NATURE OF COMPETITION IN THE AUDITING PROFESSION IN NIGERIA: THE PUBLIC ACCOUNTANT'S VIEW

By

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Abstract

An audit involves searching and verifying the accounting records and examining other evidence supporting the financial statements. By obtaining an understanding of the company's internal control, inspecting documents, observing assets, making inquiries within and outside the company, and performing other auditing procedures, the auditor will gather the evidence necessary to issue an audit report. The provision of services other than audit is a potential area of risk to objectivity on the part of the auditor identified in the statement on integrity, objectivity and independence. This paper looks at the nature of competition in the auditing profession and examines the elements of audit risk and factors that may increase or decrease audit quality in line with the performance of non-audit services by auditors. It was suggested, among others, that rotation of external auditors in all sectors should be encouraged to avoid cover up in their reporting.

Key Words: Auditing, Independence of mind, Independence of Appearance, Financial Audit, Operational audit and Compliance audit.

Introduction

When a market has many potential buyers and sellers and has no entry or exit barriers, the market structure is that of competition. The theory of perfect competition assumes that all firms are free to enter and exit markets, which ensures that large numbers of small firms make normal profits. In reality, competitive conditions often give rise to many industries consisting of a few large firms which may have considerable influence over prices charged, enabling these firms to earn abnormal profits. In this paper, we are going to look at competition in the audit industry with respect to auditors' independence. To achieve this, we will first distinguish between accounting and auditing, the types of audit and the profession of audit and assurance.

Distinction between Auditing and Accounting

Many financial statement users and members of the general public confuse auditing with accounting. The confusion results because most auditing is usually concerned with accounting information, and many auditors have considerable expertise in accounting matters. The confusion is increased by giving the title "certified public accountant" to many individuals who perform audits.

Accounting is the recording, classifying, and summarising of economic events in a logical manner for the purpose of providing financial information for decision making. The function of accounting is to provide certain types of quantitative information that

management and others can use to make decisions. To provide relevant information, accountants must have a thorough understanding of the principles and rules that provide the basis for preparing the accounting information. In addition, accountants must develop a system to make sure that the entity's economic events are properly recorded on a timely basis and at a reasonable cost.

In auditing accounting data, the concern is with determining whether recorded information properly reflects the economic events that occurred during the accounting period. Because accounting rules are the criteria for evaluating whether the accounting information is properly recorded, any auditor involved with these data must also thoroughly understand those rules. In the context of the audit of financial statements, the rules are generally accepted accounting principles.

In addition to understanding accounting, the auditor must possess expertise in the accumulation and interpretation of audit evidence. It is this expertise that distinguishes auditors from accountants. Determining the proper audit procedures, deciding the number and types of items to test, and evaluating the results are problems unique to the auditor.

Types of Audits

According to Arens and Loebbecke (2000: 11) accountants perform three main types of audits. These are Financial Statement Audits, Operational Audits and Compliance Audits.

(a) Financial Statement Audit

A financial statement audit is conducted to determine whether the overall financial statements (the information being verified) are stated in accordance with specified criteria. Normally, the criteria are generally accepted accounting principles, although it is also common to conduct audits of financial statements prepared using the basis of accounting appropriate for the organisation. The financial statements, most often included, are the statement of financial position, income statement and statement of cash flow including accompanying notes.

(b) Operational Audit.

The term operational auditing refers to comprehensive examination of an operating unit or a complete organisation to evaluate its systems, controls, and performance, as measured by management's objectives. Whereas a financial audit focuses on measuring of financial position, results of operations and cash flows of an entity, an operational audit focuses on the efficiency, effectiveness, and economy of operations. The operational auditor appraises management's operating controls and systems over such varied activities as purchasing, data processing, receiving, shipping, office services, advertising, and engineering.

Operational audits are often performed by internal auditors for their organisations. The major users of operational audit reports are managers at various levels, including the board of directors. Top management needs assurances that every component of an organisation is working to attain the organisation's goals. For example, management needs the following:

- assessments of the unit's performance in relation to management's objectives or other appropriate criteria;
- assurance that its plans (as set forth in statements of objectives, programmes, budgets, and directives) are comprehensive, consistent, and understood at the operating levels;
- objective information on how well its plans and policies are being carried out in all areas of operations and on opportunities for improvement in effectiveness, efficiency, and economy;
- Information on weakness in operating controls, particularly as to possible sources of waste; and
- reassurance that all operating reports can be relied on as a basis for action.

Compliance Auditing.

Society has always been concerned about compliance with laws and regulations by all types of organisations. As a result, compliance auditing has evolved to become an important part of the work of both external and internal auditors. Compliance auditing involves testing and reporting on whether an organisation has complied with the requirements of various laws, regulations, and agreements.

