Research Journal of Finance and Accounting
ISSN 2222-1697 (Paper) ISSN 2222-2847 (Online)
Vol 3, No 6, 2012

Assessment of the Adequacy of External Auditing in Disclosing Fraud in Nigerian Commercial Banks

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Abstract

The primary purpose of auditing is to determine the true and fair view of the financial statements and investigation relates to checking of particular record for a specific purpose. The investigations launched by the financial regulators and other stakeholders into the cases of distressed banks revealed that accountants and auditors have not done their work properly. As a result of that, this study aims at assessing the adequacy of audit in disclosing fraud in commercial Banks of Nigeria. To achieve the objectives of the study, primary and secondary data were used. One hundred (150) questionnaires were administered to the study respondents that were purposively selected from eleven (11) commercial banks in Yola, auditing firms and shareholders. Guided interviews were also conducted with some of the respondents. Analysis of Variance (ANOVA) was employed to test the research hypothesis. The analysis of responses gathered revealed that the external audit is not adequate in revealing fraud. Based on the finding, the study recommended that an interim audit should be made mandatory in the commercial banks by the regulatory authority along side forensic audit as it will reduce the gravity of frauds in commercial banks.

Keywords: Assessment, **A**uditors' report, Fraud, Management, Nigeria, Commercial banks,

1. Introduction

Auditing is a vital part of accounting. Traditionally, audits were mainly associated with gaining information about financial systems and the financial records of a company or a business. Recent auditing has begun to include non-financial subject areas, such as safety, security, information systems performance, and environmental concerns. With non-profit organizations and government agencies, there has been an increasing need for performance audits, and examining their success in satisfying mission objectives. As a result, there are now audit professionals who specialize in security audits, information systems audits, and environmental audits. An audit must adhere to generally accepted standards established by governing bodies. These standards assure third parties or external users that they can rely upon the auditor's opinion on the fairness of financial statements or other subjects, on which the auditor expresses an opinion.

Auditing as a profession arises primarily because of separation in the ownership as well as the administration of a business enterprise. The owners of a business that is shareholders pool their resources together for the purpose of establishing an enterprise, with a common goal of profit making or otherwise. These shareholders may not be available for the day to day administration of the company hence the need to appoint professional managers, whose main responsibility is to utilize the shareholders fund effectively. The managers are expected to prepare an account, that is, a quantitative statement stating how the shareholder's resources were utilized during a period referred to as accounting year.

The duties of auditors as provided in Sec. 360 (1),(2) and (5) of Companies and Allied Matters Act (2004, as amended) in preparing their reports is to carryout necessary investigations and ascertain whether, proper accounting records have been kept by the company; the company's balance sheet and (if not consolidated) its profit and loss account are in agreement with the accounting records and returns made as well as whether the information given in the director's report for the year for which the accounts are prepared is consistent with those accounts and, if they are of opinion that it is not, that should be stated in their report.

The investigations launched by the financial regulators and other stakeholders into the cases of distressed banks revealed that accountants and auditors have not done their work properly. 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 disclose fraud perpetrated in them, capital structure, management, customers' patronage, loss of goodwill or just to change the names? Faith in the audit that is essential to auditor's job waned because of severe crimes left undetected until billions of naira were lost through the Chief Executive Officers' (CEO) insider trading 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 adequacy of audit in disclosing fraud . Other objectives are: to find out the party (ies) responsible for the problems encountered by the distressed banks, and to examine the reliability of audit reports.

2.0 The concept of audit

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 vain, 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.

2.1 Objectives of audit

The objective of audit has been identified to be two folds; namely primary and secondary objectives (Adeniji, 2004). The primary objective is for the appointed auditor to write a report expressing his professional opinion on the truth and fairness of the financial statements examined so as to give confidence to those parties who may want to make decisions based on them. The secondary objectives include to detect and prevent errors and fraud and to provide other services to the client in areas such as accounting work, financial analysis, tax matters etc.

