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Relevance of Audit Report in Nigeria Financial Institutions

(A Study of Selected Banks in Nigeria)

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Abstract

This study focuses on the relevance of audit report in financial institution of selected commercial banks in Nigeria, it is a survey research based on primary data, and this data were obtained by distribution of One hundred and fifty (150) copies of questionnaire to five selected commercial banks. The Banks were selected using Purposive sampling method. The Data obtained from the questionnaire were analysed using Frequency tables and Chi-square statistical tool, and the result of the analysis show that there is significant relationship between monitoring mechanism used in most of the quoted commercial banks and the performance of the commercial banks, based on this analysis the study recommend that management of the selected commercial banks must ensure whatever monitoring mechanism chosen by the bank are careful scrutinize so that banks performance would not be affected, since both variables have direct influence on each other.

Keyword: Audit report, monitoring mechanism, financial report, transparency, accountability.

1. Introduction

Over the years various researches related to auditor's report has shown that standard auditors' reports vary across political boundaries, infact both the U.S. and International auditing standard setters continue to express concerns about the content and usefulness of these reports (American Institute of Certified Public Accountants (AICPA) and International Auditing and Assurance Standards Board (IAASB) 2006. Recently, the Chattered Financial Analyst published a report, titled Independent Auditor's Report Survey Results, which summarizes financial analysts' opinions on several questions regarding the auditor's report (CFA 2010), according to the survey only 37 percent of respondents indicate they believe the current auditor's report contains "the right amount of information, this indicate that most stakeholders do not place much importance on the content of the audit report. Furthermore, the demise of high profile corporate organisations and unending scandals in the corporate world have attracted so much attention and intensified debate on the efficacy of auditor's report as a mechanisms and means of improving financial decision of quoted companies. Nigeria like other countries of the world also witnessed corporate scandals and failures. These scandal affected banks like Oceanic Bank, Societe Generale Bank, Savannah Bank to mention a few and this banks were regularly audited by reputable audit firm with sufficient auditors endorsement, but yet, they still failed to survive. According to Boyne and Law (1991) the auditor's report is a vehicle for discharging accountability. Auditor's report usually reduce the firm's cost of capital, but only if they are credible and not self-serving. They further explained that problem in the audit report usually arise if the audit firm withhold or manipulate information in certain situations. This is because the publication of information imposes both direct and indirect costs on the disclosing firm. Besides, the cost of collecting, processing, communicating, auditing the information to be published, and the position of the audit firm may be damaged when information published is used by competitors or by governmental agencies, trade unions, clients or suppliers against the company. Nevertheless, these costs may be partially or totally off-set by the benefits accrued to the company when audit report satisfies stakeholders' demand for information (Kantudu, 2005). Research has shown the existence of a negative relationship between auditor's report and the cost of capital or the ability of the company to raise funds from the capital market (Leuz and Verrechia, 2000). But companies seem to perceive the existence of an important improvement in their image when it discloses voluntary information in its audit report(Gray and Roberts, 1989). Hence, when left unregulated the balance between costs and benefits linked to the provision of information, may represent a key factor in deciding whether or not to disclose voluntary information.

The financial reports are true and fair, and conform to the relevant rules and regulations; and the actual transactions, when the credibility of the financial information can be verified. Auditors on their part are expected to be independent and objective in the discharge of their responsibilities (Adelaja, 2009), because the report of external auditors in corporate financial statement is seen as providing key assurance and protecting the interest of shareholders (Gallegos, 2004). However, as O'Connor (2006) noted, one of the most vexing problems in the financial world today is the emphasis placed on ensuring the independence of external auditors as a result of recent corporate Scandals. Beatties and Fearnley (2002) opined that after the collapse of Enron it was generally believed that rendering of non-audit services compromised the independence of external auditors. In the real world, when business entities collapse the consequences are usually enormous. The oversight function of the auditor is placed under scrutiny when a business whose financial statement once showed no indication of any failure suddenly becomes bankrupt. As a follow up to the oversight function, the independence of the auditor in such circumstance would be in doubt.

