

AUDIT PLANNING AND CONTROL

1.0 LEARNING OBJECTIVES

After studying this chapter, readers should be able to understand:

- ◆ The general concept of audit strategy.
- ◆ The Importance of audit strategy as an effective plan for an audit.
- ◆ Internal control systems, evaluation and assessment.
- ◆ Audit documentation.
- ◆ Relationship with experts.
- ◆ Audit risks and its relative importance to audit.
- ◆ Components of audit risks.
- ◆ How to assess audit risks.

1.1 INTRODUCTION

Auditing has developed over many years, but it was not until the late nineteenth century (with the formation of joint stock companies, the predecessors to present day limited liability companies) that auditing became widely accepted in the United Kingdom and by extension, in other parts of the world. Individual firms of accountants have refined their approach to auditing from time to time and the professional accountancy bodies in various countries have published guidelines to their members on auditing procedures.

1.2 CONCEPTS OF AUDIT STRATEGY

Audit strategy is directed to the gathering of relevant and reliable audit evidence in order to support the expression of an opinion on the accounts. In carrying out an audit assignment, the auditor should:

- (a) Consider his responsibilities as defined in the terms of engagement;
- (b) Familiarise himself with the client's business and organisation;
- (c) Obtain a preliminary understanding of the principal features of the client's accounting system and internal control procedures;
- (d) Determine and record the audit strategy to be adopted;
- (e) Where it is proposed to carry out a detailed evaluation of all or certain internal controls with a view to placing some reliance on such controls, obtain a more detailed description of the accounting system and internal control procedures and review selected transactions to confirm that he has understood and recorded the system properly;

- (f) Review critically and evaluate those aspects of the client's accounting system, procedures and internal controls on which he intends to place some reliance;
- (g) Discuss any weakness in the system with the client in order, inter alia, to ascertain whether they are compensated by some other controls;
- (h) Test the system to determine whether the controls on which he intends to place reliance were operating during the period;
- (i) Report apparent weakness and breakdown in internal control to the client in a management letter; and
- (j) Based on the results of the work described above, carry out a programme of audit work to substantiate the amounts appearing in the accounts and related notes so as to ensure that the accounts show a true and fair view of the state of affairs and the results of the business.

The above paragraph summarises the basic procedures that an auditor should carry out in order to express an opinion on the accounts. It should be noted, however, that the procedures and terminology used in practice may vary, even though, the fundamental concept may be the same. Furthermore, the extent to which the auditor places reliance on the work of an internal audit department may significantly affect the nature, timing and extent of his work.

1.3 DETERMINATION OF THE AUDIT STRATEGY

1.3.1 Purpose

The purpose of determining an audit strategy is to enable the auditor familiarise himself with the client's business and organisation as well as to obtain a preliminary understanding of the client's accounting system. This will entail the preliminary identification of those internal controls on which he proposes to rely upon.

The auditor should then determine and record his audit strategy before commencing any detailed audit work. In doing so, the auditor will need to identify the optimum balance between, on one hand, relying on internal controls and reducing the level of his substantive tests, and on the other hand, placing little or no reliance on internal controls and seeking audit satisfaction from a higher level of validation procedures. The purpose of making this assessment is to enable the auditor to carry out the audit in the most effective and efficient manner. Determination of the audit strategy requires a high degree of professional judgement.

Consequently, the audit assignment should be carried out by an experienced staff, with the involvement of the audit partner.

In particular, the determination of the audit strategy for a new client will usually require considerably more time and effort than for existing clients, except where the circumstances of existing clients have changed significantly since the last audit. However, this does not mean that a

formal determination of the audit strategy is not necessary for existing clients whose circumstances do not change significantly from year to year. In all cases, a formal record of the audit strategy is essential. The overall strategy should focus on a more efficient and effective audit.

1.3.2 Audit Plans and Audit Planning Memorandum

In order to ensure a high standard of performance, it is important that the auditor should prepare adequately for his work. Planning for an audit, just like every human endeavour, is essential for the smooth performance of the audit work and its successful completion. Planning ahead for an audit work will not only guarantee a valid audit opinion but will also help the auditor to ensure that:

- (a) The audit objective is established and achieved;
- (b) The audit is properly controlled and adequately directed at all stages;
- (c) High risk and critical areas of the engagement are not omitted but that adequate attention is focused on these areas; and
- (d) The work is completed economically and expeditiously, hence, savings on audit resources.

It is important to distinguish between an audit planning memorandum. Audit plan relates to preparations made by the auditor for one specific audit engagement. While audit planning memorandum is a standing arrangement made by the auditor for the continuing engagement of a particular client. Hence, an audit plan for the audit of one client for one year while audit planning memorandum is a standing plan for the continuing audit of a client from year to year.

Points for Consideration in Audit Planning

Audit planning requires a high degree of discipline on the part of the auditor. In order to make the planning more meaningful, the auditor should take into consideration the following matters in relation to the audit engagement:

- (a) **Preliminary Work to be Done in Addition to the Real Audit Work**
This will include such matters as stocktaking, cash count, debtors' circularisation and review of previous year's working papers. This will remind the auditor of those matters brought forward from the previous year and any other points to be resolved in the current year or problems anticipated.
- (b) **Changes in Legislation or any Auditing Standards or Guidelines**
The promulgation of the Companies and Allied Matters Act, Cap. C 20, LFN 2004, brought with it a lot of changes in accounting

and auditing requirements of companies. Such legislations whether in respect of all companies or particular industrial group, must be reviewed ahead of the engagement in order to determine their effects on the operations or reporting requirements of the enterprise.

(c) **Analytical Review of Available Management Accounts and Other Management Information that Relate to the Accounts**

This will assist in establishing valuable ratios and indicators that will guide the auditor. For instance, the computation of the gross profit percentage compared with that of the previous year will provide a good indicator to the auditor of the accuracy and reliability of sales and cost of sales.

(d) **Changes in the Business or Management**

The appointment of a new Finance Controller and the establishment of a new business line or the creation of a new branch are significant changes in the circumstances of the company which will necessitate changes in the existing audit plans.

(e) **Changes in the Accounting System**

The introduction of computers such that when a company introduces significant changes in its operating procedures will require a review and evaluation of the system of internal control.

(f) **Deadlines Established for the Submission of Audit Report**

Where a client has set deadlines for its statutory activities such as the annual general meeting, it is important for the auditor to work in line with such programmes.

(g) **Use of Rotational Testing and Verification**

In practice, the auditor may not carry out a hundred percent testing or verification of the client's transactions or segments of the business. Where rotational testing or verification is adopted, it will be necessary for the auditor to determine ahead of the date of the engagement which aspects of the business should be selected for testing or verification. An example of rotational testing could be applied on the client's branches to be visited.

Points for Consideration in Audit Planning Memorandum

Audit planning memorandum should cover the following standing matters which are designed to achieve the desired audit objectives:

(a) **Terms of Engagement**

In the case of a new audit engagement, a letter of engagement should be prepared as part of the overall plan of the audit. Even in subsequent visits, the letter of engagement should be reviewed

in the light of current circumstances to ensure that all aspects of the work undertaken for the client are covered in the letter especially as they relate to taxation, accountancy, staff development and executive search.

- (b) **Audit Risk Areas**
The auditor should critically review all the areas of high risk in order to ensure that the planned procedures adequately cover such areas and that competent staff have been assigned to these areas. High risk areas may relate to the nature of the items, such as cash for a retail establishment with numerous collection points and outdoor disbursement locations. Risk may also relate to a high probability of error as in the case of stocks whose quantities are subject to estimation and are susceptible to pilferage. The risk may also relate to the structure of the organisation especially in cases of joint ownership of an organisation, where the owners are not equally represented in the management. There is therefore the risk of withholding key information from some of the directors.
- (c) **Assets and Liabilities**
These will require detailed plans since they are of continuing relevance to the financial statements of many years and the relevant vouchers may not be readily accessible. The plans relating to assets should clearly disclose their history such that current movements may easily be ascertained and adequately verified. These will apply mainly to plant and long term loans.
- (d) **Presence of Internal Auditor**
Wherever an internal auditor exists in an organisation, the auditor should develop suitable plans to review the technical competence of the internal auditor, his degree of independence and scope and quality of his work in order to determine the extent of reliance to be placed on his work and to identify the areas of work overlap.
- (e) **The Need for Specialists**
The auditor should determine ahead of his visit those aspects of the work that may require the services of specialists. This may be internal or external specialists as relates to stocks, specialist valuation for insurance or computer applications.
- (f) **Audit Approach**
Based on the review of the system of internal control, the auditor should be able to decide on the audit approach to adopt. This will be based on the extent of reliance to be placed on the system of internal control.

(g) **Timetable**

A critical aspect of the audit is the timetable. The auditor should establish plans to ensure that for each year, the audit is completed within any stated deadline for submission of the report.

(h) **Staffing**

The auditor should plan for adequate number of staff with the required skill for the audit. The training of audit staff is a long term process which will require that even from the initial appointment of the auditor, he should take steps to train suitable staff in sufficient number to handle the audit of the client.

(i) **Fees**

Based on plans already established in terms of time, staff and materials, the auditor should plan for his fees to cover staff salaries, overhead costs and leave a sufficient margin for the partners' share of profit and pension scheme. The planned fees must be discussed with the client, if not already agreed.

Understanding the Client's Business

The extent of the knowledge gained of the client's industry and business organisation greatly facilitates the performance of the engagement staff. It is essential therefore that all staff engaged in the audit are encouraged to gain an understanding of the client's business operations. Such understanding, in addition to enhancing the overall audit performance, also facilitates communication with client's staff and in assessing the reliability of representations from management and making judgement regarding the appropriateness of the accounting policies adopted and their disclosure.

The auditor may obtain knowledge of the client's business by:

- (a) Personal visits to the client's premises and operating bases and holding discussions with key officials of the company;
- (b) Reading minutes of meetings and correspondence with the client;
- (c) Reading internal audit report;
- (d) Reading previous year's audit files and permanent audit files;
- (e) Reading other materials from within the firm, e.g. management consultancy reports and feasibility reports; and
- (f) Reading relevant materials relating to the business e.g. trade journals, investment analysis and stockbroker's report.

