a high quality of adequate disclosure, thereby checking and controlling the activities of the banks in respect of loss prevention and compensation. It introduces and develops the Financial Statement Insurance (FSI) mechanism as one that can provide effectively, financial statements of a high level of assurance and of such quality as to provide reliable information with regard to the current state of affairs of the Nigerian banks. The study is thus an exploration of the relevance of Financial Statement Insurance in solving the recent corporate governance crisis which bedeviled the banking industry.

2. Review of Relevant Literature

2.1 Financial Statements

Financial statements have been defined as "the main source of information for major investment decisions including whether to lend money to a firm by investing in its bonds, to acquire an ownership stake in a firm by buying its preferred and common stock, or to buy warrant or options on a firm's stock". Financial statements are formal records of the financial activities of a business, person, or other entity. For a business enterprise, all the relevant financial information is presented in a structured manner and in a form easy to understand (Wikimedia Foundation Inc., 2010). Accounting information is provided to enable decision makers inside and outside the organization take proper and informed decisions. Inside the organization, the management makes use of accounting information for managerial decisions while other users range from investors, shareholders, government to even the general public. Financial statements convey financial accounting information to its various users.

Financial statements are the accounting reports in respect of the economic activities of an enterprise, prepared periodically and usually at the end of every financial year. These statements form an integral part of the company's annual report and accounts while their components are specified not only in Company and Allied Matters Act (CAMA), but also in Statement of Accounting Standard (SAS) No. 2 issued in November 1984 by the Nigerian Accounting Standards Board (NASB). SAS provides that "all accounting information that will assist users to assess the financial liquidity, profitability and viability of a reporting entity should be disclosed and presented in a logical, clear and understandable manner". SAS No. 2 goes on to state that the financial statements of an enterprise should state and include the following: the name of the enterprise, the period of time covered, a brief description of its activities, its legal form, and its relationship with its significant local and overseas suppliers, including the immediate and ultimate parent, associated or affiliated company.

Financial statements are required to include: Statement of Accounting Policies, Balance Sheet, Profit and Loss Account or Income Statement, Notes on the Accounts, Cash Flow Statement, Value Added Statement, and Five – Year Financial Summary. An in – depth examination of the annual reports and accounts of various companies especially public limited liability companies will show clearly that in addition to the items listed above, the following may also be found in such reports: Results at a glance, Notice of Annual General Meeting, Chairman's Statement, Report of the Directors, Report of the Audit Committee, Performance Charts, Statement of Unclaimed Dividend Warrants, Proxy Form (or Proxy Card) and Admission Form (or Admission Card) (Igben, 1999).

The cardinal objective of financial statement is to give a true and fair view of the financial affairs of an enterprise. Others are: to provide guidance to management not only in appraisal of past results, but in formulation of future policy and making informed decisions on current operational control; making tax assessment based on reported results as opposed to Best of Judgment Assessments which are often subject to objection; and the provision of financial information for various other interested parties which may include providers of finance, financial analysts, advisers, shareholders and so on (Institute of Chartered Accountants of Nigeria, 2006). The nature of financial statements is such that they are based on fundamental accounting assumptions such as going concern, accruals and consistency, as well as accounting principles and methods. Accounting principles are broad rules concerning the measurement, allocation and disclosure of financial events and transactions. Financial statements are prepared in accordance with accounting standards and methods of standards application (Ekeigwe, 1995a). The users of financial statements include, government and its agencies (e.g. tax authorities, Corporate Affairs Commission, Federal offices of statistics, Central Bank of Nigeria and so on), Banks, Shareholders, Financial Analysts, Management, Employees and Supranational organizations (International Monetary Fund, World Bank, World Trade Organization), the general public, Educators, and Auditors.

2.2 The Concept of Financial Statement Insurance (FSI)

The subject of insurance deals with financial protection against losses or harm. It is an arrangement or legal contract that protects people from financial costs as a result of loss of life and property in return for a payment premium. It is the equitable transfer of the risk of loss from one entity to another. Financial Statement Insurance (FSI) is a process whereby a company, instead of appointing and paying auditors, purchases financial statement insurance service that provides coverage to investors against losses suffered as a result of misrepresentation in financial reports (Ronen, 2002). Premiums are paid for the coverage. The insurance coverage that the companies obtain is made public. The insurance companies would then appoint and pay the auditors who ascertain and testify to the accuracy of the financial statements of the companies who are their insurance clients. The essence is to provide investors with the assurances that they can rely on financial statements issued them, to depict the true and fair view of the affairs of the banks. FSI concept believes auditors must be removed from the employment of the corporation. In other words, audits of corporate financial statements must be completed and paid for by an outside third-party entity which may be an insurance company that can examine, manage, control and accept the entire audit process and protect shareholders, customers and investors in the event that they suffer a loss as a result of misrepresentation in the financial statements.