The need for auditing of financial statements evolved basically as a result of the growing complexity in business. The separation of ownership from management particularly created a need for verification and authentication of results of operations presented in financial statements produced by management (directors) who were entrusted with resources by a third party independent of management itself to express an opinion on their truth and fair state (Gupta, 2005). In modern times the need and role of auditing has gone beyond the mere certification of financial statements in respect to their truth and fairness but have also included given an assurance that fraud and other irregularities perpetuated in organization may not go without detection. Audits are performed to ascertain the validity and reliability of information; also to provide an assessment of a system's internal control. The goal of an audit is to express an opinion on the person / organization / system (etc.) in question, under evaluation based on work done on a test basis.

Due to practical constraints, an audit seeks to provide only reasonable assurance that the statements are free from material error. Hence, statistical sampling is often adopted in audits. In the case of financial audits, a set of financial statements are said to be true and fair when they are free of material misstatements - a concept influenced by both quantitative (numerical) and qualitative factors.

3.0 Effective Auditing and Fraud Detection by Nigerian Commercial Banks

External auditors have an integral role to play in the fight against fraud and allied malpractices in commercial banks. By virtue of duty, the external auditors are supposed to serve as watchmen on behalf of management, shareholders, depositors and the entire society in the organization by planning and executing their audit assignments in a manner that leaves no material fraud, error and any other irregularity undetected reporting same via the audit report to concern parties appropriately for necessary action and decisions. According to Dyck, Morse and Zingales (2008) external auditors have a significant role to play in the detection and prevention of fraud because they are not only agents of the shareholders but their access to internal and external information makes them efficient monitors.

The existence and in fact, the high incidence of fraud in the banking industry brings to mind the question of competence, skills, due care, honesty, and integrity of auditors in banks, qualities stated by Olofin (1996) and Agbaje (1996) are expected to be displayed by an auditor at all times in every circumstance. Every bank stakeholder like in any other organization in a way relies on the auditor. This asserts the auditors strategic position. It is this very strategic position and duty of care bestowed on auditors in organizations that Iorsase (2004) notes that when fraud occurs in the work place, the question that is always asked is “where were the accountants and auditors?” Agbaje (1996) commenting on the distressed conditions of banks in the 90’s retain that “… it is a matter of grave regret that the confidence reposed on the auditors responsible for the affected banks has been brazenly dashed." This statements and comments clearly show the level of responsibility and confidence the society bestow on auditors in fraud detection and prevention in organizations. The detection and prevention of fraud in the banking industry should therefore be considered by auditors of banks as one of their most important duties whether explicitly or implicitly stated in the statutory requirements.

According to Koholga (2010) the external auditor's crucial role rest in the critical review of the internal control system in operation in the banks to ensure their continued applicability and relevance in detecting and preventing fraud. An effective and functional internal control system is an indication that the system is devoid of malpractices. The auditor, through his reviews, should be able to dictate areas in which management themselves override controls. Though the task of uncovering management fraud may be a difficult one since they are in a position to override internal controls and can conceal any misstatement, Deshmukh, Karim and Siegel (1998) postulates that auditing can detect management fraud. The evaluation of established internal control system in terms of its effectiveness and applicability and reporting appropriately on the weaknesses, making recommendations on how to overcome the identified weaknesses is an important input of the professional auditor in sanitizing banks of fraud and other malpractices.

It is necessary for the auditor to embark on reviews of the system to be satisfied that an effective system of internal check capable of forestalling fraud is in existence and is operating satisfactorily. Where it is discovered that existing internal controls systems are defective and cannot sufficiently prevent the commission of frauds, the auditor should suggest a better system that may be adequate and which is clear and practicable to strengthen the system against fraud. Though in the conduct of audit, the external auditor may have to rely on the internal auditor's work, the degree of reliance as stated by Watoseninyi (1996) and Dandago (2002) should strictly be based upon the organization, qualifications and effectiveness of the internal audit department of the bank. Reliance should be placed in a situation where he satisfies himself among others that, the internal auditor is independent of the chief financial executive, free from operating responsibilities, and reports directly to the chief executive officer; there is a favourable ratio of qualified to unqualified staff in the internal audit unit, headed by a professional; work done is evidenced by well prepared work papers as appropriate, dated and initiated, detailing items selected for tests; and that management follow up and considers internal auditors recommendations. Reliance without due consideration to these factors will definitely mislead the auditor which may give rise to undetected frauds.