Other significant factors which should be considered by the auditor to determine the audit strategy are as follows:

- (a) The auditor's responsibilities in accordance with the terms of the engagement;
- (b) The nature of the client's business;
- (c) The nature and significance of items in the year's accounts; and

- (d) The principal features of the client's accounting system and the extent and effectiveness of the related internal accounting controls, which may be gained from a preliminary understanding of the system.

Consideration of the above factors should enable the auditor determine an appropriate audit strategy which should be set out in writing, in an audit strategy memorandum, which should be approved by the audit partner.

However, the auditor should recognise that this strategy may, if necessary as a result of changing factors, be reviewed and revised as the audit progresses. For existing clients, the auditor should have much of the information he needs to determine his audit strategy in his audit files.

Nevertheless, he should still discuss with the clients management whether there have been any changes in the company's circumstances that might affect his audit approach.

The external auditor is appointed to carry out audit in accordance with specific regulatory or statutory requirements, such as the Companies and Allied Matters Act or in accordance with generally accepted auditing standards within the country concerned. In these circumstances, the terms and conditions will not call for any special consideration when determining the audit strategy. The auditor should, however, consider whether additional responsibilities arise from request by the client's management or because the client is required to conform to special regulatory or other requirements.

1.4 FAMILIARISATION WITH THE CLIENT'S BUSINESS AND ORGANISATION

The auditor needs reasonable knowledge of both the business of the client and the industry in which the client operates, how and in what places its activities are carried on, in addition to the basic financial information which will be obtained for the audit in order to understand and interpret the financial statements on which he is reporting.

In order to familiarise himself with the business and organisation of a new client, the auditor would normally:

- (a) Examine publications emanating from:
 - (i) The client, such as annual reports or interim financial statements;
 - (ii) Others, regarding the client's industry or business;
- (b) Have meetings with the client's management, in order to identify the major types of transactions entered into by the client; and
- (c) Examine the client's important internal documents, such as:
 - (i) procedure manuals;
 - (ii) legal documents, i.e. memorandum and articles of association, contracts; lease and loan agreements;

- (iii) minutes of meetings of the Board/AGM (and/or any important Committees thereof);
- (iv) policy statements; and
- (v) internal management accounts.

The auditor should also tour the client's principal places of business, such as plants, factories, shops and offices.

The auditor of a manufacturing concern, for instance should undertake a tour of the company's factory in order to familiarise himself with the production process, to see the types of scrap items and the manner of their disposal and the form of the finished products. In all other concerns, the auditor should make himself familiar with the market in which the business operates and with its methods of marketing.

Having adequate knowledge and background of the business will make the auditor to determine whether the system of accounting and internal control disclosed by his detailed review is appropriate for the business and properly records all its transactions. Such knowledge will also give the auditor an awareness of the physical realities behind the accounting records and financial statements which he examines and will enable him consider their significance more intelligently.

The auditor's task of familiarising himself with the client's business and organisation will often involve his spending additional time on the first audit of a new client.

In contrast, the need for him to spend additional time for this purpose on the audit for the second and subsequent years may be fairly limited, as he may only need to have brief meetings with key members of the client's staff to consider any changes in the client's circumstances and systems since the previous year.

However, the importance to the auditor of updating his knowledge and understanding of the client's system in this way, before carrying out any audit test, cannot be over-emphasised.

1.4.1 The Nature and Significance of Items in the Accounts

Normally, the most important factor in the determination of the audit strategy will be a review of recent accounts and other available financial information in order to assess the relative significance of items appearing in the balance sheet and the profit and loss account.

The auditor should obtain information on the nature and approximate volume of transactions, which result in significant account balances. The assessment will need to take into account any audit risks identified when analysing the clients business. Those account balances, which are considered to be insignificant, can be subjected thereafter to only limited audit procedures.

1.4.2 Preliminary Understanding of the System

In order to evaluate the potential for reliance on internal control in respect of all significant items in the financial statements, the auditor should gain a preliminary understanding of the principal features of the client's accounting system giving rise to these items, together with the related internal control procedures. This involves a consideration of the methods of and control over, processing and the principal accounting records maintained for each significant transaction type.

This preliminary understanding and evaluation of the potential for reliance on internal control should be documented, normally by way of overview flow charts. However, this preliminary evaluation, which is made for the purpose of determining the audit strategy, should be distinguished from the detailed evaluation using the internal control questionnaire.

Nevertheless, apparent weakness in internal control, which comes to the auditor's attention in the course of the preliminary evaluation, should be brought to the client's attention.

The record of the accounting system prepared for the purpose of determining the audit strategy may need to be supplemented by a more detailed description of the accounting system if the auditor intends to carry out a detailed evaluation of internal controls.

However, it should, generally, prove adequate for the purpose of planning and performing substantive tests.

During the course of the auditor's preliminary review of the accounting system and controls, he should be able to identify those items in the accounts which because of the limited volume of transactions or other factors, can be audited more efficiently through the application of substantive tests rather than reliance on internal controls. Examples of such account balances are share capital, long term debts and related interest expense, investments and related income (except when a large portfolio of investments is held). In a similar vein, he may decide to ignore internal controls entirely, either for reasons of efficiency or because the controls are not operating properly, and carry out extended validation for all balance sheet and profit and loss account items.

The auditor should identify any procedures the client applied to significant items in preparing the financial statements because they will influence the extent of the detailed evaluation of internal controls. Examples of such procedures are the counting of stocks, the reconciliation of bank balances and the establishment of provisions against doubtful debts.

1.4.3 Documentation of the Audit Strategy

It will normally be desirable to document the audit strategy in a memorandum, which together with the necessary supporting documentation, should be prepared in the first year of an engagement and revised annually thereafter. The auditor can obtain information as to changes that may be required as a result of the experience gained from using the audit strategy adopted in the previous year.

The auditor may find it helpful to discuss the planned audit strategy with the client, for example, to inform him of a proposed reduction in the extent to which the audit will involve the evaluation of internal control procedures. In some cases, the client may wish such an evaluation to take place and the auditor will need to explain that, while he would be glad to comply, it is likely to have the effect of increasing cost.

The matters set out below are those which will normally be relevant and material in determining the audit approach and which should be addressed by the audit strategy memorandum. Other matters will almost certainly be relevant to particular audit clients and will need to be incorporated in the memorandum:

- (a) Whether the terms of the engagement vary from the requirements of the Companies and Allied Matters Act and approved auditing standards and guidelines;
- (b) Whether the report and accounts will include any supplementary information, and, if so, whether an audit opinion is to be given on it;
- (c) Particular risk factors or problem areas;
- (d) The number of accounting locations and the audit approach in respect of each, that is, whether to be covered by full audit or not to be visited with reasons for the decision. Where there are a number of accounting locations, certain elements of the strategy may have to be determined and recorded for each location;
- (e) Balance sheet amounts and those likely to be:
 - (i) Insignificant; and
 - (ii) Significant.
- (f) Types and volume of transactions that contribute to material balance sheet amounts;
- (g) Assessment of the potential for reliance on the internal controls over the transactions, in particular, whether the audit of significant items in the balance sheet are to be based:
 - (i) Principally on reliance on internal controls with limited substantive tests; or
 - (ii) Principally or entirely on substantive tests with reasons for the decision.
- (h) The control objectives to be evaluated (specifying whether a computer or manual will be adopted);

- (i) Any particular factor affecting levels of compliance tests expected to be performed, and whether any control that are to be evaluated are not to be subjected to compliance tests;
- (j) Whether a more detailed understanding of parts of the accounting system is required and how this should be recorded (flowcharts or narratives);
- (k) Assessment of the potential for reliance on operational controls;
- (l) The potentials, if any, for reliance on the work of internal audit;
- (m) The approximate levels of substantive test expected to be applied to each of the balance sheet accounts and the nature of any tests requiring particular emphasis. For example, use of audit software;
- (n) An explanation of the approach to the audit of material profit and loss account items, including a brief description of any extended validation procedures to be adopted;
- (o) Where there is involvement by other auditors, that is, in the case of a group or a joint audit, the extent of liaison with the other auditors; and
- (p) Any other matters that the audit partner considers may affect the audit strategy, for example, operational matters.

1.4.4 Detailed Understanding and Recording of the System

An understanding of the procedures and controls comprising a client's accounting system is the essential basis for determining the audit procedures to be applied. This understanding is normally obtained by discussions with the client's staff. As indicated in auditing standard (the auditors operational standard), such an understanding is necessary to enable the auditor assess the adequacy of the client's accounting system as a basis for the preparation of its financial statements. The extent to which the auditor should record the client's accounting system and the method adopted will depend on both the complexity and nature of the system and on the degree of reliance that he plans to place on internal controls.

Where the auditor plans to rely on internal controls, a permanent detailed record should be prepared of the accounting and internal control procedures in force, so as to facilitate the evaluation of controls and the preparation of a programme of audit tests. This recording may be done by means of flow charts, notes on accounting procedures or an internal control questionnaire.

This record is made in order to provide the information on which the evaluation of internal control will be based. It also enables members of the auditor's staff who have no previous experience of the company's affairs, and those engaged on the audit in future years, to familiarise themselves with the system of accounting and internal control in force.

After he has prepared or updated the flow charts, and before doing any other audit work, the auditor should each year trace a transaction through the accounting system to confirm that the system has been properly understood and recorded. This is known as transaction review or walk-through test.

1.4.5 Evaluation of Internal Control

(a) **General**

The auditor must satisfy himself that the underlying books and records can be relied upon as the basis for the preparation of the financial statements, which he is auditing. The auditor should therefore make a critical review of the system of book keeping, accounting and internal control.

Those internal controls that are relevant to the expression of an audit opinion on the financial statements were defined as internal accounting controls, which comprise basic controls and disciplines over the former.

The evaluation of a clients system of internal control enables the auditor to determine whether the system contains control, which if they can be demonstrated to operate during the period, would affect the nature, extent and timing of his audit procedures.