The purpose of a compliance audit is to determine whether the auditee is following specific procedures, rules, or regulations set by some higher authority (Arens and Loebbecke 2000). A compliance audit for a private business could include determining whether accounting personnel are following the procedures prescribed by the company controller, reviewing wage rates for compliance with minimum wage laws, or examining contractual agreements with bankers and other lenders to be sure the company is complying with legal requirements. In the audit of governmental units such as school, there is considerable compliance auditing because of the extensive regulation by higher government authorities. In virtually every private and not-for-profit organisation, there are prescribed policies, contractual agreements, and legal requirements that may call for compliance auditing.

Results of compliance audits are typically reported to someone within the organisational unit being audited rather than to a broad spectrum of users. Management, as opposed to outside users, is the primary group concerned with the extent of compliance with certain prescribed procedures and regulations. Therefore, a significant portion of work of this type is done by auditors employed by the organisational units themselves.

The Profession of Auditing & Assurance

Assurance and Auditing as a profession is part of the broader service industry called public accounting (Knechel 2001). Both public accounting and auditing are subject to numerous influences and regulations. To be an auditor, an individual must be a licensed Accountant. Only licensed Accountants have the authority to conduct audits of financial statements. This creates a virtual monopoly for this type of service but also assures a certain level of quality for the services rendered.

Accountants must deal with a broad set of rules and regulations related to how they conduct their practice and the nature of the services they provide their clients. The International Accounting Standard Board is responsible for developing generally accepted international standards that can be used across international boundaries.

Practitioner and Profession Independence

Mautz and Sharaf (1961) identified two types of independence, practitioner independence and profession independence. These two types are clearly related as all audit practitioners may be regarded as members of a profession, but Mautz and Sharaf (1961) distinguish between the two because people often distinguish between an individual and the profession to which he or she belongs.

Practitioner Independence

Mautz and Sharaf (1961) noted that 'practitioner independence….is basically a state of mind' and analysed the pressures and factors 'which may colour or influence his disinterestedness'. They identified three dimensions of practitioner independence and suggested a number of guides or clues to help the auditor determine whether independence may have been infringed. According to Pany and Whittington (2004), these are:

programming independence, requiring that auditors have freedom to develop their own programme, both as steps to be included and the amount of work to be performed, within the overall bounds of the engagement;

investigative independence, requiring that no legitimate source of information is closed to the auditors. This requires that the auditors have freedom to examine information that the auditors themselves deem to be relevant. Thus, if the auditors wish to examine budgets and forecast accounts of the following period, they should be allowed to do so; and

reporting independence, meaning that the contents of the report are related to the scope of examination. They suggest that the following neatly expresses this requirement: 'You tell us what to do and we'll tell you what we can write in our report; you tell us what you want us to say in our report and we'll tell you what we have to do.'

Profession Independence

Mautz and Sharaf (1961) suggested that: 'like the individual practitioner, the profession as a whole must avoid any appearance of lacking independence'. They concede, however, that 'Auditing, unfortunately, does not have any "built in" characteristics that assure the skeptic of its integrity and independence'. They give the example of the judiciary 'giving the impression of as nearly completes independence as can be obtained', with a hierarchy of courts so that the decisions of lower judges are scrutinised by higher and more experienced judges, and note that 'nothing like this exists in auditing'.

Mautz and Sharaf (1961) refer to the fact that: 'auditing suffers from what may be described as "built-in anti-independence factors", and lists the features which they believe lead the public to doubt the independence of auditors.

It seems clear that there are forces at work within the profession presenting some challenges to the image of profession-independence. Accounting appears to be intimately associated with business-like characteristics in its structure and operation. There is little about public accounting that would encourage the uninformed person to see auditors as possessing the ultimate in independence (Kinney, Palmrose, and Scholz 2004).

Auditor's monitoring will not be valuable to people interested in the activity of organisations unless they consider that the likelihood is high that auditors will report

significant matters of concern. These writers believe in the ability of markets to influence human behaviour and recognise that the auditor is important in making believable what manager's report to owners and others. Watts and Zimmerman (1986) consider, however, that the probability of them reporting matters of concern is likely to be high because of the adverse effects on their reputation if their failure to report comes to light. They note that 'the very existence of a demand for the auditor's services depends on that probability's level being high'.

Competition in the Auditing Profession

There are possible negative effects on perceived independence arising from competition within the profession. In Shockley's (1982) view, poor audit quality might arise in this case because of lack of independence.

Shockley (1982) suggests that competition for audit clients increases audit dependency on the client because increased competition makes it more likely that an auditor will be replaced by one prepared to agree with management.