The concept of FSI is the brainchild of New York University accounting Professor Dr. Joshua Ronen. Under Dr. Ronen's approach, a company that wants financial coverage would request an assessment for FSI coverage. This is followed by the completion of a comprehensive risk assessment by the carrier (insurance company). Based on the assessment, the carrier would determine how much coverage to offer (i.e., the policy limits) and the corresponding premium. Firms with higher limits of coverage and smaller premiums would distinguish themselves in the eyes of the investors as companies with higher quality financial statements. In contrast, those with smaller or no coverage or higher premiums will reveal themselves as those with lower quality financial statements. Every company will be eager to get higher coverage and pay smaller premiums lest it be identified as the latter.

Losses as a result of financial Statement misstatements are borne one way or the other by various players including investors, customers, and the companies involved in the form of class action litigation settlements, insurance companies malpractice settlements, and the audit firms and the firms themselves through premium paid on insurance. In other words, if losses result from accounting irregularities, someone must be bearing them: either companies themselves through premia and litigation settlements, insurance companies, the auditors, and or the investors. All things considered, the cost of recoveries currently borne by investors in audit failure cases would be necessarily lower when the auditor's incentives are aligned with those of investors.

It should be noted that Financial Statement Insurance does not guarantee that investors would recoup all of their losses in event of financial statements misrepresentation. The point is that under the Financial Statement Insurance mechanism, shareholders' losses are apt to be less because of the better audit quality and the incentives companies have to improve the quality of their financial statements. Unlike insuring against non tradable assets such as personal accidents, building fires and the like, insurers can hedge their exposure in underwriting coverage for securitized assets (equities) by devising suitable means. In essence, the Financial Statement Insurance mechanism will involve induced truthful “self reporting” through the auditor’s attestation of the quality of the financial statements even when such is of poor quality and will trigger market sanctions when made public.

2.3 Significance of FSI

The Financial Statement Insurance approach is relevant to most of the market participants. First and foremost, Financial Statement Insurance will finally remove the conflict of interest issue from the external audit process. This would result in a review of the auditor’s role that could allow for them to provide an objective view of a corporation's financial health as measured by their financial statements. Shareholders would have yet another level of assurance that the financial statements that they depend upon are being prepared fairly. There would be reduction in or prevention of shareholder losses. Publication of both the available limits and premium would also provide a clear signal to the investing public of the quality of each corporation's financial statement and assist investors in making the most appropriate purchases. The movement of corporations to the Financial Statement Insurance approach will result in the instillation of confidence into their shareholders. Those who adopt Financial Statement Insurance early can gain a competitive advantage over others in their industry segments and the better channelling of savings to socially desirable project. Lastly, this research forms a basis for other research work and also educates those who are not familiar with this concept. The study adds to the increasing body of knowledge. If implemented, Financial Statement Insurance would facilitate an accounting approach based on underlying principles rather than detailed rules.

2.4 The Need for FSI

The discovered financial irregularities cast not only auditors in bad light but also regulatory controls and inadvertently undermined public confidence in the profession to detect and prevent corporate abuses. Any way one looks at it, the audit business cannot continue much longer as it is. If years of "clean" audits are no guarantee that previously reported profits are not, in fact, illusory, then what value does an audit actually provide?. Auditing is a business full of assumptions. The providers think they are providing one thing (carefully phrased as "an attestation that financial accounts based on information provided by management are in accordance with generally accepted accounting principles"), and the investing public, the users of the service, continue to believe (despite the profession's best efforts to tell them otherwise) that the service is something else: a protection against fraud, reliably affirming the financial health of the enterprise being audited (Glassman, 2006). It may seem that auditing problems are due to the conflicts created by audit firms also providing consulting services. Legislators and regulators are today holding emergency hearings about whether auditors should be able to provide these additional services. The problem of auditor independence is not, ultimately, about the provision of consulting services. The conflict is built into the auditing system itself. Auditors are supposed to be independent of management, providing a neutral "attestation" that financial reports are a fair reflection of the business. Yet, who hires the auditors? Who pays them? Who retains them? Who can fire them? Answer: Only the company they are supposed to be auditing, and no-one else. Even if they never did a dime's worth of consulting, auditors would be conflicted (Shapiro, n.d.).