The extent to which the auditor chooses to rely on the operation of internal controls in any area will be partly governed by the relative efficiency of tests to confirm the operation of internal control procedures as opposed to extended validation procedures. It will also be governed by the extent to which the auditor finds the control to be operating effectively.

The effectiveness of the disciplines over basic controls will determine the auditor's ability to rely on the confirming operation of the basic controls and the extent to which it is necessary to carry out tests of the basic control themselves.

Basic Controls

The basic controls are those controls built into the system and which operate all the time and in respect of all transactions. Typical examples are the pre-numbering of documents, the establishment of control or batch totals and the routine reconciliation of the subsidiary records with the control totals.

Disciplines Over Basic Controls

Disciplines over basic controls are those controls that are established as a check over the basic controls and which operate only occasionally or as often as management may desire. Typical examples of disciplines over basic controls are management supervision and routine stock checks.

The techniques employed to record and evaluate the system of accounting and internal controls are usually one or more of the following:

- (i) The use of narrative, with an aide memoire or checklist;
- (ii) The use of flow charts; and
- (iii) The completion of an internal control questionnaire that includes questions designed to establish what the system is, as well as questions relating to the evaluation of the relevant controls, the first two being to record the system while the third is to evaluate the effectiveness of the system.

The actual technique used depends in part on the complexity of the client's accounting system.

(b) **Management Letter**

After the auditor has completed his evaluation of the internal controls and the tests to confirm whether the relevant internal control procedures are operating, he should report to the client on any internal control deficiencies that have come to his attention and on any other matters (of an operational nature) which he considers relevant at this stage. If additional matters come to his attention later as a result of applying substantive tests, these should be reported to the client at that stage.

1.5 AUDIT EVIDENCE

The Auditor's operational standard states that 'the auditor should obtain relevant and reliable audit evidence sufficient to enable him draw reasonable conclusions therefrom. The Auditing Guidelines on Audit evidence, gives guidelines on what constitutes adequate audit evidence.

Audit evidence is information, written or oral, obtained by the auditor to support the conclusions on which he bases his opinion on the financial statements. Sources of audit evidence include the client's accounting system, and underlying documentation, tangible assets, management and other employees, customers, supplier's and other third parties who have dealings with, or knowledge of, the client's business.

The sources and amount of evidence needed to achieve the required level of assurance is a matter of judgement to be exercised by the auditor. He will, however, be influenced by the materiality of the matter being examined, the relevance and reliability of evidence available from each source and the cost and time involved in obtaining it. Often, the auditor will obtain evidence from several sources, which together, will provide him with the necessary assurance.

The auditor can rarely be certain that the accounts on which he is reporting show a true and fair view. However, he needs to obtain relevant, reliable and sufficient evidence as a basis for his opinion on any matters relating to the

financial statements. The auditor's judgement as to what constitutes relevant, reliable and sufficient audit evidence is influenced by such factors as:

- (a) His knowledge of the client's business and the industry in which it operates; and
- (b) The degree of risk of mis-statement through errors or irregularities, this risk may be affected by such factors as:
 - (i) the nature and materiality of the items in the financial statements;
 - (ii) the auditor's experience as to the reliability of the client's management and staff and of its records;
 - (iii) the financial position of the clients;
 - (iv) possible management bias; and
 - (v) persuasiveness of the evidence.

The relevance of the audit evidence should be considered in relation to the usual audit objective of forming an opinion and reporting on the accounts. The reliability of audit evidence is dependent upon the particular circumstance. However, the following general assumptions may be found helpful:

- (a) Documentary evidence is likely to be more reliable than oral evidence;
- (b) Evidence obtained from independent sources is more likely to be reliable than that secured from the client; and
- (c) Evidence originated by the auditor from his analytical reviews and physical inspection is more reliable than evidence obtained from others.

The auditor should consider whether the conclusions drawn from different types of evidence are consistent with one another. When audit evidence obtained from one source is in conflict with that obtained from another, the reliability of each remains in doubt. Additional evidence will be needed to resolve the inconsistency. However, when the individual items of evidence relating to a particular matter are all consistent, then the auditor has obtained a cumulative degree of assurance higher than that which he obtains from the individual items. This is on the basis of the principle of synergy.

1.6 AUDIT TESTS

(a) **Types of Tests**

Audit tests are referred to in practice by a variety of names. Generally, audit tests can be divided into two types, compliance and substantive tests:

- (i) Compliance tests are those designed to provide evidence as to whether the internal control procedures are being operated as planned; and
- (ii) Substantive tests are those designed to substantiate the validity, accuracy and completeness of amounts appearing in the financial statements and related notes.

Test the Operation of Internal Control Procedures (Compliance Test)

Internal control procedures are tested in order to provide reasonable assurance as to the proper operation of those accounting controls upon which the auditor may rely when determining the nature, extent and timing of his substantive tests. If the auditor can satisfy himself that the basic controls over an accounting operation have continued to operate satisfactorily throughout the period under review, that is, the disciplines over the basic controls are effective, he may reasonably:

- (a) Reduce the level of the related substantive test; and
- (b) Carry out some of them as at dates other than the end of the accounting period.

The auditor may sometimes find that the disciplines over the basic controls are either not effective or absent in some areas, and he may not be able to carry out some of his substantive testing procedures before the end of the accounting period, because he will not have been able to satisfy himself as to the continued operation of the basic controls throughout the period under review. In such circumstance, the auditor may either have to increase the level of his tests over the basic controls or it may be appropriate for him not to test the internal control procedure but to perform instead extended validation procedures if this results in a more efficient audit.

Substantive Testing Procedures

Substantive testing procedures represent the final stage of the audit leading to the expression of an audit opinion. They comprise direct tests of account balances and other information contained in the financial statements and other procedures of a more general nature that indirectly provide evidence of the validity of the amounts appearing in the financial statements, referred to as “other auditing procedures”.

Examples of such other auditing procedures are:

- (a) Analysis of fluctuations in account balances; and
- (b) Analysis of financial trends and ratios involving the review of the financial position and performance of the client as expressed by significant performance indicators, such as, gross profit percentage, ratio of debtors, stock and various expenses to sales.

The nature, extent and timing of substantive testing procedures, are dependent on the reliance that the auditor can place on the internal controls. Where he cannot, or prefers, in the interest of a more efficient audit, not to rely on them for the purpose of limiting his substantive tests, it will be necessary for him to perform extended validation procedures. Depending on the nature of the identified internal control weaknesses, this will involve:

- (a) Going to a greater depth in the procedure already contemplated, that is, seeking more complete documentary evidence in support of payment made;
- (b) Performing additional procedures not otherwise contemplated. For example, by confirming accounts payable with suppliers in case where this would not otherwise have been done; and
- (c) Performing more tests of the nature already contemplated, such as, by verifying a greater proportion of the items making up an account balance or, in verifying completeness of recording, by checking either a greater number of items or for a longer period of time.

In particular, it may be decided in the light of the evaluation of internal control not to carry out tests on the internal controls over transactions but to carry out extended validation procedures on income and expenditure accounts by means of an examination of a large number of transactions, in order to verify the reliability of the accounting records.

1.7 AUDIT DOCUMENTATION

1.7.1 Audit Working Papers

A working paper is any document or record containing a report, correspondence and any other information that an auditor collects or any record which the auditor produces in the course of the audit procedures to discharge his professional duty to clients. An audit is erroneously regarded as a process by which the auditor piles up papers or heaps of books. However, the more paper the auditor amasses, the better the audit he has done.

Standards on Audit Documentation are: Nigerian Standards on Auditing (NSA 4 - Documentation) and the International Standards on Auditing (ISA 230 - Documentation)

The NSA states that:

- (a) The auditor should document matters which are important in providing audit evidence to support the auditor's opinion and evidence that the work was carried out in accordance with NSAs.
- (b) The auditor should prepare working papers which are sufficiently complete and detailed to provide an overall understanding of the e-audit.
- (c) The auditors should record in the working papers information on planning the audit, the nature, timing and extent of the audit procedures performed and the results thereof, and the conclusions drawn from the audit evidence obtained.

The extent of working papers which the auditor produces or obtains is a matter of professional judgement since it is neither necessary nor practical to document every matter the auditor considers. In assessing

the extent of working papers to be prepared or retained, it may be useful for the auditor to consider what would be necessary to provide another auditor who has no previous experience of the audit work with an understanding of the work performed and the basis of the principal decisions taken but not the detailed aspects of the audit.

From the above, it can therefore, be inferred that the main objective of the auditor's working papers is to record and demonstrate the steps which have been taken by the auditor to enable him form an independent opinion on the financial statements upon which they are required to report.

Therefore, in order to achieve this objective, audit working papers should provide:

- (a) Information about the organisation being audited, including its recent history;
- (b) Evidence of work done in the course of the audit;
- (c) A means of controlling the current year's audit work and also as a means of planning the subsequent year's audit; and
- (d) Schedules in support of the accounts audited and summaries of the client's books.

1.7.2 Reasons or Advantages for Preparing Audit Working Papers

In general terms, the underlisted benefits can be derived from well drawn-up and properly organised audit working papers:

- (a) To ensure that the audit work is conducted methodically and systematically. Without properly organised working papers, the auditor can rarely maintain a perfect grasp of the work he carries out in which case the audit cannot be carried out in an orderly manner.
- (b) To provide continuity in the case of audit staff leaving midway through the audit engagement. Experience has shown that audit staff may resign his employment even before a particular audit is concluded. Without working papers, it will not be possible to know which aspects of the work have been completed, hence the audit may have to be recommenced from the start.
- (c) To enable an independent review of the audit work. The person who carries out the review of the audit work does not need to be present when the audit exercise is carried out. With the relevant working papers, he can carry out an effective review of the audit work.
- (d) To provide support for the audit opinion expressed. The opinion expressed by the auditor in his report is based on the work he carried out and this can only be meaningful if documented on working papers.
- (e) To provide supporting details for all items appearing in summary in the published balance sheet and the profit and loss account.

