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Assessment of the Institutional Regulatory Framework of Auditor Independence in Nigeria

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Abstract

The study assessed the effectiveness of the institutional regulatory framework of Auditor Independence in Nigeria. The study is purely a library research aided by content analysis. The results identified weakness inherent in the regulatory framework assessed such as ineffectiveness of whistle blowing in Nigeria; violation of Auditor's reporting independence; negligence on the Part of Audit Regulators and External Auditors in Nigeria; absence of unified Code of Corporate Governance in Nigeria and proliferation of Accounting Professional Bodies and decline in Ethics. The study, recommended that, harmonisation of the multiplicity of corporate governance codes and accounting professional bodies in Nigeria by Financial Reporting Council of Nigeria is a pre-requisite for promoting auditor independence among external auditors. Also, regulators in Nigeria should create more stringent regulatory procedures to detect fraud, mete out appropriate disciplinary measure and well as penalise companies and audit firms for erring. Furthermore, the accountancy professional body (ICAN) should promote the dignity of its members by making the appointment of external auditors less dependent on the executive directors and more dependent on the non-executive directors, audit committees and shareholders.

Key words: Auditor, Regulation, Independence, Framework

Introduction

Over the last decade, in the wake of major audit failures, the quality of accounting information has become increasingly crucial. Corporate scandals and presumed audit failures have brought auditor independence, and consequently, audit quality, into the forefront (Brandon, 2003). This led regulatory authorities to propose various reforms to restore investor confidence in the proper functioning of capital markets, such as the Sarbanes Oxley Act (SOX) adopted in 2002 in the U.S. or the Directive on Statutory Audit adopted in the EU effective from April 2014 and 2003 Code of Corporate Governance for Public Companies in Nigeria.

Auditor independence was and still crucial and at the heart of the public accounting profession. For decades, users of financial statements, governing/regulatory bodies, academics and practitioners have been debating on how to assure highest levels of independence in order to retain trust in the accounting profession and thus in the quality of audited financial statements (Houqe, Zijl, Keitha, Dunstan, & Karim, 2010). Legal institutions that safeguard the interests of investors are an integral part of financial development. Reforms that bolster a country's legal environment and investor protection are likely to contribute to better growth prospects. Francis, Khurana and Pereira (2003) found no evidence that better accounting practice, independent of a country's underlying legal systems, was positively related to financial market development. The objective of this study is to assess the institutional regulatory framework of Auditor independence in Nigeria

An Overview of Institutional Regulatory Framework of Auditor Independence in Nigeria

The Securities and Exchange Commission (SEC): Weak corporate governance has been responsible for some recent corporate failures in Nigeria. In order to improve corporate governance, the Securities and Exchange Commission (SEC), in September 2008, inaugurated a National Committee for the Review of the 2003 Code of Corporate Governance for Public Companies in Nigeria to address its weaknesses and to improve the mechanism for its enforceability. In particular, the Committee was given the mandate to identify weaknesses in, and constraints to, good corporate governance, and to examine and recommend ways of effecting greater compliance and to advice on other issues that are relevant to promoting good corporate governance practices by public companies in Nigeria, and for aligning it with international best practices. This was an attempt to regain the confidence of the public (Okpara, 2010).

The Board of SEC therefore believes that this new code of corporate governance will ensure the highest standards of transparency, accountability and good corporate governance, without unduly inhibiting enterprise and innovation. Despite the fact that the 2011 code applies only to public companies, the Securities Exchange Commission has encouraged private companies to adopt its principles in the conduct of their affairs.

Every public company is required under Section 359 (3) and (4) of the CAMA to establish an audit committee. It is the responsibility of the Board to ensure that the committee is constituted in the manner stipulated and is able to effectively discharge its statutory duties and responsibilities. At least one board member of the committee should be financially literate. Members of the committee should have basic financial literacy and should be able to read financial statements. At least one member should have knowledge of accounting or financial management. Whenever necessary, the committee may obtain external professional advice.