The problem is made even worse by the way the output of an auditor's work is structured. They are permitted only, in reporting to the public, to issue a standardized letter with fixed language, basically saying one of two things: either "We concur" or "We have reservations" (usually with no elaboration or explanation.) Since the latter option is equivalent to dropping the guillotine, it's not used too often. There's not much else auditors are allowed to do. Where a management is doing something questionable or on the edge, the auditors' choice is to go along, or to resign, causing a public scandal (and a loss of their own revenues). Auditors do not seem to have much ability to influence the management team. All they have got is a threat to resign. Honorable, well-intentioned people try, with integrity, to get management to do the right thing, but unless they have incredible guts, they are forced to accept a lot of grey areas before they have to pull the trigger. If they are to do their job, auditors need more than these options in reporting their findings.

The latest banking crisis is shaking up not only the financial industry, with bankers probed about loans to corporate miscreants, but also the political environment with the CBN being maneuvered toward reforms. The question on the minds of everyone from executives to the regulators is, how should the audit system be fixed?

2.5 Financial Statement Insurance as a Market-based Solution

Is there a potential cure for the investors "lack of confidence" in financial statements? The independence of auditors (meaning independence from parties that have an interest in the financial statement of an entity; it is essentially an attitude of mind characterized by integrity and objectivity approach to the audit process) or the lack thereof proves a major challenge to the quality of the audit process. Unfortunately, prosecution and punishment may not adequately deter wrongdoing, as intentional misrepresentation is difficult to discover or prove. Overloading the regulatory structure and adding layers of supervision and monitoring by the government would be inefficient and socially wasteful and contribute little in the short run to cultivate ethics in auditor's engagement. Rather, the solution lies in the model that eliminates the perverse incentives of auditors and restores that level of independence that is expected of the auditor in the course of his work. This means a mechanism that instills trust and an effective level of confidence in the financial statements certified by auditors.

The solution proposed is a financial statement insurance mechanism that promotes improved alignment of incentives, and hence better quality audits. The introduction of Financial Statement Insurance (FSI) can significantly reduce if not eliminate market inefficiencies arising from uncertainty regarding the quality of financial statements. Financial statement insurance (FSI) would make for a significant change in the principal-agent relationship. As insurance companies could be the proper principal for the auditor. With FSI, companies would have the option to buy FSI policies to insure them against claims that their financial statements are misleading. FSI insurers would hire auditors to review the quality of the corporation's accounting and estimate the risk that it will mislead investors. Insurers would offer companies coverage on the basis of an expert risk assessor's report (Ronen, 2003).

In Ronen's proposal, shareholders would vote whether to accept the maximum insurance offered, an amount suggested by management or no insurance. The key is that it is the FSI insurer, and not the corporation, that would commission an audit of the financial statements. The scope of the audit would be controlled by the insurer.

1. The Financial Statement Insurance Procedure

The FSI underwriting procedure starts with a review of the potential insured. The review is performed, on behalf of the FSI carrier (insurance firm), by an expert risk assessor, who investigates the nature of conditions such as: (a) The nature, stability, degree of competition, and general economic health of the industries in which the potential insured operates (b) The reputation, integrity, operating philosophy, financial state, and prior operating results of the potential insured's management (c) The nature, age, size, and operating structure of the potential insured, and (d) The potential insured's control environment and significant management and accounting policies, practices, and methods.

The FSI process might proceed as follows:

Step 1— The potential insured requests an insurance proposal from the FSI carrier. The proposal contains, at a minimum, the maximum amount of insurance being offered and the related premium. Typically, it also specifies a schedule of amounts of coverage below the maximum along with associated premiums. The proposal request is made prior to the preparation of the potential insured's shareholders' proxy on the basis of the underwriting review described above. The reviewer can be the same auditor who will eventually audit the financial statements.