- Working papers provide greater detail and meaning to items which appear in summary on the financial statements.
- (f) To provide a permanent record of tests and procedures carried out. Working papers are a lasting record of the detailed work carried out by the auditor and which would have been easily lost if not documented on working papers.
 - (g) To provide a guide for the planning of future audits. For subsequent audit engagements, the auditor may refer to previous working papers as a guide of the procedure to be carried out.
 - (h) May be used as evidence in the event of litigation against the auditor. Working papers are valid documents which the auditor may need to present as evidence of the work he has carried out in the event of litigation.
 - (i) To confirm that all aspects of the work have been completed. Working papers serve as effective checklist that all aspects of the work have been carried out.

The published financial statements of a company comprise only classified and suitably summarised items reported on a few pages of the annual report. Audit working papers provide greater details of these items hence, helping to explain the meaning and the origin of the component transactions. Audit work cannot be based on intuition, rather it is on rational, articulate and ordered thinking on the part of the auditor. Without keeping a record of the procedures carried out or to be undertaken, the auditor is unable to maintain a perfect grasp of the work. The auditor's memory is likely to fail without a well-ordered record of the work he has performed or intends to perform.

1.7.3 Qualities of Good Audit Working Papers

No standard format is advocated for audit working papers. It is however, important to ensure that working papers not only conform with the requirements of a particular firm but also satisfy the requirements of an independent reader. The following guidelines should be observed when writing up working papers:

- (a) Each working paper should be clearly headed with the client's name, the subject matter of the working paper, the date of the engagement, the initials of staff preparing the working paper and the date;
- (b) As far as possible, working papers should be prepared on standard stationery;
- (c) Details of work done must be clearly shown as to leave no doubt in the minds of readers;
- (d) Questions asked, answers received, observations made, queries raised, replies received and conclusions reached should be clearly stated;

- (e) Completed working papers should be serially numbered and suitably arranged in the audit files;
- (f) Points carried forward and the subsequent disposal of such points must be clearly stated on the working paper;
- (g) Each working paper must bear the signature/initials of the manager or partner who reviewed it; and
- (h) Each working paper should be suitably cross-referenced to the related parts of the audit file.

1.7.4 Contents of Audit Working Papers

Audit working papers are usually arranged in two files according to their contents, namely, the current audit file and the permanent audit file.

(a) **The Current Audit File**

This file contains information relevant to the year under consideration and it is based on the contents of this file, that the auditors form opinion on the client's financial statements.

The current file will typically contain the following documents:

- (i) A copy of the financial statements being audited and the trial balance;
- (ii) The audit programme, which will contain the list of audit work to be done and the list of audit tests to perform;
- (iii) Schedules of major items in the profit and loss accounts and the balance sheet;
- (iv) List of audit queries and their dispositions;
- (v) List of matters requiring the engagement audit partner's attention;
- (vi) Extracts of minutes of meetings of the board and management;
- (vii) A description of the internal control systems in operation;
- (viii) Letters of Representations from management;
- (ix) Checklists for compliance with statutory disclosure requirements and accounting standards; and
- (x) Management letter setting out internal control weaknesses in the system to the client.

(b) **The Permanent Audit File**

This file contains information of continuing importance, which will be required for more than one audit. With the contents of this file, the auditors will have a better understanding of the client's operations and business. The file will also typically contain the following information:

- (i) A brief history of the business as to the nature of business, major competitors, major sources of revenue and operating industry;

- (ii) List of major accounting policies;
- (iii) Copies of statutes and regulations governing the entity's accounts and audit;
- (iv) Names and addresses of the company's directors including details of service contracts with them; and
- (v) The memorandum and articles of association of the business;
- (vi) Copies of documents of continuing importance and relevance, such as Legal Mortgages and Debenture deeds;
- (vii) An organisational chart of the business showing names of responsible officials and lines of reporting;
- (viii) Addresses of the registered office and all other premises, with a short description of the work carried on at each;
- (ix) Names and addresses of the company's subsidiaries and associated companies; and
- (x) List of books, other records and where they are kept.

1.7.5 Working Paper Standardisation

Standardisation of working papers means the adoption of working papers, which can be used on all audits. The use of standardised audit working papers may improve the efficiency with which they are prepared and reviewed.

The standardisation of audit working papers has the following advantages:

- (a) Staff become familiar with them;
- (b) Improves efficiency;
- (c) Matters are not overlooked;
- (d) They help to instruct audit staff;
- (e) Work can be delegated to lower level staff; and
- (f) Work can be controlled and reviewed much more easily. However, despite the benefits of standardising the routine documentation of audit work, the system has the following drawbacks:
 - (i) Initiatives may be stifled;
 - (ii) Audit work becomes mechanical; and
 - (iii) It reduces the exercise of professional judgement.

1.7.6 Ownership of Working papers

From the definition of working papers in 1.7.1 on page 17, working papers not being the end product that the client needs, belong to the auditor. It is important to distinguish between working papers and the client's books and records. In principle, the books and records of the business given to the auditors to examine and from which they compile their working papers belong to the client.

However, where the auditor is being owed for his professional services, he can exercise a lien over the client's books and records and not on his

working papers that belong to him ordinarily. In **WOODWORTH vs. CONROY (1976)**, it was held that auditors do not have a general right of lien but a particular right of lien. A general lien is exercisable over all the books and records of a client where the debt owed is not traceable to a particular book or record. A particular lien is exercisable over a specific book or record that the debt can be traced to.

In order to exercise the particular right of lien, the courts are of the opinion that the following conditions must be satisfied:

- (a) The books and records must belong to the debtor client and not a third party no matter how closely associated or connected with the debtor client;
- (b) The accountant must have obtained possession by proper means;
- (c) Work has been done on the books and records; and
- (d) The debt for which the lien is exercised must be in respect of work done on the books and records and not other books and records belonging to the same clients.

1.7.7 Retention of Audit Working Papers

It is a general principle that working papers should be retained for as long a period as possible. In respect of audit, the working papers should be retained for a minimum period of six years.

1.7.8 Expert Evidence

(a) Introduction

The Nigerian Standard on Auditing (NSA) 27, on “Using the Work of an Expert”, defines expert as a firm or person possessing special skill, knowledge or experience in a particular field other than accounting or auditing. Though the auditor’s education and experience make the auditor generally knowledgeable in business matters, but he/she is not expected to have the expertise of a person trained for or qualified to engage in the practice of another profession or occupation.

For instance, an accountant is not expected to possess the specialist skills of a medical doctor, engineer, pharmacist or actuary. During the course of an audit, the auditor may need to use audit evidence in the form of statistical data, reports, opinions, valuations or statement from experts such as valuers, engineers, architects, actuaries, geologists, lawyers, stockbrokers or quantity surveyors.

Circumstances in which the work and report of such experts may be used include the following:

- (i) Valuations of certain types of fixed assets including land and buildings, plant and machinery, works of art and antiques;
- (ii) The measurement of work done or to be done on long term contracts for the purpose of revenue recognition;

- (iii) Valuation of certain types of stocks and consumable materials including the determination of their quantity, conditions and composition, for example, jewellery and other precious stones and chemicals;
- (iv) Geological determination of mineral and petroleum reserves and the characteristics of those reserves;
- (v) The legal interpretation of agreements, statutes and regulations;
- (vi) Legal opinion on the outcomes of disputes and litigations;
- (vii) Actuarial advice for the purpose of assessing the cost of pension provision; and
- (viii) Actuarial determination for the purpose of assessing the technical reserves of a life insurer.

When the auditor uses the work of an expert employed by the firm, the auditor will be able to rely on the other firm's systems for recruitment and training to determine that expert's capabilities and competence.

(b) **Reliance on Experts**

When determining the need to use the work of an expert in the course of his audit, the auditor should consider the following factors:

- (i) The materiality to the item being examined in relation to the financial statements;
- (ii) The nature and complexity of the items including the risk;
- (iii) Whether there are alternative sources of audit evidence;
- (iv) Whether the work or report of the expert is readily available. For example, in the construction industry regular site valuation reports by quantity surveyors are prepared for the contractee company and this can be made readily available to the auditor at no additional cost;
- (v) The cost and time involved in obtaining evidence from the expert balanced against the benefit of obtaining evidence from this source; and
- (vi) The reputation, qualification, competence and objectivity of the particular expert concerned.

It is pertinent to note that though the auditor may rely on the work of an expert and reduce the extent of his work, the ultimate responsibility to report on the truth and fairness of a client's financial statement is that of the auditor alone and cannot be reduced or affected by this reliance.

1.8 AUDIT RISKS

Audit risk is the term given to the risk that the auditor will reach an invalid opinion or conclusion from his audit work. Although some level of risk will have to be accepted, in practice, a firm will need to quantify its acceptable level of audit risk.

At the planning stage, the auditor should assess the risk of material errors or misstatements in the following areas:

- (a) In the financial statements as a whole; and
- (b) In each of the component items in the financial statements, such as Cash, Stocks, Debtors, Creditors and (in the balance sheet) and Sales, Expenses and Purchases (in the profit and loss account).

This assessment will be kept under constant review as the audit progresses. Since material errors could arise intentionally or unintentionally, the auditor needs to be alert to all circumstances in which the errors could arise. Material misstatements may of course arise from irregularities including fraud. The Auditing Practices Committee's operational guideline titled "The Auditor's responsibility for detecting and reporting fraud and other illegal acts" states that in assessing the risk of material irregularity, the auditor may wish to consider the following areas:

- (a) **Business Environment**
 - (i) Nature of business, its services and its products. For example, a company that mainly receives cash for its sales will have its income (cash) readily susceptible to misappropriation;
 - (ii) Circumstances which may exert undue influence on management, such as, the holding of shares or options by management;
 - (iii) Accounting methods;
 - (iv) Transactions with related parties;
 - (v) Company performance, for example, the deliberate distortion of the financial statements to meet a profit forecast; and
 - (vi) Management integrity. This includes conduct aimed at evading tax liabilities.
- (b) **Control Environment**
 - (i) Skill, integrity and effectiveness of management;
 - (ii) Competence of control personnel;
 - (iii) Internal control system in operation within the enterprise;
 - (iv) Existence and effectiveness of internal audit function;
 - (v) Unusual transactions;
 - (vi) The recruitment and training of staff;
 - (vii) Complex corporate structure;
 - (viii) Management's overall control, that is, the extent of supervision; and
 - (ix) Excessive authority vested in a senior staff.

