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AUDIT PRACTICES IN THE NIGERIAN BANKING SECTOR: ARE THERE SIGNIFICANT DIFFERENCES AFTER THE ADOPTION OF 2011 CORPORATE GOVERNANCE CODES FOR BANKS?

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ABSTRACT

This study examines if significant differences exist in auditing practice in the Nigerian banking sector given the adoption of the Central Bank of Nigeria code of corporate governance for banks in 2006. Data used in the analysis were picked from the annual report and accounts of sampled banks in Nigeria. The pairwise t-test was used to test for significance differences in choice variables including composition of the audit committee and audit quality. The use of the pairwise t-test resulted in delaminating the periods into periods before adoption of the code of corporate governance and period after the adoption of the code of corporate governance for banks. Findings resulting from the significance of the t-test statistics reveals that significant differences exist in composition of the audit committee and audit quality for some banks in Nigeria. This implies that the adoption of the CBN code of corporate governance for banks have improved auditing (internal and external) practices in the Nigerian banking industry. However, there should be improved efforts by the regulatory agencies in the banking industry in ascertain the level of compliance of individual banks in Nigeria to the code of corporate governance as regards to the auditing practices. This is to determine the banks that comply and the ones that fail to comply so that erring banking firms can be sanctioned adequately.

Key Words:

INTRODUCTION

In current periods, series of made known cases of accounting indecencies in Nigeria has taken the devotion of stockholders and watchdogs alike (Semiu and Temitope, 2010). Such indecencies are testified in relation to NAMPAK, Springbank, Finbank, and Wema Bank in Nigeria. Consequently, concerted efforts have been geared to enhancing and solidify the independence of various stakeholders (board of directors, shareholders, auditors, CEOs, MDs etc) of a firm. In business world as regards a firm is seen as a link between stakeholders, owners, managers, board of directors, employees, government, regulators and general public. The term firm seeks to satisfy the ego of all these stake holders and continue to exist. Corporate governance has been devised to enhance and strengthen the independence of various stakeholders of a firm and involves structure, system decisions, restrictions and mechanisms that put in place to balance the yearning and expectation of firm stake holders. Good governance has eight main characteristics, they are as follows: Accountability, transparency, participatory, agreement oriented, approachable, effective and efficiency, equitable as well as rule of law.

The typical agency standpoint that separates corporate managers from external stakeholders involves an intrinsic skirmish. Corporate regulator apparatuses are the ways by which managers are well-ordered to perform in the interest of investors. Adeniyi (2012) refers to internal control arrangement as the complete control system, financial or else, established in demand to transmit the enterprise management's policies, protect the asset and secure as much as imaginable the fullness and exactness of the rewards. Corporate governance control systems include both internal and external. The internal systems could be viewed as managerial incentive plans, executive monitoring, local auditor, and the audit group. The external systems include external shareholders or debt holding monitoring, and the external auditor. These corporate governance control mechanisms try to put in place systems to eliminate perceived agency delinquent inherent in the divorce between firm ownership and management, and also enhances reliable, high quality financial reporting.

A segment of the corporate governance principles hinges on internal and external control mechanisms which largely centers on auditing practices and perceived quality of audited financial reports of the firm. Auditing has been upbeat in improving audit quality. This has been done by dispensing standards fixated on discovery and independence (Ricchiute, 1998; IFAC, 2009 in Semiu and Temitope, 2010). Local control system is the charge of the group of directors and audit committee and is liquidated using the assistance of internal auditors and audit committees, and completed by the opinion of the outer auditor. Thus, the objective of an the external auditor in respect of internal control is to express a proficient view on the impartiality of the presented financial reports in all material respects toeing the line of GAAP. Investors outside the firm rely on financial statements to make economic decisions and in this regards the audit affords assurance, lessens uncertainty, risk and misstatement instigated by any error or fraud.