In addition to its statutory functions, the audit committee should have the following additional responsibilities as stated in the SEC regulation: assist in the oversight of the integrity of the company's financial statements, compliance with legal and other regulatory requirements, assessment of qualifications and independence of external auditor; and performance of the company's internal audit function as well as that of external auditors; establish an internal audit function and ensure there are other means of obtaining sufficient assurance of regular review or appraisal of the system of internal controls in the company; (c) ensure the development of a comprehensive internal control framework for the company; obtain assurance and report annually in the financial report, on the operating effectiveness of the company's internal control framework; discuss the annual audited financial statements and half yearly unaudited statements with management and external auditors; review and ensure that adequate whistle-blowing procedures are in place. A summary of issues reported are highlighted to the chairman; review the independence of the external auditors and ensure that where non-audit services are provided by the External Auditors, there is no conflict of interest; and preserve auditor independence, by setting clear hiring policies for employees or former employees of independent auditors;

SEC stipulates that companies should have a whistle-blowing policy which should be known to employees, stakeholders such as contractors, shareholders, job applicants, and the general public. The whistle-blowing mechanism should be accorded priority and the Board should also reaffirm continually, its support for and commitment to the company's whistle-blower protection mechanism. The whistle-blowing mechanism should include a dedicated "hot-line" or e-mail system that could be used anonymously to report unethical practices. A designated senior level officer should review the reported cases and initiate appropriate action, if necessary at the level of the Board or CEO/MD to redress situation.

In order to safeguard the integrity of the external audit process and guarantee the independence of the external auditors, companies should rotate both the audit firms and audit partners; Companies should require external audit firms to rotate audit partners assigned to undertake external audit of the company from time to time to guarantee independence. Audit personnel should be regularly changed without compromising continuity of the external audit process;

External audit firms should be retained for no longer than ten (10) years continuously. External Audit firms disengaged after continuous service to company of ten (10) years may be re-appointed after another seven (7) years since their disengagement.

Companies and Allied Matter Act 1990 AS AMENDED (CAMA): The CAMA 1990 as amended provides numerous provisions for auditing practices and auditor independence in Nigeria. CAMA provides for the appointment, qualification, remuneration, rights, functions, powers, auditors' report, and removal of auditors and the establishment of an audit committee. These are provided in sections 357 to 369 in part XI of CAMA. However, the Registrar of Companies at the Corporate Affairs Commission (CAC) is to monitor compliance with these requirements and specify obsolete penalties in case of non-compliance. According to Okike and Adegbite (2012), CAMA (1990) is the main legal framework for corporate governance in Nigeria. Also, there is an overriding need to promote transparency in financial and non-financial reporting.

Section 357 of CAMA states that: every company shall at each annual general meeting appoint an auditor or auditors to audit the financial statements of the company, and to hold office from the conclusion of that, until the conclusion of the next, annual general meeting.

Section 359 state that the auditors of a company shall make a report to its members on the accounts examined by them, and on every balance sheet and profit and loss account, and on all group financial statements, copies of which are to be laid before the company in a general meeting during the auditors' tenure of office. The auditors' report shall state the matters set out in the Sixth Schedule to the Act. In addition to the report made under subsection (1) of this section, the auditor shall in the case of a public company also make a report to an audit committee which shall be established by the public company. The audit committee referred to in subsection (3) of this section, shall consist of an equal number of directors and representatives of the shareholders of the company (subject to a maximum number of six members) and shall examine the auditors' report and make recommendations thereon to the annual general meeting as it may think fit: Provided, however, that such member of the audit committee shall not be entitled to remuneration and shall be subject to re-election annually.

Section 361state that, the remuneration of the auditors of a company- in the case of an auditor appointed by the directors, may be fixed by the directors; or (b) shall, subject to the foregoing paragraph, be fixed by the company in general meeting or in such manner as the company in general meeting may determine. For the purposes of subsection (7) of this section, "remuneration" includes sums paid by the company in respect of the auditors' expenses. Although section 361 says the company in general meeting should fix the remuneration of auditors, but in practice they usually delegate that power back to the directors and that falls back to the Executive Management of the company who probably in the first place recommended the auditor to the Board and in turn to the general meeting. This may impair auditor independence.