In reaching his decision as to the areas to be tested and the number of balances and transactions to be examined, the auditor will need to consider information available from prior experience and his knowledge of the client's operations.

The procedures adopted by the auditor for the purpose of detecting material errors and irregularities in conducting an audit, will depend on his judgement as to:

- (a) The extent of directly relevant legislation;
- (b) The relative effectiveness of different audit tests;
- (c) The risk that a particular type of irregularity, error or breach of directly relevant legislation could impair the true and fair view of the financial statements; and
- (d) The risk that such irregularity can occur and remain undetected by the company.

1.8.1 Determination of Audit Risk

A firm's audit risk is derived from an assessment of the following elements:

- (a) **Inherent risk:** This derives from the characteristics of the client's products or services it deals in. It derives from the type of industry in which the client operates and will vary according to the accounts item being examined;
- (b) **Control risk:** This is the risk that the internal control system may not prevent or detect material misstatements or errors; and
- (c) **Detection risk:** This is the risk that the auditors substantive audit tests and procedures and his review of the financial statements will not detect material misstatements or errors.

Audit risk, therefore, is the product of the above stated risks –

(AR= IR x CR x DR) where:

AR = Audit Risk

IR = Inherent Risk

CR = Control Risk

DR = Detection Risk

Therefore, it is advisable to identify, assess and estimate or calculate audit risk in any given scenario.

Example of Audit Risk Estimation

Suppose the Inherent Risk of material misstatement of the capital expenditure total is 70% (meaning that there is a 70% chance of an error occurring), but that the internal control system is strong and the non-detection by controls (Control Risk) is low - say 20% that it will not be detected.

At this stage, we can say that the risk is 14% (70% x 20%). We can now say that there is a 14% risk that material misstatements or errors in capital expenditure will occur and the internal controls will not detect it.

The auditor will usually consider that an overall audit risk of about 5% for any item in the financial statements will be considered appropriate and acceptable.

Thus, in this case, the auditor must consider the risk that any of his proposed audit tests and procedures will not detect the material misstatement. Suppose the detection risk is 30% (there is a 30% chance that the misstatement will not be detected by the audit tests), then the overall audit risk is 4.2% (70% X 20% X 30%) and this risk is considered acceptable.

If the audit risk turns out to be unacceptable, then the auditor has to plan and execute further substantive test procedures. However, the auditor may still need to perform additional audit work where he is put on enquiry, even if the audit risk level is perceived acceptable.

In assessing the level of audit risk of a company, the auditors should bear the following factors in mind:

(a) **Inherent risk**

- (i) The company's performance and profitability;
- (ii) The nature of the business, its services and the susceptibility of its products or services to market forces;
- (iii) The financial stability of the company at present time and in the foreseeable future;
- (iv) The incidence of related party and unusual transactions;
- (v) The susceptibility of the company's assets to fraud and misappropriation;
- (vi) The auditors previous experience with the company as regards the records reliability and the explanations given by the management;
- (vii) Circumstances that may exert undue influence upon the company's management. For example, the pressure to meet budgeted profits; and
- (viii) The likelihood that error could have a material effect upon the financial statements.

(b) **Control Risk**

- (i) The strength, quality and effectiveness of its management
- (ii) Whether the company has an effective internal audit department;
- (iii) The internal controls of the company and the competence of the accounting personnel;

- (iv) The degree of supervision exercised by the management of the company; and
 - (v) The nature of the accounting methods in operation. For example manual or computerised records
- (c) **Detection risk**
- (i) Recruitment procedures of the audit firm;
 - (ii) Use of latest audit techniques and procedures;
 - (iii) The qualifications, experience and competence of the engagement team; and
 - (iv) The method and timing of the audit review procedure.

1.8.2 Benefits of Audit Risk Assessment

The benefits of audit risk assessment are:

- (a) It saves audit cost and fees;
- (b) It ensures that the audit work is completed expeditiously and economically;
- (c) It removes all avoidable pitfalls in the audit procedure;
- (d) It reduces the possibility of under or over auditing;
- (e) It results in a more effective and efficient audit work;
- (f) It focuses the auditors attention on factors which are more likely to result in misstatement; and
- (g) It facilitates the use of sampling and the attendant benefits derived therefrom.

1.8.3 Limitations of Audit Risk Assessment

The limitations of audit risk assessment include the following:

- (a) Subjective values have to be placed on inherent and control risk;
- (b) It may result in a mechanical approach which leads to a loss of auditor's judgement;
- (c) The auditor may spend more time on the mechanic of the process and assessment at the expense of time spent obtaining audit evidence; and
- (d) The assignments of risk levels are often not suitably specific which puts into question the validity of any conclusions reached.

1.8.4 Factors that could Minimise Audit Risks

Audit risk may be reduced if some of the following "positive" factors are identified:

- (a) The enterprise is financially stable without excessive debts, and is likely to remain so in the foreseeable future;
- (b) The enterprise is profitable, if its objective is to make profit;
- (c) The proprietor, in the case of a private company plays active role in the business;
- (d) The internal controls are strong and the company's accounting personnel are competent;

- (e) The past audit experience has provided evidence of good accounting controls with no major audit problems; and
- (f) The enterprise's relationship with the regulatory authorities has been good.

1.8.5 Audit Risk Evaluation

Evaluating audit risk helps to identify which types of error and irregularity are most likely to occur. The audit work can then be planned to investigate particular risk areas thoroughly.

Audit risk should be evaluated and documented in the audit plan. Some firms have already developed comprehensive risk questionnaires which interrogate the client's financial and management environment in considerable detail.

It is imperative to emphasise that a perfect audit does not exist and it is almost inevitable that the auditor will find errors during the course of the audit and be faced with the decision as to whether these errors are material. He must decide whether the error would influence the financial statements users if it were known to them, and at the same time, determine whether the error is indicative of other errors, which in turn, might expose him to greater audit risk.

A material error could occur through non-disclosure misstatement or omission of an item. Errors will normally be thought of in terms of monetary amounts. In these cases, the auditor should consider the amount in relation to the general view given by the financial statements, the total of which the amount forms a part, associated totals and previous years' figures. However, material error can occur if the information in the financial statements is not presented and described properly. In addition, the auditor may find that there are several errors, which maybe considered individually to be immaterial but collectively may have a significant effect on the financial statements.

However, there are no specific guidelines as to how materiality decisions are made, as materiality is essentially a matter of judgement.

In the final analysis it is the duty of the auditor to determine how his assessment of the risk will affect the audit and whether he could issue a clean audit report or not based on his assessment.

1.9 SUMMARY AND CONCLUSIONS

Audit strategy is essential in every audit process as this reduces audit time and invariably the audit cost. However, the strategy to adopt is dependent on the auditor's assessment and evaluation of the client's internal control system in operation. Documentation of the audit as evidence of work done is equally important by compiling good quality audit working papers. Aside from gathering evidence within the client's operating environment, the auditor may also look for evidence elsewhere by making contacts with experts.

Audit risk assessment is an important aspect of audit, the result will determine the nature, extent and timing of the auditor's substantive audit test programme. Where the assessment shows that the risk is high, the auditor is expected to pay particular attention to the transaction caption and design detailed level of substantive test programme. In carrying out the assessment, the auditor is expected to take into consideration the client's operating environment and the controls in operation.

The auditor is also expected to employ latest and good auditing tests, procedures and techniques so as to limit the possibilities of audit errors and wrong conclusion.

Refer to Comprehensive Questions and Suggested Solutions in Appendix II, page 303.

1.10 REVISION QUESTIONS

1. Describe the basic steps to be taken by an auditor in order to express an opinion on a client's financial statements.
2. Discuss the factors to be considered by the auditor in order to determine an audit strategy.
3. Discuss the need for the auditor to familiarise himself with the client's business.
4. Discuss the need for audit strategy documentation.
5. What is the rationale behind the auditor's evaluation of internal controls?
6. What is audit evidence?
7. Discuss the various types of audit tests.
8. What are the reasons for compiling audit working papers?
9. Discuss the qualities of good audit working papers.
10. Who is an expert and enumerate areas of assistance to auditors?
11. What are the factors to consider before placing reliance on experts?
12. What do you understand by the term "Audit risk"?
13. Briefly discuss the elements of audit risk.
14. Briefly enumerate the limitations of audit risk assessment
15. Discuss the factors that are likely to influence the auditor to minimise audit risk.
16. Discuss the likely benefits of audit risk assessment.

Refer to Suggested Solutions to Revision Questions in Appendix I, page 297.

ORGANISATION AND MANAGEMENT OF PROFESSIONAL OFFICE

2.0 LEARNING OBJECTIVES

After studying this chapter, readers should be able to:

- ◆ Understand how audit firms' offices and office facilities should be;
- ◆ Be able to appraise the type of relationship that ought to exist among partners;
- ◆ Be able to assess the importance of good staff management within an audit firm;
- ◆ Be familiar with the system of quality control expected to be established by each audit firm;
- ◆ Understand the need for training and retraining of all categories of personnel in an audit firm;
- ◆ Understand fully the underlying concepts of assurance engagements;
- ◆ Be able to appraise the standards required for various aspects of audit assignments;
- ◆ Understand the cause of the expectation gap and how to handle the possibility of the occurrence of fraud;
- ◆ Be familiar with negotiation skills as may be appropriate for both internal and external use; and
- ◆ Understand auditors' liability in all its ramifications.

2.1 INTRODUCTION

Audit firms are generally of three types, namely:

- (a) Small firms, which include sole practitioners and partnerships with two or three partners and constitute the most common type of audit firms.
- (b) Medium sized firms, bigger than the small firms but not as big as the "Big Four" networks. Some of the medium-sized firms have international cooperation with other firms.
- (c) The "Big Four" firms consist of the very big international firms, largest by fee income and have global affiliations. They were previously six till 1998 when the merger of Coopers & Lybrand with Price Waterhouse reduced this category of firms to five and subsequently in 2002, the merger of Andersens with Deloitte and Touche following the Enron saga later reduced them to four.