2. Statement of Problem

The occurrence of a number of financial scandal in recent times has contributed to poor performance of many of the quoted companies in Nigeria. More–often- than-not companies involved in this financial scandal are usually being audited by reputable audit firm, who are well respected for their professional opinion and the well prepared audit report. This situation has made most investors to lose confidence in the audit report prepared by the auditors. This problem of this study is to examine why highly respected audit firms, still finds it difficult to ensure that audit reports prepared by them are always accurate and error free despite their years of experience in the field of auditing.

3. Objectives of the Study.

The main objectives of this study is to examine the relevance of audit report in Nigeria financial institutions, while the specific objectives are ;

- to ascertain if any relationship exist between monitoring mechanism and performance of business of the selected quoted banks in Nigeria.
- to Identify the relationship that exist between accountability of the auditor's report and performance of business of the selected quoted banks in Nigeria

4. Research Question

- Is there any relationship between monitoring mechanism and performance of the selected quoted banks in Nigeria?
- Does any relationship exist between accountability and performance of of the selected quoted banks in Nigeria?

5. Research Hypothesis

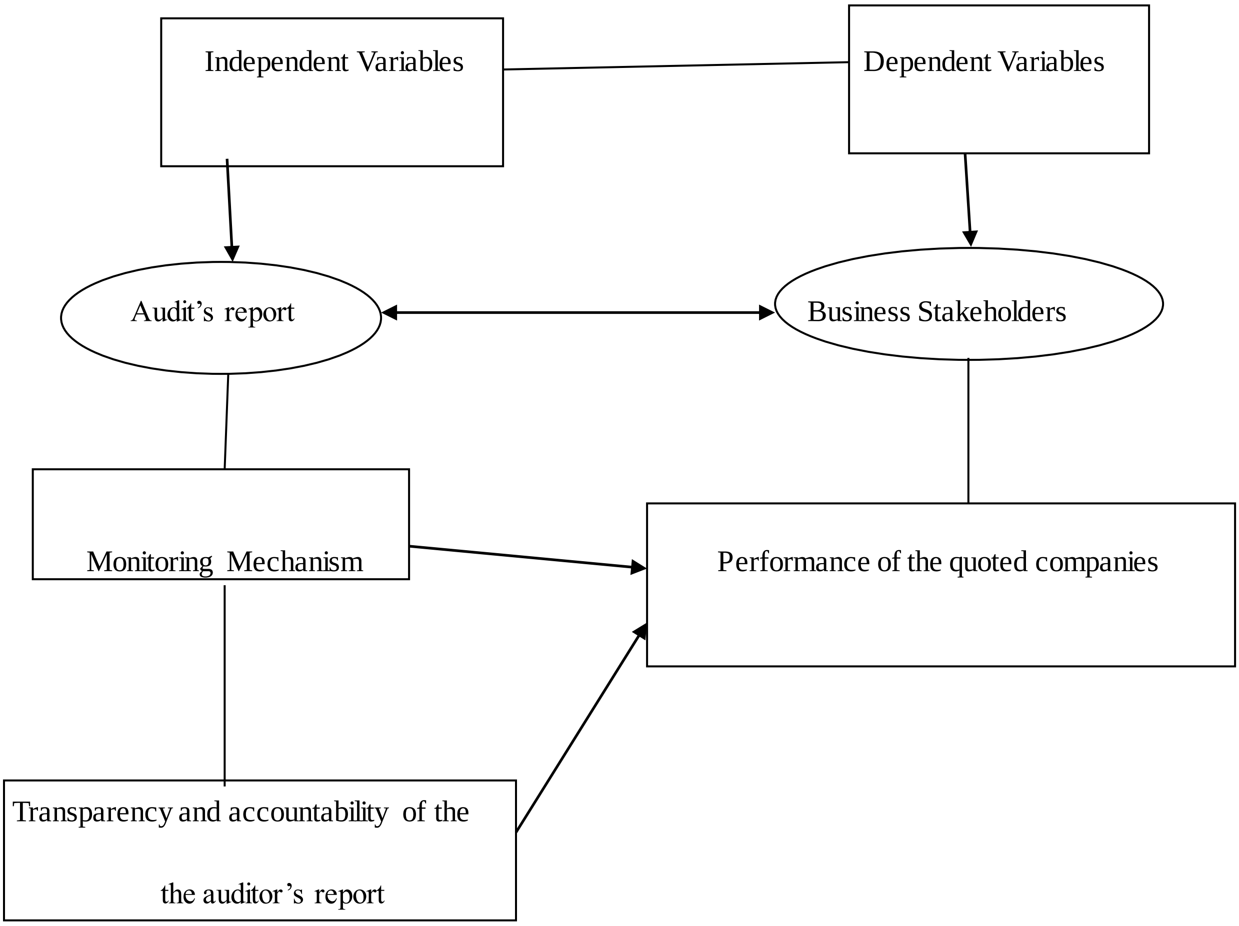
Ho_1: There is no relationship exist between monitoring mechanism and performance of selected quoted banks in Nigeria.