Step 2—The proxy offers the following alternatives: (i) The maximum amount of insurance and related premium as offered in the insurance proposal (ii) The amount of insurance and related premium recommended by management (iii) No insurance.

Step 3—If either of the insurance options set forth in Step 2 is approved, then the reviewer and the auditor cooperatively plan the scope and depth of the audit to be conducted.

Step 4—If, after the audit, the auditor is in the position of rendering a clean opinion, the policy is issued. That is, the originally proposed coverage and premium will be binding on the insurance carrier if the auditor's opinion turns out to be clean. If the auditor's opinion is qualified, the insurer will not provide any coverage unless the company can then renegotiate different terms with the insurer, which would depend on the auditor's findings and reasons for qualification. To the extent the policy terms are renegotiated, the new agreed-upon terms would be publicized.

Step 5—The auditor's opinion will contain a paragraph disclosing the amount of insurance that covers the accompanying financial statements and the associated premium.

3.1 Claims Settlement Process of FSI

The FSI carrier and the potential insured cooperatively select a fiduciary organization whose responsibility is to represent the financial statement users when a claim is made. Part of the fiduciary's responsibility is the assessment of claims before notifying the FSI carrier. After the fiduciary notifies the FSI carrier of a claim, the FSI carrier and fiduciary mutually select an independent expert to render a report as to whether there was an omission or misrepresentation and whether it did give rise to the amount of losses that resulted. Within a short time after receiving the expert's report, the FSI carrier compensates the fiduciary up to the face amount of the policy for the damages.

3.2 Benefits of Financial Statement Insurance

Movement to the FSI approach would result in a number of benefits for most of the participants in the audit process. First and foremost, FSI will finally remove the conflict of interest issue from the external audit process. This would result in a realignment of incentives so that external auditors could provide an objective view of a corporation's financial health as measured by their financial statements. Shareholders would have yet another level of assurance that the financial statements that they depend upon are being prepared at an arm's length.

Conventional wisdom sees the conflict of interest that arises when clients pay auditors as an unavoidable fact of life. It is not. With FSI, companies buy insurance policies and insurers hire and pay auditors to perform audits, making the auditor's boss insurers, not management or audit committees. Following the proverb *whose bread I eat, his song I sing*, when auditors are paid by insurers rather than those they audit, audit quality should improve (Cunningham, 2006). Auditors would boast stronger reputations as watchdogs with attendant deterrent effect and would wield greater power to pressure managers when necessary to apply accounting policies promoting more reliable financial statements.

Publication of both the available limits and premium would also provide a clear signal to the investing public of the quality of each corporation's financial statement and assist investors in making the most appropriate purchases. Underwriters for their part should be interested in the basic changes that FSI would require. The active involvement in the risk assessment and financial statement audit process would be unlike any other line of coverage that they write. Directors and officers' liability underwriters, for example, are fortunate if they can obtain a current copy of an audited financials prior to determining acceptance and premium for a risk. Additionally, since the carrier would be the one establishing the relationship with the auditor, the carrier would be providing significantly more value-added services than with traditional insurance products.

Auditors too should benefit from the changes brought about by the FSI concept. For the most part, the scope and amount of audit work is expected to remain about the same, so the auditors would not have to sacrifice any of their current workload. They will, however, have to get used to working for a new boss, (i.e., the insurance company). But by establishing the relationship with the insurance carrier, they can remove the conflict of interest concerns that have followed them for years. They can go back to the original concept of guardian of the public good.

Banks should also see benefits from the movement to the FSI approach. In this new era of transparency, corporations will need to do all they can to instill confidence in their shareholders. Early adopters of FSI can expect to gain a competitive advantage over others in their industry segments. In addition, rating agencies and stockbrokers should be better able to assess the true value of an FSI organization, and thereby place a premium on their stock. Additionally, these companies should be the beneficiaries of a flight to quality that will be a natural outgrowth of this movement.