It should be noted that the CAMA regrettably does not provide for joint audit or rotation of auditors. By virtue of S358 CAMA only chartered accountants can be appointed as auditors of companies.

The Financial Reporting Council of Nigeria: The Financial Reporting Council of Nigeria (FRC) is a unified independent regulatory body for Accounting, Auditing, Actuarial, Valuation and Corporate Governance practices in public and private sectors of the Nigerian economy. The body is also to address current institutional weaknesses in regulation, compliance and enforcement of Standards and the development of robust arrangements for monitoring and enforcing compliance with financial reporting standards in Nigeria.

The Financial Reporting Council (FRC) of Nigeria Act 2011 repealed the Nigerian Accounting Standards Board (NASB) Act of 2003, and created the Financial Reporting Council whose task shall be to: Protect investors and other stakeholders interest; Give guidance on issues relating to financial reporting and corporate governance; Ensure good corporate governance practices in the public and private sectors of the Nigerian economy; Ensure accuracy and reliability of financial reports and corporate disclosures; and, Harmonize activities of relevant professional and regulatory bodies as relating to Corporate Governance and Financial Reporting.

The FRC is empowered to *"enforce and approve enforcement of compliance with accounting, auditing, corporate governance and financial reporting standards in Nigeria"*. To this end, it is further empowered to: issue rules and guidelines for the purpose of implementing auditing and accounting standards; demand assessment of internal controls, including information system controls with independent attestation; require code of ethics for financial officers and certification of financial statements by Chief Executive Officer and Chief Financial Officer; and insist that entities provide real time disclosures on material changes in financial conditions or operations.

S. 8 (1) The Council shall: Develop or adopt and keep up-to-date auditing standards issued by relevant professional bodies and ensure consistency between the standards issued and the auditing standards and pronouncements of the International Auditing and Assurance Standards Board. Where the directors disclose the extent of compliance with Code of Corporate Governance in the annual report, require an auditor to report separately whether the disclosure is consistent with the requirements of the Code (Section 44(3)).

The Institute of Chartered Accountants of Nigeria (ICAN) and Association of National Accountants of Nigeria (ANAN): In Nigeria, there are two main professional accountancy bodies: The Institute of Chartered Accountants of Nigeria (ICAN) and the Association of National Accountants of Nigeria (ANAN). The two bodies are responsible for the production of professional accountants in Nigeria. The Federal Parliament Act No. 15 of 1965 gave ICAN charter status and a monopoly to regulate the accountancy profession in Nigeria and to make regulations governing disciplinary actions against erring members (ICAN Act 1965) before ANAN was approved by the Federal Government.

They are also involved in ensuring that members maintain high professional conduct in the discharge of their professional duties through continuing professional education programmes and ethical awareness.

Under the provisions of the ICAN Act 1965 the accounting and auditing profession is required to provide the necessary assurance of 'fairness in the conduct of banking businesses'. In addition, section 29(1) of the Banks and Other Financial Institutions Act 1991 (BOFIA 1991) provides that banks must annually appoint an 'approved auditor'

Global Development: The International Auditing and Assurance Standards Board (IAASB) is an independent standard-setting body that serves the public interest by setting high-quality international standards for auditing, quality control, review, other assurance, and related services, and by facilitating the convergence of international and national standards. In doing so, the IAASB enhances the quality and uniformity of practice throughout the world and strengthens public confidence in the global auditing and assurance profession.

Convergence of auditing standards is part of the International Federation of Accountants (IFAC) agenda. There was a proposed revision of standards on Review Engagements. This is to provide alternative in jurisdiction where audit for small companies are not mandatory. In response to the call for a separate auditing standard for Small and Medium Enterprises (SMEs), the IAASB recently issued an Audit Practice Alert regarding the audit of fair value accounting estimates under the current situation in the market where the level of uncertainty is very high.