Ho_2 : There is no relationship between transparency/accountability and performance of the selected quoted banks in Nigeria.

6. Literature Review

7. Conceptual Framework

Fig. 2.1 Relationship between Dependent and Independent Variables.



Source: Diagram Conceptualised from literature Review.

8. Concept of Audit Report.

Marton and Shrives (1991) defines audit report as the most comprehensive document available to the public and therefore, the main disclosure vehicle. There are a number of factors that determines the quality of auditor's report as used by previous studies. One of the most arguable factors is the monitoring mechanism of the company, Fama and Jensen (1983) have argued that the credibility and transparency of auditor's report of a company depends on the effectiveness of the monitoring mechanism of the company itself. This has led researchers to examine the effects of several monitoring mechanisms such as board of directors, audit committees, internal audit and external audit to the financial reporting quality. Since the board of directors receives its authority for internal control and other decisions from stockholders of corporations, Beasley (1996) and Fama and Jensen (1983) claimed that the highest internal control and monitoring mechanism is the board of directors. Based on this fact, researchers have argued that board of directors has an effect on the quality of financial reporting.

9. Theoretical Framework

- **Stewardship Theory**

The explanation of stewardship theory was put forward by Donaldson and Davis (1989) according to them most managers have the tendency to act in the best interest of their firm, by emphasizing the collective goal of the organisation instead of their self serving option. Their finding further suggests that most stewards are motivated only by making the right decision which are usually in the best interest of the organisation, because of the strong assumption that stewards will also benefit from the right decision taken in the long run. Similarly, Davis, Schoorman and Donaldson (1997) define stewardship theory as the process where stewards protect and maximize shareholders wealth through improved firm's performance, because by doing so, the stewards recorgnise, that his utility function is maximized. This, stewardship theory refers more to the manager and chief executive as the main individual responsible for the stewardship function in the organisation. In another, definition, Block (1996) reported that the stewardship role is depicted with service to the firm over self interest, he further established that organisation and individual role can be easily achieved by honouring the stewardship relationship and treating followers like owners and partners. In extension of this theory, Caldwell and Karri(1990) was of the opinion that there is a covenant like duties owed to all stakeholders that have likelihood of understanding the importance of stewardship and the conditions of the environment. Stewardship, can best be described as the behaviour that consider that considers the long term interest of the organisation as well as that of the shareholders rather than the individual self interest.

Donaldson and Davis (1989) also argued that stewardship role ignores individualism, but place more attention to the manager and executive because, they are the major once responsible for playing the role of stewards by ensuring their interest is agreement with that of the organisation.