Most of the issues discussed in this chapter are applicable to all the types of audit firms except for partners' relationships which are not applicable to sole practitioners. The scope of operations and the type of clients may also vary across the types of audit firms. For example, multinational corporations may find it easier to appoint any of the "Big Four" as their auditors.

2.2 OFFICE AND OFFICE FACILITIES

Audit firms render services to their clients. They are service organisations and inevitably spend a greater proportion of the working hours at clients' premises. Their offices should however be well located and the layout of the office should be professional in outlook. The environment must be neat and conducive for professional work. Decisions for office-based operations traditionally involve placing people who must interact near one another. Therefore, office space in audit firms should be apportioned according to the various services rendered to clients. These will include:

- (a) Audit/Assurance Services: Usually, this is divided into industrial sub-groups like manufacturing, financial, energy and public in order to ensure efficiency and high quality;
- (b) Taxation Services;
- (c) Management Consultancy Services;
- (d) Insolvency Services; and
- (e) Corporate Advisory Services, other than the preparation of documents for public use.

Each of the sections should be well arranged and have clearly demarcated offices for the sectional staff. Responsibilities and reporting procedures should be clearly defined for the partners, managers, supervisors and trainees.

In view of the fact that the key input for all service operations is human resources, audit firms should endeavour to provide conducive office space for their staff.

Other inputs for service operations include the facility where the service is provided, any material or equipment needed in providing the service, together with the relevant technology that makes the service provider more effective and efficient. Audit firms should therefore provide adequate facilities for the staff offices as well as those items that are required for use in clients' offices, taking into consideration developments in modern technology. The following essential facilities should be provided for various grades of professional staff:

- (a) Laptops for all audit seniors and above;
- (b) Local Area Network to aid intranet connectivity;
- (c) Stand-by generator;
- (d) Calculators; and
- (e) Standard printed stationery such as bank confirmation letters, circularisation letters, audit programmes, e.t.c.

Audit firms should take into consideration the negative impact that a poorly located and badly designed office can have on their image.

2.3 PARTNERS' RELATIONSHIP

There are many advantages of partnership type of business over sole proprietorship. These advantages are also applicable in the case of audit firms. The following advantages of large firms over small ones are clearly distinguishable:

- (a) The growth of the firm is quicker;
- (b) Liabilities are shared among the partners;
- (c) Responsibilities are also shared by the partners;
- (d) The partners can specialise and become versatile in some specific areas of service; and
- (e) The partners' specialist areas complement one another.

An audit firm, like any other partnership, remains a business entity and must be run as such. There is, therefore, the need for the relationship among the partners to be regulated by a written agreement, which is often referred to as a "Partnership Deed". This document contains the rights and privileges of the partners, bearing in mind that a partnership is a contract of utmost good faith. The Partnership Deed should cover such issues as:

- (a) Profit sharing ratio;
- (b) Salaries, if any;
- (c) Interest on capital;
- (d) Admission of a new partner;
- (e) Resignation, retirement or death of a partner;
- (f) Operation of the Partnership Account;
- (g) Arbitration clause for conflict resolution;
- (h) Different categories of partners, that is, salaried, profit sharing, or sleeping; and
- (i) Dissolution of the partnership.

Partners should demonstrate among themselves their commitment to the growth and survival of the firm. Each of them should appreciate the need to have in place a system of effective management, which is one way of ensuring that the firm, through them, can:

- (a) Grow and thrive;
- (b) Meet all challenges and turn them to advantages;
- (c) Use their resources wisely;
- (d) Consistently satisfy their clients; and
- (e) Continuously and consistently earn profits.

The partners should work together as a team and make deliberate efforts to mitigate general business risks, especially the risks of losing clients and the risk of litigation.

Any of these two types of risks can lead to the failure of the business, so it is in the interest of the partners to work assiduously to prevent such risks. They should ensure that their engagements are carried out professionally and in compliance with appropriate regulations and standards.

2.4 STAFF MANAGEMENT

Managing people in organisations is the most important function and it is the key to the successful conduct of the organisation's business. Management has been defined in various ways but can be said to involve directing the use of an organisation's resources in a way that efficiently accomplishes the organisation's goals. More than ever before, managers now need skills in making the best use of the organisation's resources, especially its people. Successful managers are those who have moved beyond a focus on control and authority; replacing it with efforts to establish credibility, build commitment, and lead a team. The traditional basic functions of a manager (which consists of planning, organising, leading and controlling) are, however, still very relevant.

In recognition of the afore-mentioned, an audit firm should have in place a partner, called the Staff Partner, who is placed in charge of staff matters. He is to ensure that all staff receive due attention in matters affecting them. He is responsible for:

- (a) Acquiring the appropriate human resources through human resource planning, recruitment and selection. In this way, human resources made available to the firm are of the right calibre and in the right mix;
- (b) Annual performance evaluation to ensure that staff get adequately appraised and remunerated for good performance and those who do not measure up to standard are made aware of their inadequacies with a view to making them improve;
- (c) Welfare of staff generally, including arrangements for prompt payment of salaries, regular review of staff emoluments to ensure payment of competitive salaries to retain workers, adequate medical facilities, leave arrangements, e.t.c.;
- (d) Staff training and development, focusing on employability rather than job security;
- (e) Preparation of staff work schedule on weekly basis; and
- (f) General administrative matters to keep work going and uninterrupted.

2.5 QUALITY CONTROL

An audit firm should be dedicated to the pursuit of the highest quality in all its operations. Quality control should not be in respect of each particular engagement only, but must also be a culture in the entire firm.

Quality control policies and procedures should be documented and communicated to the firm's personnel. The International Audit and Assurance Standards Board (IAASB), a standing committee of IFAC issued in February

2004, its first International Standard on Quality Control (ISQC) which provides guidance specifically on quality control for audit firms.

The thrust of the standard as set out in paragraph 1.3 of the ISQC is as follows:

“The firm should establish a system of quality control designed to provide it with reasonable assurance that the firm and its personnel comply with professional standards and regulatory and legal requirements and that reports issued by the firm or engagement partners are appropriate in the circumstances” (ISQC 1.3).

Other important aspects of quality control in an audit firm are highlighted below:

- (a) An internal culture that considers quality as being important should be inspired by the leaders, that is, the partners of the firm; and in order to boost this, an individual or unit of the firm may be appointed to oversee quality in the firm;
- (b) In order to be reasonably assured that the firm’s personnel can comply with professional standards and regulatory and legal requirements, appropriate policies and procedures should be put in place to provide the firm with adequate staff that possess the capabilities, competence, and commitment to ethical principles required to perform its engagements;
- (c) The policies and procedures referred to in (b) above should cover recruitment, performance evaluation, promotion, career development, compensation, training and other personal needs and overall welfare of the firm’s personnel;
- (d) An audit firm should have policies and procedures to ensure that the engagement partner (whose responsibility it is to assign the engagement team) is capable of performing his duties well, and the key staff of the client plus those charged with the client’s governance know who the engagement partner is;
- (e) An audit firm should have a manual of standard engagement procedures given to all staff (either in hard or soft copy) to ensure that engagements are performed in accordance with those standards at all stages, that is, fieldwork and supervision stages;
- (f) An audit firm should have in place policies and procedures for the review and responsibility for issuing reports, that is, when and how the audit report should be issued;
- (g) An audit firm should have policies and procedures to determine when it will be necessary to use the services of a quality control reviewer, that is, using second partner quality control review. This is compulsory for the audit of financial statements of all listed companies;
- (h) An audit firm should also have in place standards to determine what a suitable quality control review consists of, that is, documentation requirements, timing, nature, and extent of such a review, and the criteria for eligibility;

- (i) An audit firm should establish policies and procedures designed to provide it with reasonable assurance that consultation, if and when required, has been carried out and its nature, scope and conclusions have been documented;
- (j) As regards monitoring, an audit firm should have policies to ensure that its quality control procedures are adequate, relevant, operating effectively and duly complied with. A monitoring team should be put in place for this purpose; and
- (k) The results of the monitoring activity, which should be done either on a continuous or periodic basis, should be reported to the management of the firm on an annual basis and such reports should be treated appropriately by both the management collectively and each engagement partner in particular.

An example of **Monitoring activities** and impact of **Report** on such activities is that monitors may ignore deficiencies that are found as one-offs, but if the deficiencies are repetitive or systematic, corrective action must be taken. Again, if in the course of monitoring, evidence is gathered that an inappropriate report might have been issued on a particular engagement, the audit firm may seek professional advice. This is a sort of pre-emptive action against a likely action for negligence.

Continuous monitoring involves an ongoing evaluation of the quality control system to ascertain if the system is up to date with regulatory and legal requirements and professional standards. This allows for a continuous review of the quality control system of the firm. On the other hand, periodic monitoring involves a periodic inspection of a sample of engagements selected in such a way that within a given period (say two to three years) at least one engagement per engagement partner would have been reviewed. The Institute has a special a special body called the Public Practices Monitoring Committee (PPMC) responsible for monitoring the quality of audit work of member firms.

Those medium sized firms having international cooperation with other firms and the “Big Four” firms usually have a standard manual of quality control system to be followed by all member firms. The other types of firms are encouraged to adopt the system of having a standard manual for the use of their staff. This is because there is really no substitute for ensuring that all engagements are carried out at the highest quality level.

In providing services to clients, an audit firm’s clients may be grouped into their various broad industrial sectors, for example, manufacturing, banking, insurance, e.t.c. However, this will be a function of the size of the firm. Such groupings facilitate specialisation on the part of staff as well as the partners.