Decent business management by groups of directors is known to stimulate excellent financial reporting that engenders an significant influence on investor confidence (Levitt, 2000). Traditionally, outer auditor plays an imperative part in strengthening the integrity of financial data (Wallace, 1980 in Semiu and Temitope, 2010, Mautz and Sharaf, 1961). The consequence of thorough management practices on the eminence of financial reportage has freshly gained devotion from researchers, predominantly in the United States (Beasley, Carcello, & Hermanson, 2000; Abbott, Park, & Parker, 2000, McMullen, 1996). The key aim of such studies is the link amongst audit groups and deceitful financial reporting, with outputs commonly supportive of an inverse relationship. While these fallouts give indication from a robust and classy capital market atmosphere, small research has been steered in countries where capital markets are not advanced and where management processes are still sprouting. However, thorough business management practices are relevant in countries that are struggling to obtain trustworthiness among universal investors. Thus, this work studies the implications of corporate governance on audit practice in Nigeria in a highly regulated banking sector of Nigeria. Specifically, the study examines if significant differences exist in auditing system in the Nigerian banking segment given the adoption of the Central Bank of Nigeria (CBN) code of business management for banks in 2006.

REVIEW OF RELATED LITERATURE

Conceptual Review

Given the consequences and the aftermath of the 2004 bank consolidation exercise, the CBN identified lack of good corporate governance for underperformance of banks in Nigeria and hence the enactment of a code of corporate governance for banks in Nigeria in 2006. Corporate governance has no sole acknowledged concept. This is often ascribed to the enormous variances in nation-states corporate governance codes (Solomon 2010). The definitions differ founded on the frame work and cultural circumstances of the country under contemplation (Armstrong and Sweeny, 2002). Corporate governance came into use in the 1980s to approximately define “the general principles by which business and management of companies were directed and controlled” (Doetal, 2011). O' Donovan (2003) perceive corporate governance as “an internal system encompassing policies, processes and people which serve the needs of shareholders and other stakeholders by directing and controlling management activities with good business survey, objectivity and integrity” which means that it describes the moral, legal and ethical significance of a company to the protection of its stakeholders interest. Ahmed, Alam, Jafer and Zana (2008) stated that the objective of corporate governance is to guarantee that corporations/ banks are managed in the finest interest of the economy and proprietors. Ogbechie (2011) stated that corporate governance is predominantly imperative to banking industry in Nigeria because a number of financial letdowns, deceptions and doubtful business practices had harmfully affected investor's sureness. Ogbechie (2011) further stated that the financial fitness and performance of banks are significant for the country's economic growth. Thus, the principle of corporate governance of a corporation is to establish clarity all over an organization by the power division and tasks between the shareholders, executive management and the auditor.

Theoretical Framework

Corporate governance studies are influenced mainly by the agency theory traceable to the breakthrough job of Adam Smith in 1776 known as the *The Wealth of Nations* that proposed that ―an administrator with no absolute proprietorship of a corporation would not make the exact choices, nor exert the similar care as would a proprietor. This opinion is dependable with the Jensen and Meckling (1976) propagation of agency theory. The theory contends that where there is departure between management and proprietorship, the manager pursues self-interest that may not always be in the finest welfares of the proprietor. This certainly departs from those obligatory to optimize the returns of the shareholder. Agency problem can take dissimilar forms such as unfavourable selection and moral danger (Eisenhardt, 1989). Harmful selection can take place if the agent distorts his capacity to do the works allocated and gets selected as an agent. Such agent's poor performance, although acting to the principal's benefit, will cause a residual cost to the principal (Jensen and Meckling, 1976). The charges, arising from sub-prime act by agents are dubbed agency costs. To alleviate the cost of the agency, a principal is anticipated to create regulating procedures to frequently check on agent's conduct and outcomes of the performance (Jensen and Meckling, 1976; Fama, 1980). These established controls and reporting processes could be referred to as corporate governance. This theory has enthused several governance investigations and the embracing of numerous corporate governance values and codes in several countries.