- **Contingency Theory**

Contingency theory is an approach to the study of organizational behavior in which explanations are given as to how contingent factors such as technology, culture and the external environment influence the design and function of organizations. The assumption underlying contingency theory is that no single type of organizational structure is equally applicable to all organizations. Rather, organizational effectiveness is dependent on a fit or match between the type of technology, environmental volatility, the size of the organization, the features of the organizational structure and its information system. Contingency theories were developed from the sociological functionalist theories of organization structure such as the structural approaches to organizational studies by (Woods, 2009). Contingency theory is used to describe the relationships between the context and structure of internal control effectiveness and organizational performance, especially reliability of financial reporting.

10. Empirical Framework

- **Relevance of Audit Compensation and Audit Quality**

Divergent views in literature depict that audit compensation/fees has a relationship with the financial reporting quality to some extent; in that, financial reporting quality usually affected fees paid to external auditors. For instance, quality may be decreased with fees if marginal forces associated with managerial influence overwhelm those associated with the scope of activities or reputational incentives. If these forces" relative ultimately reverse, then "financial reporting" quality can also share a positive relationship with compensation dependence over domains where this dependency is more considerable. For instance, Francis and Ke, (2003); Reynolds, and Francis, (2004) found that audit fee does have a negative relationship with earnings quality, and thus improve the quality of financial reporting. On the other hand, Gul et al., (2003) examines the relationship between audit fees and discretionary accruals in a sample of Australian and firms, their results show a positive association between financial reporting quality (discretionary accruals) and audit fees. They dispute the belief that audit fees erode independence. Audit fees are also used as a measure of audit quality; the perceptions of some researchers behind these studies is that audit fees reflect additional audit effort which leads to a higher level of audit quality (Carcello, Hermanson, Neal & Riley 2002)

11. Methodology

This study is a survey research that involves distribution of One hundred and fifty(150) questionnaire to various respondents in the selected Banks, but only one hundred and ten(110) was returned. These banks include Guaranty Trust Bank Plc, United Bank for Africa, Wema Bank Plc, First Bank of Nigeria Plc, Zenith Bank Plc and th were selected using the purposive sampling technique. The data generated from the questionnaire were then analysed using Frequency, percentages and Chi-square inferential statistical tool of SPSS(Statistical Package for Social Sciences (version 20)).

12. Model Specification

The study used the Chi –statistic model to analyse the data obtained, The formula for this model is as follows.

Chi Square formular $$X^2 = \frac{(O_i - E_i)^2}{E_i}$$

WHERE: O_i = the observed frequency
E_i = the expected frequency
X^2 = the value of the random variables

13. Data Analysis and Interpretation

- **Hypothesis testing and interpretation.**

Decision Rule: Decision Rule: Accept the Null hypothesis if Chi-square value calculated is lesser that Chi-square value tabulated, but, in a situation where the Chi-square value calculated is greater than the Chi-square value tabulated then the Alternate hypothesis will be accepted while the Null hypothesis will be rejected.

Hypothesis Testing

Ho_1: There is no relationship between monitoring mechanism and the performance of quoted companies.

Table 1. Monitoring mechanism chosen by the organisation improves the performance of the quoted companies.

		Frequency	Valid Percent	Cumulative Percent
Valid	Strongly agreed	69	62.7	62.7
	Agreed	7	6.4	69.1
	Undecided	1	.9	70.0
	Disagreed	19	17.3	87.3
	Strongly Disagreed	14	12.7	100.0
	Total	110	100.0	

Source: Field Survey, 2017

Table 2. Monitoring mechanism chosen by the organisation improves the performance of the quoted companies.

	Observed N	Expected N	Residual
Strongly Agreed	69	22.0	47.0
Agreed	7	22.0	-15.0
Undecided	1	22.0	-21.0
Disagreed	19	22.0	-3.0
Strongly Disagreed	14	22.0	-8.0
Total	110		

Source: Field Survey, 2017

Table 6. **Chi-Square Test Statistics**

	Monitoring mechanism chosen by the organisation improves the performance of the quoted companies.