The increase use of analytical reviews like ratio analysis by the external auditors can substantially bring to limelight accounting anomalies large enough to be investigated which may uncover fraud. This strategy however has its limitations. As documented by Brazel, Jones and Zimbelman (2009) academic research suggests that external auditors' analytical procedures are ineffective at detecting fraud for at least three reasons. First is that auditors may not recognize unusual trends and ratio within the financial statements because they lack a sufficient understanding of their client business. Secondly, they tend to rely on management's explanations without adequately testing their validity. And thirdly, traditional analytical procedures using financial statement data lead to high rates of misclassification and therefore yield limited success in identifying fraud.

3.1 Roles of Accounting Firms in External Audit

Dwelling on the role of accounting firms that perform external audit function, Shohet (1988) in Anyafo (2005) observes that instead of being professional accounting firms that provide services for their usefulness and competitiveness, audit firms of today generally provide services to satisfy legal requirements. This assertion seems to

highlight one important reason why malpractices such as fraud continue to exist in the Nigerian commercial banks despite the annual external audit exercise banks are subjected to. Because the detection of fraud and other malpractices is not the primary legal requirement of audit, external auditors are most often seen as not going extra length in conducting reviews that could uncover these malpractices. 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 especially Bakre (2007) argues that accounting professionals have increasingly used their expertise to conceal and promote anti-social
practices. 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. The auditor's position is derived from the provision of statutory laws on auditing, for the detection of fraud is not made a duty of auditors but rather that of management through establishment of effective internal control system. Though it is a well known fact that audit and investigation are two distinct assignments; nevertheless, auditing strictly is to satisfy legal provisions at the neglect of the relevance of the audit function is rather a disservice to shareholders who appoint external auditors to conduct examinations and the society at large.

Studies have also shown that external auditors rarely detect fraud in the course of audit assignment especially fraud perpetrated by management (Deshmukh, Karim and Siegel, 1998) which probably is because of management position to override internal controls and conceal fraud perpetrated by them. For example, investigations into the financial report of Afribank implicated Akintola Williams & Deloitte in facilitating an overstatement of the bank's account by the management. Other Nigerian cases as stated by Bakre (2007) have also been documented in which a number of professional accounting firms were involved in, and indicted for, anti-social practices in conflict with their professional claims to be acting in the public interest; and it was suggested that the matter needed further investigation. In the light of the aforementioned, and on the strength of empirical evidence Hansen, McDonald, Messier and Bell (1996) concluded that auditors' probably do not have adequately developed cognitive models for fraud risk assessment.

Further studies conducted by Deshmukh, Karim and Siegel (1998) in the area of auditors' detection of management fraud using Signal Detection Theory (SDT) model established that auditors can detect management fraud but to do so they must accept disproportionate false alarm rates. The submission of this study implies that the external auditor's correct decision-making concerning management fraud depends to a large extent on the assumption that there is occurrence of management fraud which will lead to thorough investigation to ascertain the true position of things. This however is contrary to auditing requirements since auditors are not to approach audit assignment with suspicion of the existence of fraud. 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.

Based on the aforementioned, it is hypothesized that:

Ha: The External Auditing performed in commercial banks In Nigeria is inadequate in revealing fraud.

4.0 Methodology

The current study was a survey research. The data were analysed using Analysis of Variance (ANOVA). A total of 150 respondents made up of bank employees at managerial levels, practicing Accountants, and shareholders participated in the survey.