2.6 TRAINING

The professional reputation of an audit firm revolves heavily around the quality of the work performed, which in turn is a function of the type of personnel employed. The human resources, therefore, constitute the most valuable and

vital resource of the firm. Audit firms must, therefore, have a policy of investing heavily in the training and re-training of all categories of their personnel. Training should always be accompanied with development of human resources because through training and development, the audit firm can enhance the skill of its personnel. Training and development activities may also enhance motivation and positive attitudes by making work more interesting and supporting such needs as achievement and self esteem.

Training has been defined as “the organisation’s efforts to help employees *learn* job-related knowledge, skills and behaviour”; while development is defined as “the organisation’s efforts to help employees *acquire* knowledge, skills, and behaviours that improve their ability to meet changes in job requirements and customer needs” (Wright and Noe, 1996).

In order to have an effective training system, the audit firm will need to design the system that suits its requirements. The process for designing effective training systems could follow the steps listed below:

- (a) Assessment of training needs, based on the analysis of the entire organisation, the tasks, and each individual staff;
- (b) Assessment of employees’ readiness for learning;
- (c) Creation of a learning environment;
- (d) Ensuring transfer of training, that is, employees being able to apply what they have learnt to their jobs;
- (e) Selection of appropriate training methods; and
- (f) Evaluation of the training programme, including the opinion of the trainees about the programme and the impact of the programme on their behaviour. This is the step that provides feedback for modifying the organisation’s training system.

Training Methods

There are various methods of training from which an audit firm may select.. There are formal, that is, outsourcing and informal, that is, in-house, training methods and the choice may be a function of the size of the audit firm and employees’ training needs.

The following are the most common techniques that could be used for training personnel of an audit firm:

(a) **Presentation Methods**

This involves the trainer telling or showing trainees the information that they are required to learn. These methods consist of lectures, use of audio-visual materials such as overhead projector slides, videotapes and multimedia facilities. They could take place in a classroom setting or via tele-conferencing. They are methods used for seminars, workshops and some in-house training programmes;

(b) **Hands-on Training or Hands-on Learning**

This is used when trainees try new skills in the course of the training session. These methods include on-the-job training, business games, case studies, simulations, and interactive video; and

(c) **Group Building Techniques**

This method involves training programmes for building group identities and teaching inter-personal skills through discussions and shared experiences. It is particularly common for organisations using teamwork as they apply these techniques during retreats for their personnel.

Employee Development

The key resource to any audit firm is the quality of its staff. In order to ensure high quality audit work, the firm should at all times have adequate quality and number of staff necessary for the efficient and effective execution of the audit requirements of its clients.

It follows then that the firm should have in place adequate procedures for:

- (a) Recruitment and retention of staff of the right quality; and
- (b) Training and re-training of its staff.

The staffing policy of the firm should be designed to ensure that only highly qualified personnel are recruited and that such staff are adequately trained to give them on the job experience. Hence the employment policy of the firm should be based on qualification, skill and cognate experience. It is necessary to adequately motivate the staff to ensure high morale and reduce staff turnover. Some firms source their trainees from among only University graduates with a minimum of a prescribed honours degree. Some firms have in-house training outfit where they organise formal and continuous training of their staff while others outsource this to consultants. In all situations, the training and re-training of staff ensures that their skills and experience are constantly updated and are relevant to the needs of their clients.

In addition to the training and retraining of staff required to improve the skill and experience of audit staff, it is also essential for the firm to provide the necessary technical support to the staff to enhance their efficiency and effectiveness.

The type of technical support a firm may provide to its staff will include; audit manuals, standard audit programmes, standardised working papers, internal control questionnaires, checklists, provision of professional journals, internal newsletters, personal computers, and computer audit software.

Technical support provided to staff tend to standardise performance and help in the review processes. The technical support, especially audit manual, which the firm provides to its staff is a very good reference material to audit staff which guides them at all stages of the engagement.

Employee development requires that the audit firms use some combination of formal education, assessment, job experiences, and interpersonal relationships. These methods are geared mainly at ensuring that the firm's workforce is prepared for the growth and survival of the organisation:

- (a) Formal education is aimed at attaining more qualifications, for example, audit trainees who are encouraged to take the professional examinations of the Institute, qualified staff who are encouraged to obtain post-graduate qualifications through part-time programmes (at the Universities) in the vicinity of the firm;
- (b) Assessment is done by collecting information about employees' behaviour, communication style, or skills and then providing the employees with a feedback. This is used to identify the employees' strengths, weaknesses, and their potential for occupying management positions;
- (c) Job experiences are designed by the organisation to expose employees to various aspects of the entire operations of the organisation. This could be done by both vertical and lateral moves; vertical moves through promotions and lateral moves through job rotation or transfer; and
- (d) Interpersonal relationships are promoted by the organisation when deliberate attempts are made to encourage employees or managers to be *mentored* by more experienced members of the organisation. This is aimed at enhancing the development of the employee or manager with less experience.

Note:

The “Big Four” firms or some of the medium-sized firms can arrange for some of their staff to go on overseas training or attachment to offices of their overseas sister firms. In some cases, they may send some of their senior staff for either local or overseas “train-the-trainers” courses, which in turn will provide the opportunity for those who have been so trained to transfer such training to other employees.

2.7 STANDARDS FOR ASSURANCE ENGAGEMENT

The International Standard on Auditing (ISA No. 100 on Assurance Engagements) defines assurance engagement as “one in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users, other than the responsible party, about the outcome of the evaluation or measurement of a subject matter against criteria”. When this definition is put in the context of a statutory audit as a type of assurance service, then it can be written thus:

“a statutory audit is an assurance engagement in which an auditor expresses opinion on a set of financial statements designed to enhance the degree of confidence of the shareholders, other than the management, about the outcome of the evaluation or measurement of the financial statements against accounting standards/law”.

In other words, an audit is an assurance engagement exercise aimed at giving an independent opinion on the truth and fairness of financial statements. The traditional role of auditing has been centred around giving assurance on the

assertions made by the management of an enterprise in the financial statements prepared in respect of that enterprise. This is an assurance service offered to the owners of the enterprise and in the case of a company, the assurance service is offered to the shareholders.

2.7.1 Underlying Concepts of Assurance Engagement

The need for assurance service has arisen because of the fact that owners and managers of businesses are often different people such that owners (shareholders) would require more confidence in the report of managers (directors). This need has continued to be pertinent as a result of the increase in the volume of information made available and required as a result of the following developments:

- (a) Growth in international communication methods especially the proliferation of reporting on the Internet and the use of the World Wide Web; and
- (b) Additional areas in respect of which information is required, may relate to corporate social responsibility, environment reporting, corporate governance, etc.

Elements

The various **elements** which are peculiar to assurance engagement are:

- (a) Existence of a three-party relationship which involves:
 - (i) the practitioner;
 - (ii) the responsible party; and
 - (iii) the intended users;
- (b) Identification of the subject matter;
- (c) Existence of suitable criteria;
- (d) Availability of sufficient appropriate evidence; and
- (e) Written assurance report in appropriate form to include appropriate conclusion.

Types of Assurance Engagement

There are basically two types of assurance engagement and they are:

- (a) An assertion-based engagement, where the accountant declares that a given assertion, that is, claim or declaration is in his opinion true. An example of this type is the statutory audit; and
- (b) A direct reporting engagement, where the accountant reports on issues that have come to his attention during his evaluation. An example of this is a management performance report.

Peculiarities of Assurance Engagement

There are certain peculiarities of assurance engagements:

- (a) Those that vary according to the elements of the engagement. For instance, depending on the engagement itself, the criteria and the subject matter the level of assurance that the practitioner can give is either reasonable or limited.

It is not possible to give an absolute level of assurance because of the limitations inherent in the process of carrying out the assignment. There are two possible levels of assurance and they are:

- (i) Reasonable, that is, high level of assurance, where the practitioner would conclude that the subject matter materially conforms to the criteria. For example, a statutory audit; and
 - (ii) Limited level of assurance, where the practitioner has no reason to believe that the subject matter does not conform to the criteria, that is, he believes that it is possible that the subject matter conforms to the criteria.
- (b) Those that depend on the subject matter. In this case, the subject matter may fall into any of the following three categories:
- (i) Data (financial statements or forecasts);
 - (ii) Systems and procedures (internal control systems or computer systems); and
 - (iii) Behaviour (corporate social responsibility, environmental performance or corporate governance).

Characteristics of Assurance Engagement

A matter that can be subjected to an assurance service, should have the characteristics of being:

- (a) Identifiable;
- (b) Capable of consistent evaluation and measurement; and
- (c) Capable of procedures and evidence gathering.

There are many examples of assurance engagements. The statutory audit is the most common example. Other examples include the following reports on:

- (a) Management Performance;
- (b) Risk Assessments;
- (c) Corporate Governance;
- (d) Performance Related Data;
- (e) Systems and Controls;
- (f) Corporate Social Responsibility Performance;
- (g) Prospective Financial Information;
- (h) Environmental Performance;
- (i) Report for Lenders and other Investors;
- (j) Reports relating to e-commerce; and
- (k) Non-statutory Audits and Reviews.

In view of the recent developments in the accounting profession, resulting in the growth of assurance services, it is necessary to draw attention to the implications of this trend for the profession.

Each audit firm should be conscious of the following implications:

- (a) Possibility of declining audit requirement resulting in decrease in audit fee but compensated by an increase in fee income from other assurance services;
- (b) Need for accountants to acquire a broad skill base in order to meet the requirements of non-audit assurance services;
- (c) Increase in potential liability of accountants resulting from a diversity of engagements; and
- (d) From the point of view of the public:
 - (i) Increase in expectation gap; and
 - (ii) Possibility of mistaking all other assurance services as audit in a re-packaged form.

2.7.2 Quality Control Practices and Procedures

Quality control at the level of an audit firm has been covered in the previous chapter. Quality control in this chapter is in respect of an individual assurance engagement, in this case, the individual audit assignment. There is an International Standard on Auditing – ISA 220 on Quality Control for Audit work. The auditing standards or guidelines issued by ICAN are normally in conformity with the International standards and guidelines issued by IAASB. However, where there is a conflict between the two, the Institute’s Standards and Guidelines will prevail.