Another competitive measure taken by auditors to out wit opponents is through the provision of non audit services. According to Kinney *et al* (2004), the provision of non audit service can lead to a better audit. The auditor will gain more familiarity with the client's internal control system and through that improves quality and accuracy of the audit.

However, there are problems related to the provision of non-audit service. Many believe that providing non audit service to an audit client could impair the quality of the audit (Firth-2002). When providing non-audit service, the auditors often gain a close relationship with management that can cause a situation where the auditors take sides with the client instead of following regulations.

There is also a risk that the increased income that is due to the provision of both audit and non-audit services could add to the auditing firm's dependence on the client (Firth-2002). When facing the risk of losing both the audit and the non-audit services of a client, it is believed that an auditor is less willing to criticise a client's financial statements than if the auditor only provides one of the services. The prohibition of non-audit services to an audit client is based on three principles that are considered to be determinants for the independence of the audit profession:

- an auditor cannot function in the role of management;
- an auditor cannot audit his or her own work; and
- an auditor cannot serve in an advocacy role for his or her client.

Auditors Personal Interest in the Client

These include: auditors' emotional, financial or other personal interests. Auditors may favour, consciously or subconsciously, their self-interest over their interest in performing the financial statements audit.

These could arise, under the following circumstances:

- loans to or from client;
- benefits by way of goods or services or hospitality from a client;
- beneficial interest in shares and other investments;
- senior audit employee joining client; and
- other personal or family relationships with the client.

The concern about tenure arises because if a company and an auditing firm have been in close association for a long time, this may lead to auditors identifying with their client's management with a consequent detrimental effect on independence.

An auditor must be concerned with both independence, in fact; and independence, in appearance. Independence in appearance means that an auditor should do nothing to undermine the public's perception that he or she has no vested interest in the outcome of an audit. The perception that an auditor is not independent, or has a potential conflict of interest in providing audit services of the highest quality, undermines the value of those services even if the auditor is completely unbiased and objective. An auditor who does not possess independence, in fact, may be tempted to bias the execution of the audit, which could manifest itself in poor decisions related to the gathering and evaluation of evidence or the nature and extent of disclosures in the financial statements. An auditor whose personal wealth is dependent on the success of the client is less likely to ensure that “bad news” is adequately examined by the audit team and reported in the financial statements (Citron, 2003).

If an auditor has any question about potential impairment of independence, a thorough examination of the situation should be conducted and consultations made with regulatory authorities.

A professional needs to be objective in the course of performing his/her duties. Such a professional after behaving objectively will need to be independent of the owners of the business for which he/she is working. Objectivity and independence often go together and accountants and, especially, auditors should not only be objective but also act independently of the entity they are working for.

It is in the interest of the public at large that if the work of professionals should be relied upon by the same public, those professionals should be independent of their clients in the way they conduct themselves. As in the case of integrity, the society poses some threats to the independence of professionals while it is the responsibility of the individual professionals and their professional bodies to ensure that necessary safeguards are put in place to reduce the risk involved. The Code of Ethics of the International Federation of Accountants (IFAC) States that independence requires:

(a) “Independence of mind: The State of mind that permits the provision of an opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional skepticism.

(b) Independence in appearance: The avoidance of facts and circumstance are so significant that a reasonable informed third party, having knowledge of all relevant information, including safeguards applied, would reasonably conclude that a firm's integrity, objectivity or professional skepticism had been compromised”(Ashworth, 2003).

An auditor must always approach his work with objectivity and independence. The approach must be in a spirit of independence of mind, whereby auditors express opinions independently of the entity and its directors.

Conclusion

The recent controversy over auditor competition raises a number of questions. Is the switch to an economic based concept of auditor independence on economic imperative or does it represent the death of the profession? Can the profession survive the rivalry and intrigues within and outside it? Why has the profession made such halting progress in recent years?

As Carmichael (1999) noted separating independence from ethical notions like integrity and objectivity has potential consequences. One of these consequences has been discussed by Williams (1999), who argued that the substitution of a strictly economic discourse for the traditional discourse of accounting, of which the old notion of independence was a part, deprives accounting of any effective moral language with which to assess itself ethically and articulate any of its ethical problems. What the new model of independence proposes is the abandonment of an explicitly moral idea of what it means for a person to be a good accountant.

In Nigeria, according to Osisioma (2009) and World Bank (2004), the auditing profession suffers from the following lapses;

- There is no independent oversight body responsible for the registration of auditing licensing requirements and disciplinary matters.
- The existing professional bodies act as both the examining body and licensing authority for their members engaged in public auditing practice.
- The disciplinary mechanisms for auditors may be inadequate which may have undermined the independence of auditors in Nigeria. In some regulated industries like Insurance and Securities markets, the appropriate agencies have no involvement in the auditor's appointment as well as in the removal or resignation of auditors.