Agency theory denotes a set of proposals in leading a contemporary corporation which is is a characteristic of divorce between proprietorship and management to control and direct the use of their joint capital for forthcoming improvements. Management typically, may not always own shares but may own pertinent expert skills in handling the business. The theory proposes many valuable ways to scrutinize the relationship between owners and managers and confirm if the ultimate aim of optimizing the owners' earnings is attained. Jensen and Meckling (1976) recognize managers as the agents working to maximize the returns to the shareholders, who are the principals. Thus, the potential for such agency problems should be minimized (Fama and Jensen, 1983). This becomes the essence of governance principles and as prescribed for deposit money banks in Nigeria.

Empirical Review

James (2012) examined the importance of local auditors in Nigerian banking sector in using interview led with twenty three local auditors in nine (9) deposit money banks. The interview was organized around 10 questions obtained from Literature, local audit guide of two banks, corporate governance manual of CBN and that of Security and Exchange Commission (SEC). Results exposed that mainstream of local auditors contemplate organization as most vital driver of corporate governance.

Semiu and Temitope (2010) give proof on corporate governance, audit quality, and firm associated qualities from advancing country, Nigeria with the aid of logistic regression approach. Findings reveal that possession by non-executive principals has the likelihood of swelling the auditing quality. Proof shows that business leverage and company size are imperative elements in quality of audit. The study further advocates that the constitution of non-executive principals as board members should be continued and upgraded to boost audit excellence.

Ilaboya and Iyafekhe (2014) studied the influence of board size, audit firm type, board independence, audit committee size, firm size and audit committee independence on audit report interval employing time series and cross-sectional study statistical information covering 5 years from 2007 to 2011 while applying regression analysis based on Ordinary Least Square (OLS). Ilaboya and Iyafekhe (2014) indicated that firm size, board size and audit firm type had a considering effect while audit committee size and board independence had no meaningful effect on audit report interval.

Theofanis, George, Evaggelos and Ioannis (2010) investigated tentatively the role of local auditing to corporate management. More so, they studied the relationship between various corporate management elements, such as the local audit process, the audit committee, board of directors, and the external auditor. Via an long-drawn-out literature appraisal, the study's ingenuity is the provision of an unified conceptual structure regarding business corporate management and internal audit. The results of their literature review indicate that internal auditing performs an imperative function in active corporate management.

Fatimah and Sherliza (2012) studied the relationship among audit committee proficiency and internal audit roles' features, with audit quality, which is captured by using audit fee.

Applying openly obtainable data of 200 Malaysian registered companies for both 2009 and 2010, Fatimah and Sherliza (2012) recorded a clear link between external audit fee and two (2) of the audit committee features. Further, a clear link was found between external audit fee and a feature of the internal audit role, which is the dimension of the internal audit role.

Dennis, Michael, and Nicole (2013) examined empirically the audit fees-governance systems nexus employing data from German listed companies. Using different model specifications controlling for possible endogeneity of the governance variables, (Dennis, et al., 2013) identified two major findings. That function-based management payment has a meaningful and clear influence on audit fees, and a corresponding nexus between audit fees and the audit committee formation.

The review of the empirical literature above used various corporate governance indices to determine effect or relationships with auditing in various inter country analysis. This study deviates from the above and examined if there are significant differences in auditing practice for the Nigerian banking sector given the use of a code of corporate management for banks in Nigeria using the pairwise t-test statistics. The essence is to determine the implication of corporate management on auditing practice in Nigeria. This is the gap filled by this study.

METHODOLOGY

The study adopts the *ex-post facto* research design as it relied on historic data obtained from the annual financial declarations and reports of appraised quoted Nigerian deposit money banks. Due to the need for obtainability, dependability and data accuracy, eleven (11) quoted deposit money banks were sampled. In testing the hypotheses, the parametric statistical combined variance/ paired sample t-test was adopted in line with the studies of Adegbaju and Olokoyo (2008) and Sanni (2009). The paired sample t-test has the advantage of determining whether significant differences exist in audit committee composition and audit quality of banks before and after the adoption of the corporate management code for banks. This results in creating two samples of pre (years 2000, 2001, 2002, 2003, 2004, 2005 and 2006) and post of (years 2007, 2008, 2009, 2010, 2011, 2013 and 2014).

stated thus; $t\ n_1 + n_2 - 2 = \dfrac{X_1 - X_2}{S\,(X_1 - X_2)}$

Where; $X_1 =$ Sample mean value of the specified variable in the pre-Corporate Governance Code period. $X_2 =$ " " " " " " " post- " " " period.