Chi-Square	134.000[a]
Df	4
Asymp. Sig.	.000

a. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 22.0.

Calculated Chi-square (X^2 C)= 134.000

Tabulated Chi-square (X^2 T)= 9.488

Level of Significance=5%

Degree of freedom(df)= 4

From the above analyses, it can be observed that the calculated chi-square value (X^2C) of 134.000 for each of the variables under this hypothesis is greater than the tabulated chi-square (X^2T) of 9.488 at 0.05 level of significance, at a degree of freedom of 4 respectively. Hence, the Null hypothesis will be rejected. while the Alternate Hypothesis will be accepted, which implies that Monitoring mechanism chosen by the organisation has significant relationship with the performance of the selected quoted banks.

Ho_2: There is no relationship between transparency/accountability of auditor's report and performance of the selected banks.

Table 4. Transparency/accountability of auditor's report contributes significantly to the performance of the selected quoted companies.

		Frequency	Valid Percent	Cumulative Percent
Valid	Strongly agreed	57	51.8	51.8
	Agreed	13	11.8	63.6
	Undecided	1	.9	64.5
	Disagreed	17	15.5	80.0
	Strongly Disagreed	22	20.0	100.0
	Total	110	100.0	

Source: Field Survey, 2017.

Table 5. Transparency/accountability contributes significantly to the performance of the selected quoted companies.

	Observed N	Expected N	Residual
Strongly Agreed	57	22.0	35.0
Agreed	13	22.0	-9.0
Undecided	1	22.0	-21.0
Disagreed	17	22.0	-5.0
Strongly Disagreed	22	22.0	.0
Total	110		

Table 6. Chi-Square Test Statistics

	Transparency/accountability of the auditor's report contributes significantly to the performance of the selected quoted companies.
Chi-Square	80.545[a]
Df	4
Asymp. Sig.	.000

a. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 22.0.

Calculated Chi-square (X^2 C)= 80.545
Tabulated Chi-square (X^2 T)= 9.488
Level of Significance=5%
Degree of freedom(df)= 4
Interpretation of result
From the above analyses, it can be observed that the calculated chi-square value (X^2C) of 80.545 for each of the variables under this hypothesis is greater than the tabulated chi-square (X^2T) of 9.488 at 0.05 level of significance, at a degree of freedom of 4. Hence, the Null hypothesis will be rejected. while the Alternate Hypothesis will be accepted, which implies that transparency and accountability in the audit report affect the performance of the quoted companies.

14. Discussion of Findings

The finding of this research work indicates that there is significant relationship between monitoring mechanism and the performance of the selected quoted banks, because the chi-square calculated(i.e.134.000) was greater the chi-square tabulated(i.e.9.488). The findings also emphasises that there is positive relationship between the transparency and accountability of the auditor's report and the performance of the selected quoted banks, because the chi-square calculated(80.545) was greater the chi-square tabulated(9.488)

15. Conclusions and Recommendations

Both prior research and the findings of this study indicate that the expectation gap of most stakeholders is still significant. However, the selected respondents provide some new perspectives on the expectation gap. One critical finding of our research is the lack of consensus as to what is the intended communication of the auditor's report. Even the participating auditors have difficulty describing and agreeing on the intended communication of the auditor's report. Furthermore, the stakeholders provided rich discussions on their perceptions regarding the auditor's report concepts, their experiences on using the reports, and their suggestions about possible improvements to the reports. The stakeholders also provided concerns associated with those suggestions. The study recommended that before any of the responses provided by the respondents is implemented, it is necessary to understand the possible risk factors, because any change to the auditor's report will usually have some risk associated to them. Stakeholders, are also advised not to place all the confidence on the auditor's report because, they may be issue relating to auditor's independence in the course of the audit work. The auditors should also make an effort to ensure that the level of materiality attached to the auditor's report is fully disclose in the auditor's report.

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