International Forum of Independent Audit Regulators (IFIAR) serves the protection of public interest through enhancement of audit quality. The body shares knowledge of audit market environment and practical experience of independent audit regulatory activity. It provides the contact point for other international bodies which have interest on audit quality. It is now a global expectation that auditors of public interest entities are regulated by a body which is independent of the accounting profession. The acceptance of International Financial Reporting Standard (IFRS) in Nigeria is expected to enhance not only the quality of financial statements but also the audit of such statements.

In reaction to the decline of public trust in accounting and reporting practices, the US enacted the Sarbanes-Oxley Act of 2002 (also known as the Public Company Accounting Reform and Investor Protection Act of 2002 and commonly called SOX) which imposed stricter regulation on governance. Sarbanes–Oxley was named after sponsors U.S. Senator Paul Sarbanes (D-MD) and U.S. Representative Michael G. Oxley (R-OH). As a result of SOX, top management must individually certify the accuracy of financial information. In addition, penalties for fraudulent financial activity are much more severe. Also, SOX increased the oversight role of boards of directors and the independence of the outside auditors who review the accuracy of corporate financial statements. The bill, which contains eleven sections, was enacted as a reaction to a number of major corporate and accounting scandals, including those affecting Enron, Tyco International, Adelphia, Peregrine Systems, and WorldCom. These scandals cost investors billions of dollars when the share prices of affected companies collapsed, and shook public confidence in the US securities markets.

The Sarbanes-Oxley Act of 2002 (often shortened to SOX) is legislation passed by the U.S. Congress to protect shareholders and the general public from accounting errors and fraudulent practices in the enterprise, as well as improve the accuracy of corporate disclosures. The U.S. Securities and Exchange Commission (SEC) administers the act, which sets deadlines for compliance and publishes rules on requirements.

Title II of the act (Independence of Auditor) consists of nine sections and establishes standards for external auditor independence, to limit conflicts of interest. It also addresses new auditor appointment requirements, audit partner rotation, and auditor reporting requirements. It restricts auditing companies from providing non-audit services (e.g., consulting) for the same clients.

On one hand, in furtherance of the requirements of Section 201 of the Sarbanes Oxley Act of 2002, the American Securities and Exchange Commission adopted final rules prohibiting accounting firms from providing non-audit services to their audit clients that are SEC reporting companies. The prohibition of specified non-audit services is predicated on three basic principles; (i) an auditor cannot function in the role of management; (ii) an auditor cannot audit its own work; and (iii) an auditor cannot serve in an advocacy role for its client.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C.78j–1), as amended by this Act, is amended by adding at the end the following: Audit Partner Rotation—It shall be unlawful for a registered public accounting firm to provide audit services to an issuer if the lead (or coordinating) audit partner (having primary responsibility for the audit), or the audit partner responsible for reviewing the audit, has performed audit services for that issuer in each of the 5 previous fiscal years of that issuer.''

Section 10A of the Securities Exchange Act of 1934 (Sec 204), as amended by this Act, is amended by adding at the end the following: Reports to Audit Committees—Each registered public accounting firm that performs for any issuer any audit required by this title shall timely report to the audit committee of the issuer such as all critical accounting policies and practices to be used; all alternative treatments of financial information within generally accepted accounting principles that have been discussed with management officials of the issuer, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the registered public accounting firm; and other material written communications between the registered public accounting firm and the management of the issuer, such as any management letter or schedule of unadjusted differences.''.

Critique of Auditor Independence Regulations in Nigeria

i. Appointment of External Auditor

Following the specification of CAMA, the shareholders are responsible for the appointment of the external auditors, but in practice, this had been breached, posing threat to the independence of auditors. The professional auditors are guided by the Institute of Chartered Accountants of Nigeria (ICAN) and Security and Exchange Commission. The Institute should promote the dignity of its members by making the appointment of external auditors less dependent on the executive directors and more dependent on the non-executive directors, audit committees and shareholders.

ii. Remuneration of External Auditor

Companies and Allied Matters Act (1990) as amended; specified that auditor should be remunerated by persons who appointed him or her. However, in practice, there is consistent breach of this code as the auditor is remunerated by management which practically would impair auditor independence. Regulators should also consider reviewing the basis for charging auditor fees in term of the characteristics and risks peculiar to audit clients. According to Idigbe (2007), although section 361 says the company in general meeting should fix the remuneration of auditors in fact they usually delegate that power back to the directors and that falls back to the Executive Management of the company who probably in the first place recommended the auditor to the Board and in turn to the general meeting. The parlance is that he who pays the piper dictates the tune.