It is clear that in cases where there is a public interest, as in the case of the auditing profession, self-regulation with little or no interference from government and no representation of financing from various interested parties is inappropriate. What we have in the Nigerian case is a situation where the accountancy profession is acting as a watchdog over its own member's affairs and as a result is more prone to regulatory capture.

The provision of non-audit services by auditors to audit clients has had a significant impact on auditors' independence and the profitability of their firms. CAMA (1990) section 358 (2a) disqualifies a person or firms who or which offers to the company professional advice in a consultancy capacity in respect of secretarial, taxation or financial management from acting as auditors of that same company. This ensures that an auditor is independent in appearance of the organisation on whose accounts he reports.

Usually, these non-audit services are very profitable and sought after, with the resultant effect that, in the past, auditors were tempted to succumb to management pressures on external audit issues in order to retain the audit engagement, and so to provide the very profitable non-audit services.

Professional accounting is under considerable economic pressure, which has intensified in recent years. As Elliot (1994) notes, the traditional audit service is not now a growth industry. The low profitability of traditional audit service produces concomitant pressure to provide value to clients in other ways, which include consulting, management

advisory services, and even contracting to perform corporate functions such as internal control.

Commercial pressures also push the profession to expand into new areas. Barley (1995) notes that in today's world, survival to the auditor means finding new value-added products to sell to clients.

Recommendations

Prohibition of other services: It has been suggested that auditors should be prohibited from performing any other work for what client companies. Consequently, this would remain the self-interest threat of losing lucrative work if the auditors displease the directors.

In Nigeria, auditors accept all services except those for which the auditor has no expertise as long as there are separate engagement letters. The existing independence rules are clearly breached. The same auditor is allowed to prepare and audit the financial statements due to a lack of qualified accountants.

Enhance the capacity of the various accountancy bodies to supervise and monitor its member: A designated monitoring and investigative unit would be responsible for carrying out practice review for auditors and audit firms. The practice review would evaluate an audit firm's quality assurance arrangements, its audit approach, and the working papers with regard to selected audit engagements. Valid complaints against auditors and audit firms would also be investigated. In the case of material infractions, this monitoring and investigative unit would recommend appropriate sanctions against the auditors and audit firms.

Strengthen capacity of the regulatory bodies and review adequacy of statutory enforcement provisions: Take necessary steps to strengthen capacity of the regulators (including Registrar of Companies at the Corporate Affairs Commission, Securities and Exchange Commission, National Insurance Commission, and the Central Bank of Nigeria) that enable them effectively deal with accounting and financial reporting practices of the regulated entities. Revive legislation to provide for effective sanctions and penalties to remove the requirement for approval of financial statement by regulators prior to publication and to clarify the roles of the Nigerian Stock Exchange and Securities and Exchange Commission in monitoring and enforcement.

Full convergence of SAS with IAS, full adoption of ISA and compulsory observance of these standards: The Nigerian Accounting Standards Board (NASB), should fully adopt all existing International Accounting Standards (IAS) where no local standard (SAS) exists. More so, all existing SAS should be reviewed in line with current development in financial reporting.

Finally, we wish to reiterate the rotation of external auditors in all sectors of the economy to avoid cover-up in their reporting of the financial situations of an organisation under audit. Appointment of auditors beyond three years will erode the integrity and independence of the auditor as well as provide safe haven for corruption which, by extension has been responsible for the collapse of many banks and other companies. The rotation will, further, give room for the teeming number of young indigenous firms.

The bill for an act to establish the Financial Reporting Council of Nigeria has come at the right time to emphasise the need for compliance with financial reporting standards and

the steps to be followed in monitoring compliance. The professional accountant, must, therefore, realise the primacy of an accurate financial reporting system.

It should be borne in mind that when things go wrong, it is the firm of external auditors that is culpable and not the lead or reviewing partners. None the less, the audit contract is between the audit entity and the external audit firm. Hence, it is the audit firms that should rotate not the audit personnel.

Nigerians should learn to introduce policies peculiar to our environment rather than copying copiously what happened in other countries. The adverse effect is that very few firms are controlling the audit of multinational companies in the country to the detriment of small-and medium-scale external audit firms.

Mandatory rotation would prevent the audit firm from developing too cozy a relationship with the client and also provides an incentive for the audit firm to carryout work to a high standard because, they know that the quality of their work will be observable to some extent when a new firm of auditors take over the audit.

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