FSI would also allow Generally Accepted Accounting Principles (GAAP) to become more principle-based. Properly motivated auditors and corporations would no longer need the guidance that complex rules are supposed to provide. Nor would comparability be a reason to keep the detailed GAAP rules. With FSI, the financial reports would provide a rounded narrative, and investors could compare corporations by looking at the policy size/premium cost disclosure. It has been argued that the US model of specifying rules that must be applied has allowed or encouraged firms such as Andersen to accept procedures that, while they conformed to the letter of the rules, violated the basic objectives of GAAP accounting. For example, although SPEs in Enron usually appeared to have the minimum required three percent of independent equity, Enron in fact bore most of the risk. The contention is that general principles such as UK GAAP, which require auditors to report a "true and fair view" of an enterprise, are preferable to the over-specified US model, and that the US model encourages corporate officers to view accounting rules as analogous to the Tax Code.

Another overwhelming advantage of FSI is that auditors will finally be free to play one role only, that of detective. Because the FSI insurer wants to minimize its risk, it will insist on a thorough, impartial audit, including verification of assets and revenue, rather than just sample testing of records. Auditors will comply to please the insurer, who can offer repeat business, if not an in-house position.

3.3 Limitations of Financial Statement Insurance

FSI may prove too complex and easily or better suited to a litigious market i.e. issues arising from the operation of FSI can be easily taken to the court of law, which is rules-based rather than principles-based.

Another limitation is the placing of significant new burdens and risks on auditors, thereby adding inefficient risk-bearing that makes it even harder for smaller and riskier firms to enter the public markets**.** Also, the FSI scheme might induce an excessive, and harmful, degree of auditor conservatism. Class Action security litigation can involve sellers who suffer losses resulting from overly conservative statements as well as the typical purchasers' class. Removing the conflict of interest through the FSI scheme will minimize the potentially adverse effects given rise to by the subjectivity that is inherent in accounting decisions.

There is the issue of collusion between Firm and Insurance Carrier. Although collusion between the company being audited and the insurance company is not probable under the FSI regime, it may be argued that since the audited firm chooses the FSI carrier out of a list of possible companies, it will be in the interest of the insurance company to offer a premium no higher than the competitive rate in order not to be excluded from the FSI market. The potentially colluding insurance carrier will have to be compensated for the loss by charging unjustifiably high premium on other policies underwritten for the benefit of the audited company. Is it possible that to avoid the payment of potential shareholder claims, an insurance carrier –principal – and hence, the auditor – its agent – could intentionally overlook the need for a restatement that GAAP indicated as necessary? Superficially, this may suggest that the insurer would prefer covering up the discovery by its auditor, and hence avoid it.

4. The Need to Restore Investor Confidence in Banks

Reasons such as poor lending facilities and a restricted deposit base have led to bank crisis in the past. There is a perceived risk that bank failure will continue in earnest and healthy banks will experience financial and liquidity difficulty unless action is taken to restore depositor confidence quickly in the present dispensation. One vitally important issue which must be confronted as soon as it becomes known to the regulator that a bank is in financial difficulties is whether the problem is one of insolvency or illiquidity. Where the problem is one of illiquidity the central bank, using its last resort as a lender, may be in the position to supply sufficient temporary financial support to circumvent the problem. This power is discretionary and traditionally should only be used where the central bank is satisfied that the institution is not insolvent. Where a bank is in an insolvent state, main concern of both the regulator and the central bank is to decide, as quickly as possible, whether the failure of the bank would lead to any risk of contagion. In this situation, the interest of the depositors of the bank must also be considered. The existence of a deposit protection scheme does provide a safety net, but this is limited in scope and the liquation of a bank will inevitably lead to some losses for all depositors. The best course of action is to avoid liquidation wherever possible.

However the failure of a bank, especially where a large number of depositors are to lose money, is an unappealing prospect to the government of the day. From a political perspective, bank failure may be a more unattractive, or less unattractive, option if the depositors may or are not going to loose their savings. However, paying off depositors may also be politically unpopular where the cost to the taxpayer is substantial. Accordingly, it appears that where a fully funded deposit insurance scheme is in place, there will be less pressure on the government to provide a support operation when a bank is in serious financial difficulties. Nevertheless, more must be done to restore investor confidence in the Nigerian banks.

Banks experiencing difficulty need special protection. The reason that banks are a special case is the banking of deposits. A bank deposit is an unsecured, capital- certain claim which implies a strong element of trust. Banks borrow short to lend long and this is the key source of risk. Banks' deposits are typically payable on demand or with a relatively short period of notice. The fragility of financial system is built on public confidence. The confidence of the public, investors, shareholders, government and depositors, in the Nigerian banking sector have been largely eroded by the prevailing crisis of failure that the banks are experiencing. The need to address the issues that are consequent to this bank crisis and the investors' lack of confidence in the banking system is of utmost importance.