***4.1* Result**

Table 1: Inadequacy of audit performed in commercial banks

Respondents	Strongly agree	Agree	Disagree	Strongly disagree	Total
Bankers	25	31	4	10	70
Practicing Accountants	15	16	12	7	50
Shareholders	12	11	4	3	30
Total	52	58	20	20	150

Source: Field Survey, 2012.

Applying the ANOVA,

$SS_T = x_1^2 + x_2^2 + x_3^2 \ldots\ldots\ldots\ldots x_{12}^2 – Q^2/N$

$SS_B = xx^2/n + yy^2/n + zz^2/n - Q^2/N$

$SS_W = SS_T - SS_B$

$Df = N – t$

$SS_T = 25^2 + 31^2 + 4^2 + 10^2 + 15^2 + 16^2 + 12^2 + 7^2 + 12^2 + 11^2 + 4^2 + 3^2 - 150^2/12$

$SS_T = 2666 – 1875$

$SS_T = 791$

$SS_B = 70^2/4 + 50^2/4 + 30^2/4 - 150^2/12$

$SS_B = 2075 – 1875$

$SS_B = 200$

$SS_W = 791 – 200$

$SS_W = 591$

Table 2: ANOVA Summary

Source	SS	Df	MS	F ratio
Between	200	2	100	
				1.53
Within	591	9	65.67	
Total	791	11		

Source: Researchers' Computation, 2012.

Level of significance = 0.05; F distribution at 0.05 $F_{2, 9} = 4.26$

The calculated F- value is 1.53 while the critical value at 0.05 level of significance is 4.26. Therefore, H_o is accepted because the calculated value is less than the critical value, that is to say, external auditing performed in commercial banks is inadequate in revealing fraud.

The result of the study which says that the external auditing of commercial banks is inadequate in revealing fraud is on the premise of the primary objective of auditing which is the expression of opinion on the truth and fairness of financial statements of the organization, not fraud detection as it is a secondary objective which auditors normally overlook. Over the years, auditors have been giving unqualified reports to their clients, after which the clients were declared distressed (example, Oceanic bank, Intercontinental bank, Finbank, Afribank, Union bank). Nigerian auditors do not normally produce a qualified audit report and this can be attributed to the Nigerian factors known as bribery and corruption as gathered from the respondents which is making the audit reports unreliable. The Chief Executive Officers of the banks connived with the auditors in order to give an unqualified audit report to cover the injury they inflicted on the organization as reported by the former Economic and Financial Crime Commission (EFCC) Chairperson Farida Waziri in Saturday Tribune 22 August, 2009 and ThisDay 22 August, 2009. As a result of this, the EFCC invited 10 forensic experts to trace N1trillion allegedly stolen by some former bank chiefs. The aim was to get a detailed account of how the fund was stolen.

However, some respondents were of the view that, the auditors always claim that management normally hide some documents from them. The governing statutes in respect of this gave the auditors the right to ask for any document that may help them carryout their assignment effectively. The usefulness of an audit was frequently called into question as they generally failed to uncover fraud. Despite the criticism, auditors continued to minimize the importance of their role in detecting fraud by stressing that such duty rested with the management. As a result of the questionable role of auditors in fraud detection, some organizations have resorted to forensic audit. Hence, other possible solutions could be suggested.

5.0 Conclusion

Based on the findings of the study, it could be concluded that the external auditing performed in commercial banks are inadequate in disclosing fraud, and as result of that forensic audit is needed. In line with these, the study therefore makes the following recommendations:

i. Since the external audit is not effective in revealing fraud, the governing statutes should be amended to inculcate interim audit, and forensic audit. Although, this may increase cost on banks, but it will reduce the incidence of fraud drastically, especially, those perpetrated by the management. And the forensic auditors should check for the professional negligence of external auditors.
ii. The scope of audit should be expanded by placing emphasis on the secondary objective of audit.
iii. Management should ensure that necessary documents and books are made available to auditors.
iv. Fraudsters should be properly sanctioned.

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