iii. Rotation of External Auditor

There exists only partial agreement between the codes of Central Bank of Nigeria and Security and Exchange Commission on rotation of auditor (10 years), but they disagreed on the period which an audit firm could be re-appointed. The CBN code specified reappointment after another 10 years while the SEC code stated 7 years for re-appointment after disengagement. There is the need for these regulators to align on this all important issue. Prolonged service of audit firm has been found as a contributor to decline in auditor independence in Nigeria, leading to collaboration with the management of companies in perpetrating falsifications (Bakre, 2007).

iv. Independence of Internal auditors

Section 8.1.1 of the Central Bank of Nigeria code provides for internal auditors to be largely independent while section 8.15 of the Security and Exchange Commission code places a limitation on the independence of the internal audit. Where the divergent codes exist on an important matter of this nature, the management would take advantage of the loopholes and frustrate the independence of the internal auditor. There is need to review the legislations to clarify the roles and powers of each regulatory body to ensure uniformity of codes.

v. Ineffectiveness of Whistle blowing in Nigeria

At the time of this report, the only form of protection for whistle-blowers could be found in S.39 (1) of the Economic Financial Crimes Commission (Establishment) Act 2004 and S.64 (1) Independent Corrupt Practices and other Related Offences Act 2000. There is no specific legislation that directly deals with whistle blowing.

The fear of victimisation and weak institutional power had kept many potential whistle blowers from speaking up against corporate malpractices. People tend to maintain the silent culture even when there is an obvious malpractice being perpetrated by the board or other prominent stakeholders. There should be structures put in place for protection of whistle blowers. Nigerian National Assembly should not delay any further to pass the Whistle-blowers Protection Bill and enforce its implementation to curtail corrupt practices capable of inhibiting their well-being. This would serve as a framework for promoting good corporate governance practice in Nigeria.

vi. Auditor's reporting Independence

The same regulation that empowered the whistle blowers is capable of strengthening the auditor in exercising his / her reporting independence. This would also encourage the auditors to be both independent in fact and in appearance. This way, auditor's ability to reveal to the public any information believed should be disclosed would become more pronounced and compromise of independence would be minimal.

vii. Negligence on the Part of Audit Regulators and External Auditors in Nigeria

The collapse of major companies in Nigeria, especially Banks was largely due to window dressing of their reports thereby concealing outrageous malpractices in the company. This practice weakened the quality of earnings of companies listed on the floor of the Nigerian stock Exchange. It was also partly blamed on auditors as revealed in the study of Bakre (2007) and Oluwagbuyi & Olowolaju (2010). Auditors had been indicted of deliberate falsification and overstating the profit of organisations. Audit regulators relied on those reports without detecting their catastrophic effects, not only on the companies but also on the Nigerian capital market in general. Laxity on the part of the regulators to detect window dressed and fraudulent reports of companies further aggravates this problem and negatively affects the earnings quality. Regulators in Nigeria should create more stringent regulatory procedures to detect fraud, mete out appropriate disciplinary measure and well as penalise companies and audit firms for erring.

In addition, there is no provision in CAMA restricting the involvement of the auditor with the company. The only penal provisions are section 368 which imposes a duty to exercise such care diligence and skill reasonably necessary in performance of auditor and section 369 which imposes criminal sanctions on those who supply false statement to the auditor. The result is that auditors become over involved with companies, doing management consultancy and tax. They also offer human resources consultancy work for the very company they audit. They therefore lose their independence and professionalism in preparing their auditors report (Idigbe, 2007).

viii. Absence of Unified Code of Corporate Governance in Nigeria

Idornigie (2010) disclosed that Nigeria has multiplicity of codes of corporate governance with distinctive dissimilarities namely; one, Security and Exchanged Commission (SEC) code of corporate governance 2003 addressed to public companies listed in the Nigeria Stock Exchange (NSE); two, Central Bank of Nigeria (CBN) Code 2006 for banks established under the provision of the bank and other financial institution ACT (BOFIA); three, National Insurance Commission (NAICOM) Code 2009, directed at all insurance, reinsurance, broking and loss adjusting companies in Nigeria; four, Pension Commission (PENCOM) Code 2008, for all licensed pension operators.