4.1 Restoring Investors' Confidence

Huge bank collapses caused directly by the unethical behavior of senior executives and huge losses for investors who relied on the financial information produced by those corporations have been experienced in the history of banks. As a result, public trust towards banks, their directors, managers and their auditors, has been destroyed and public expectation regarding honesty, integrity and transparency has increased considerably. The responsibility for fair and transparent financial disclosure lies partly with the auditors. Auditors therefore audit financial statements according to the standards of their profession and their firm. Hence, financial statements and related disclosures are the tools that a company uses to communicate its financial performance to its shareholders. Shareholders want to know that financial statements and other financial information received are a fair representation of financial performance (Ekeigwe, 1995b).

They need to have confidence that the information can be trusted. Providing this confidence is not only the role of the auditor but also the Management**:** The preparers of the company's financial statements are the management. They are directly responsible for the financial statements and the extent of the information disclosed. They are also responsible for the company's financial reporting process and internal control structure. If this system works as expected, investors get the result that they expect which is "a true and fair" picture of the company's financial performance and health. The problem is that the incentives driving auditors' behavior are not properly aligned to provide unbiased financial statements.

In the current social arrangement, auditors operate under perverse incentives: they are paid by the companies they audit and hence they are not independent of the CEOs who ultimately decide on the hiring of their services. While, theoretically, auditors are supposed to be the agents of the shareholders, in practice it is management that engages the auditor. Shareholders admittedly vote on management's recommendation of which auditor's services to hire, but the decision is effectively handed over to management. This is manifested in widely dispersed share ownership and the mechanism of proxy voting resulting in many shareholders giving their proxy votes to management, and others refraining from voting altogether. This arrangement creates an inherent conflict of interest that results in the relationship that exists between the client (the principal) and the auditor (the agent). The client principal (management) who engages the auditor ultimately pays for the services and hence structures the compensation of the auditor-agent to elicit such actions (opinions) of the auditor that would best serve his own interests. The fear of losing a constant flow of future audit fee, effectively guarantees that the auditor complies with management's wishes. The threat of legal liability is not sufficiently emphasized to balance the incentive of doing management's bidding. Moreover, the expected cost of litigation and other penalties is recouped on the average from the clients; the auditor does not recoup his expected litigation costs from each client in proportion to the latter's contribution to the risk of the auditor being litigated against or fined and to the consequent damages. Furthermore, the recoupment is made out of the client-corporation's resources, thus diminishing the wealth of shareholders who purchased the shares at prices potentially inflated as a result of misrepresentations (Cunningham, 2004).

Thus, instead of the shareholders being protected, they end up supporting the existence of this perverse relationship between the auditor and the management. It may seem that the liability exposure of the auditors is not high enough and that it should be increased sufficiently to deter malpractice, but substantially increasing auditors liability will certainly drive auditors out of the business. Therefore, no action, legislation, regulation, enforcement, or litigation can satisfactorily resolve the conflict of interest. These checks and balances are sound and necessary but they will not restore the confidence that has been eroded by the series of bank failures. .

There is need to create an agency relationship between the auditor and an appropriate principal whose economic interests are aligned with those of shareholders, who are the ultimate beneficiaries of the auditor's attestation. Such a realignment of interests would restore the "complete public's trust". In the context of a free market mechanism, the insurance carriers are being recommended as those who can serve the role of such a principal? The insurance carriers are an eminently reasonable candidate.

4.2 Findings

This research finds out that:

(i) There is an inherent conflict of interest that results in the relationship that exists between the management (the principal) and the auditor (the agent). The principal (management) who engages the auditor ultimately pays for the services and hence structures the compensation of the auditor-agent in such a way that will influence the actions (opinions) of the auditor that would best serve his own interests and not the interests of the public (investors).

(ii) The main reason for the continuous wave of failure of banks is the lack of confidence in the banking system which led to bank runs. The investors believe that bank failure will continue in earnest and bank will experience financial and liquidity difficulty unless action is taken to prevent complete erosion of depositor confidence.

(iii) The problems facing many Nigerian banks include; weak corporate governance, late or non-publication of annual accounts, gross insider abuse, insolvency, weak capital base and over dependence on public sector deposits.