$S\,(X_1 - X_2)$ = the standard deviation of the change from the combined variance and thus estimated as:

$$S\,(X_1 - X_2) = \sqrt{S^2P}$$

$$= \sqrt{S^2_{X1} - S^2_{X2}}$$

$$= \sqrt{\frac{(n_1 - 1)\,S^2 + (n_2 - 2)S^2}{n1 + n2 - 2}}$$

$$S^2P = \frac{(n_1 - 1)\,S^2 + (n_2 - 2)S^2}{n_1 + n_2 - 2}$$

Where;

$S\,(X_1 - X_2)$ = Population standard deviation.

S^2_{x1} = Sample variance value of variable in the pre- Corporate GovernanceCode period. S^2_{x2} " " " " " post- " " " period. n_1 = Sample size of the pre- Corporate Governance Code period.

n_2 = " " post- " " ,,

$n_1 + n_2 - 2$ = Degree of freedom.

S^2P = Pooled variance of the two samples

Definition of variables

Composition of the Audit Committee: This is a dichotomous variable, assigned 1 if there are at three minimum non – decision-making directors on the audit group, and 0 if otherwise0.

Audit Quality: This is dichotomous in description and the audit firm size (Big four or non-Big four) was used as a stand-in for audit quality and equals 1 if the external auditor of a deposit money bank in Nigeria is among the Big four (Deloitte, Ernst and Young, PriceWater Coopers and KPMG) and 0 if otherwise.

FINDINGS

The result of the t-test for composition of audit committee and audit quality are as presented in table 1.

Table 1: Paired Samples Test for **Composition of Audit Committee (CAC) and Audit Quality**

	Paired Differences					T	df	Sig. (2-tailed)
	Mean	Std. Deviation	Std. Error Mean	95% Confidence Gap of the Difference				
				Lower	Upper			
Pair 1 CACpre – CACpost	.85714	.37796	.14286	.50758	1.20670	6.000	6	.001
Pair 2 AUDITQpre - AUDITQpost	.71429	.48795	.18443	.26301	1.16556	3.873	6	.008

Source: Author's SPSS Version 17.0 Computation

The pairwise t-tests shows that there exist significant differences in means of the variables as the 2-tailed significance < 0.05 significance value and hence reveals that significant differences exist in configuration of the audit committee and audit quality variables for the sampled banks. This implies that the use of the CBN system of corporate management for banks have improved audit (internal and external) practices of deposit money banks in Nigerian.

CONCLUSION

The era of post code of corporate governance has brought a clear and better understanding ways to guide the banking industry in Nigeria. This can be professed in terms of organizational structure, data integrity and disclosure necessities, excellence of industry transparency management, reporting relationship, due process, better risk administration, character of auditors both internal and external as well as the audit group functions. Thus, thorough corporate management practices are vital in countries endeavoring to advance trustworthiness among global investors. This is predominantly so in Nigeria. This study examined the implications of corporate governance on audit practice in Nigeria in a highly regulated banking sector of Nigeria. Specifically, the study examines if significant differences exist in auditing practice in the Nigerian banking subdivision given the adoption of the Central Bank of Nigeria code of corporate management for banks in 2006. Thus, the significance of the t-test statistics of some of the sampled banks reveals that significant differences exist in composition of the audit group and audit quality for some banks in Nigeria. This implies that the adoption of the CBN code of corporate governance for banks have improved auditing (internal and external) trainings in the Nigerian banking industry. However, there should be improved efforts by the regulatory agencies in the banking industry in ascertaining the level of compliance of individual banks to the system of corporate management particularly about to audit practices for sanctioning.

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