Since 2011, when the Financial Reporting Council of Nigeria was created, the Council has been primarily saddled with the responsibility of issuing codes of Corporate Governance in Nigeria. Disparities in the provisions of the key element of firm-level governance arising from the proliferation of codes of corporate governance including Security and Exchange Commission Code, Central Bank of Nigeria code, Pension Commission and National Insurance Commission codes respectively impact negatively of the activities on both the audit committee as well as external auditors. Demaki, (2011) found that disparities in the provisions of the key element of firm-level governance arising from the proliferation of codes of corporate governance in Nigeria, namely, SEC code (2003), CBN code (2006), PENCOM code 2008, and NAICOM Code 2009 respectively impact negatively on the economy.

The FRCN should ensure continuous review of company codes of corporate governance which encompasses audit committee and external auditor activities. This would go a long way in sustaining investor's confidence and also serve as benchmark for monitoring and implementing corporate policies and practices at firm –level.

ix. Proliferation of Accounting Professional Bodies and Decline in Ethics

The more accountancy bodies in existence in Nigeria, the more divergent codes on auditor independence. Such a situation would be extremely unhealthy in achieving auditor independence. Also, the profession had witnessed a decline in ethics as found by Adeyemi and Fagbemi (2011). Harmonisation of the multiplicity of corporate governance codes and accounting professional bodies in Nigeria by Financial Reporting Council of Nigeria, is a pre-requisite for promoting auditor independence among external auditors.

x. Weak Code of Conduct in Nigeria

The weakness of the codes of conduct for Nigerian companies had been partly responsible for the huge financial crisis in Nigerian Stock Market as established by (Wilson 2006). CBN (2006) reported that despite the significance of good corporate governance to national economic development and growth, corporate governance was still at a rudimentary stage as only 40% of publicly quoted companies, including banks had recognized corporate governance in place. There is need to employ measures for strengthening the company codes as well as the existing committees, especially, the audit committee, in order to forestall good performance and hence better quality of earnings. Campaign against insider dealing, share price manipulation and other similar practices should continue. This will forestall the confidence of stakeholders and enhance the independence of auditor.

As observed by Aina and Adejugbe (2015), the informal nature of most businesses and the high level of government ownership in Nigeria pose challenges to the practice of corporate governance. As a result of the weak corporate culture in these institutions, Nigeria witnesses a very high incidence of corporate failures (Komolafe, 2007). The Securities Exchange Commission Code (SEC CODE) and other codes are complimentary to Companies and allied Matters Act 2004 (CAMA).

Conclusion

The study assessed the effectiveness of the Institutional Regulatory Framework of Auditor Independence in Nigeria such as The Securities and Exchange Commission (SEC); Companies and Allied Matter Act 2004 as amended (CAMA); the Financial Reporting Council of Nigeria (FCN); The Institute of Chartered Accountants of Nigeria (ICAN) and Association of National Accountants of Nigeria (ANAN) and global regulatory framework. In the light of the weakness identified in the study, the following recommendations are suggested. First, harmonisation of the multiplicity of corporate governance codes and accounting professional bodies in Nigeria by Financial Reporting Council of Nigeria is a pre-requisite for promoting auditor independence among external auditors. Second, campaign against insider dealing, share price manipulation and other similar practices should continue. This will forestall the confidence of stakeholders and enhance the independence of auditor. Third, regulators in Nigeria should create more stringent regulatory procedures to detect fraud, mete out appropriate disciplinary measure as well as penalise companies and audit firms for erring. Four, the accountancy professional body (ICAN) should promote the dignity of its members by making the appointment of external auditors less dependent on the executive directors and more dependent on the non-executive directors, audit committees and shareholders.

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