(iv) There is an assurance mechanism called traditional financial statement auditing, which relies on the tripartite principal –agent- beneficiary model. The process involves a company engaging and paying an auditor. The auditor provides assurance for use by third parties. The third party assurance takes the form of the auditor's written opinion concerning managerial assertions. When third parties incur damages arising out of the assured information, they have legal recourse. Auditor assurance is limited because of challenges auditors face because the auditor reviews the assertions of those responsible for hiring, firing and paying it; due to the relationship that arises between those parties and the auditor, the independence, necessary to provide objective assurance is subject to compromise.

(v) The benefits and usefulness of financial statements insurance exceeds the limitations of financial statements insurance.

(vi) The independent auditor may be held liable for losses suffered by those who relied on the statement the auditors examined. Section 368 CAMA 1990 as amended shows the liability of the auditor if he negligently prepares the financial statement.

(vii) There have been some recent reforms to meet objectives for which FSI is proposed but FSI compares favourably to them. Recent reforms do not achieve any of the objectives that FSI achieves. The Sarbanes-Oxley Act (SOX) and Public Company Accountability Oversight Board (PCAOB) address auditor independence by putting supervisory authority in the hands of board audit committees rather than in managers, restricting non-audit services, and enhancing regulatory oversight. These reforms may reduce audit failure, but companies are still paying the auditor. They consciously attempt to make auditors act more like insurers, while FSI has achieved this via the provision of a better alternative way out.

5. Conclusion and Recommendations

The Nigerian banking sector, a foundation industry in the economy, has been under a lot of scrutiny and pressure from the public as result of the series of financial failure. The lack of investors' confidence in the banks whether as a result of reliance on misleading financial statements by which they have suffered great loss or the continuous failure of banks perceived to be healthy, highlights the need to restructure the system the bank uses to communicate its financial performance to investors and all other interested parties (creditors, regulatory bodies, shareholders, analysts, government, and the public). These parties need to be assured that financial statements and other financial information received are the fair representation of a genuine financial performance. They need to have confidence that the information can be trusted. Providing this confidence is not only the responsibility of auditors but also management. But because of the conflict of interest inherent in the relationship between management and auditors, this expectation has been illusory and pervasive.

Financial statement insurance provides a framework by which this conflict of interest is eliminated via a realignment of interest by the intervention of insurance companies. This framework would provide another level of assurance that financial statements present a 'true and fair view', and thus restore complete trust in the Nigerian banking sector. It is against the aforementioned advocacy that the following recommendations have been found worthwhile:

i. The banking sector is a vital sector in any economy as food is a necessity for survival. The fragility of financial system is built on public confidence, and the need for applying financial statement insurance to help restore this confidence cannot be denied. Banks should increase their level of awareness of this concept and apply it as this could help increase better communication with stakeholders and also greater investor confidence and trust.
ii. Rating agencies, stockbrokers, regulatory bodies, the government, professional bodies, research centers, auditors, and investment entities should brace up to embrace the FSI concept by updating their skills and knowledge in this regard. In this new era of transparency, early adopters of FSI can expect to gain a competitive advantage over others in their industry segments. In addition, rating agencies and stockbrokers should be better able to assess the true value of a Financial Statement Insurance organization, and thereby place a premium on their stock.
iii. It should be made mandatory for banks to adopt Financial Statement Insurance. This will provide a level playing field and comparability of information. For every bank, investors will know that the auditors work for insurers and that FSI coverage and premium information are available for comparison. The Securities and Exchange Commission (SEC), Central Bank of Nigeria (CBN), Corporate Affairs Commission (CAC), and the association of insurance companies should come together to map out a FSI-underlined blueprint that could get them out of the business of routine auditing regulation and disclosure oversight, freeing resources for other uses, including prosecution of what should be a very small number of deceptive financial disclosure cases.
iv. The academia, research/risk oriented organizations, professional insurance, financial and accounting bodies should step up an awareness drive of FSI through various platforms such as training programmes, workshops, conferences, seminars and symposia.
v. Lastly, the Nigerian government should back up the introduction of FSI into the polity with a strong will. Taking the practical FSI steps exposed in this paper will go a long way in sanitizing the nation's financial, banking, and economic terrains.

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