The Audit Engagement Partner is responsible for each audit engagement assigned to him right from the beginning to the conclusion. He has an engagement team (the staff assigned to the assignment) who should work together to implement quality control measures that are applicable to each particular audit engagement.

The Quality Control Standard covers the following different sections:

- (a) **Leadership Responsibilities**
The engagement partner should take responsibility for the overall quality on each audit engagement assigned to him.
- (b) **Ethical Requirements**
The engagement partner should consider whether members of the engagement team have complied with ethical requirements, as stated for example in the Professional Conduct of Members of ICAN (Fundamental Principles and Statements, as discussed in Chapter 22).
- (c) **Acceptance/continuance of client relationships and Specific Audit Engagements**
The engagement partner must ensure that the requirements of the standard on quality control in respect of accepting and continuing with the audit engagement (as stated in Chapter 13)

are met. If he has received any information that would have made him to decline the engagement in the first place, he should immediately communicate that information to the firm for the purpose of taking quick action.

(d) **Assignment of Engagement Teams**

The audit engagement partner is responsible for ensuring that the engagement team is appropriately experienced and qualified as a unit fit for the particular assignment.

(e) **Engagement Performance**

This consists of various factors for which the engagement partner is responsible. These factors include direction, supervision, review, consultation, differences in opinion, and quality control:

- (i) Under direction, the engagement partner should inform members of the engagement team of their responsibilities, nature of the entity's business, risk-related issues, problems that may arise and the detailed approach to the performance of the assignment;
- (ii) Under supervision, the audit engagement partner is the overall supervisor for the whole assignment but it is usual that within the team, the senior members supervise the junior ones. For example, the audit manager supervises the audit senior, etc.;
- (iii) Under review, the work is subjected to constant evaluation to ensure that the objectives of the engagement procedures are met and the evidence obtained is both appropriate and sufficient. The audit engagement partner must be sure of a thorough review before issuing the audit report;
- (iv) Under consultation, the partner should ensure that difficult and/or contentious matters are subjected to appropriate consultation and well documented;
- (v) Differences of opinion could arise between the audit staff and their manager or between the entire audit team and their audit engagement partner or even between the partner and the quality control reviewer. In any of these cases, the differences should be resolved in accordance with the firm's policy for such matters.
- (vi) Quality control review requires the audit engagement partner to appoint a reviewer with whom he discusses and finalises all significant matters before issuing the audit report.

(f) **Monitoring**

The audit engagement partner should refer to the results of monitoring of the firm's quality control systems and consider whether such results have any impact on the particular audit that he is conducting.

Quality Control Review

In view of the importance of quality control review, which is the concluding part of the engagement performance section, it is considered essential to mention here that a good quality control review should include:

- (a) An evaluation of the significant judgments made by the engagement team, for example, materiality and significant risks; and
- (b) An evaluation of the conclusions reached in formulating the auditor's report, for example, conclusions on difficult/contentious issues or on matters having differences of opinion.

2.7.3 Advertising and Publicity

Advertising and publicity for Chartered Accountants in public practice (auditors) are covered under Statement No. 8 of the Professional Conduct for Members. The Institute appreciates that auditors are in business and, therefore, need to advertise their services, and seek publicity for their products and achievements. The Institute, therefore, gives the following guidance on advertising and publicity:

- (a) A member is allowed to seek publicity for and advertise his/her services, achievements and products in any way consistent with the dignity of the profession;
- (b) In doing so, he/she should not project an image inconsistent with that of a professional person bound to high ethical and technical standards;
- (c) Advertisements should be clearly distinguishable as advertisements;
- (d) Advertisements must comply with the law and should be legal, decent, clear, honest and truthful;
- (e) If reference is made in promotional material to fees, members should not make comparison in such material between their fees and the fees of other accounting practices, whether members or not;
- (f) Promotional material should not make disparaging references to or disparaging comparison with the services of others, for example, claims of size or quality are subjective and may be difficult to substantiate and therefore should be avoided;
- (g) Unsolicited promotional or technical material should not be sent to a non-client by facsimile transmission or other electronic means; and
- (h) In relation to audit or other financial reporting work, a member should not make an unsolicited personal visit or telephone call to a person who is not a client with a view to obtaining professional work from the non-client.

2.7.4 Fees

Section 361 of CAMA provides that the remuneration of auditors may be fixed by the directors, if the auditors are appointed by the directors. However, in other cases, the auditors' remuneration shall be fixed by the company at the annual general meeting or in such manner as the company in general meeting may determine. Remuneration in this context consists of the auditors' fees and expenses.

Statement No. 7 in ICAN's Professional Conduct for Members makes extensive provisions for fees to be charged by Chartered Accountants, and these provisions are highlighted below:

- (a) It is noted that a chartered accountant is entitled to charge for his/her services:
 - (i) Such specific fee as he/she has agreed with the client; or
 - (ii) A fee calculated in accordance with any agreement with the client; or
 - (iii) In the absence of an agreement, a fee calculated by reference to the custom of the profession.
- (b) In the case of where there is no agreement on the basis of the fee, a member of the Institute should charge a fee which is fair and reasonable, having regard to:
 - (i) The seniority and professional expertise of the persons necessarily engaged on the work;
 - (ii) The time expended by each of those persons;
 - (iii) The degree of risk and responsibility which the work entails; and
 - (iv) The priority and importance of the work to the client; and any expenses properly incurred.
- (c) As regards fee quotations and estimates, a member should inform a client in writing, prior to the commencement of the engagement, of the basis upon which any fee he proposes to charge that client for his services will be calculated and, on request and where practicable, the level of fees likely to be charged for any assignment. All these must be preceded with discussions with the client during which explanations of the basis on which fees are charged must have been given. The information on fees is usually provided in the Engagement letter.
- (d) Quoting a fee that is lower than that of another member is not considered improper by ICAN's guidelines. However, such a member should take care to ensure that the client has a full and complete understanding of:
 - (i) The services to be covered by the fee; and
 - (ii) The basis on which the fee is to be determined both for the current and future years.

- (e) Audit firms obtaining work having quoted levels of fees which are significantly lower than those charged by existing auditors or quoted by other tendering firms should be aware that their objectivity may appear threatened. Such firms should be prepared to demonstrate in the event of a complaint being made to the Institute that:
 - (i) The work done was in accordance with Auditing Standards and Guidelines; and
 - (ii) The client was not misled as to the basis on which fees for the current year and subsequent years were to be determined.
- (f) In cases where fees rendered exceed, without prior agreement, a quotation or estimate or indication of fees given by a member by more than a reasonable amount, the member should be prepared to provide the client with a full and detailed explanation of the excess and to take steps to resolve speedily any dispute which arises.
- (g) A member whose fees have not been paid may be entitled to retain certain books and papers of a client upon which he/she has been working, by exercising a lien and may refuse to pass information to the client or his successor accountant until those fees are paid. Such a member should however be prepared to take reasonable steps to resolve any dispute relating to the amount of that fee.
- (h) Fees should not be charged on a percentage, contingent, or similar basis in respect of audit work, reporting assignments and similar non-audit roles incorporating professional opinions including expert witness assignments. This is because such methods may be perceived as a threat to objectivity and for other works as requiring such methods to be used; a member should only adopt such methods after careful consideration.
- (i) Cases where percentage, contingent, or similar basis could be used include:
 - (i) Bankruptcies, liquidations, receiverships, administrations, voluntary arrangements and similar work where percentage of realisation/distribution is required either by statutory provisions or by tradition; and
 - (ii) Advising on a management buy-out, raising of venture capital, acquisition search or sales mandates, where a contingency basis is applicable.

In either case, the capacity in which a member has worked and the basis of remuneration should be made clear and well documented by the member in contemplation that a third party may have to rely on it.

- (j) Reference to fees in promotional material has been covered under **Advertising and Publicity**.

2.7.5 Tendering

In view of the guidelines in Statement No. 8 of ICAN's Professional Conduct for Members, covering "Obtaining Professional Work", which has been referred to under **Advertising and Publicity**, tendering should commence only when a firm has been approached by a prospective client. Before proceeding to tender, the auditors (either the sole practitioner or the partners) have decided that their firm is capable of carrying out the assignment at a reasonable fee.

Therefore, whenever a firm is approached by a prospective client, the auditor will have to consider many factors including:

- (a) Whether he/she wants to do the work, considering all the necessary ethical factors;
- (b) Whether he/she is not disqualified by any statutory provisions from carrying out the assignment;
- (c) Whether the firm has available the appropriate calibre of staff for the job, and if not what will be required to get the appropriate staff;
- (d) Whether the proposed timetable for the work fits with the firm's current work plan;
- (e) Whether non-accounting specialist skills are necessary, and if so which ones are required;
- (f) Whether staff shall need further training for the work, and if so how much will such training cost; and
- (g) What fees to quote for the work.

A tender (which is the audit proposal) does not have a particular format. The format is usually a function of what the prospective client wants the audit firm to do. However, there are usually some vital matters which should be included in the tender while the tender could either be in the form of a document sent to the prospective client or presented by members of the audit firm at an agreed time and date. Some of the important matters are:

- (a) An assessment of the needs of the prospective client, for example, audit, taxation, accounting;
- (b) The proposed approach to the engagement;
- (c) The assumptions made to support the proposed approach;
- (d) An outline of how the firm intends to meet those needs, including the key staff to be involved;
- (e) The fee and the basis on which it has been calculated or estimated; and
- (f) A brief outline of the firm.

Note

Tendering should be handled as professionally as possible; no assumptions of familiarity with the prospective client should be made. It should be borne in mind that the prospective client must have invited other firms to tender as well; and this simply implies that the tender being submitted should be comparable with what the other firms might submit. It should also be competitive enough.

2.7.6 Engagement Letter

The Auditing Standards Committee of ICAN issued an Auditing Guideline on Engagement Letter in November 1990. The Guideline gives guidance on the procedures to be followed before the commencement of an audit. The principles contained in the Guideline, which are highlighted below, should also be followed in the case of non-audit engagements. If purely accounting services are provided to a non-corporate client, the engagement letter should specify clearly that these services will be performed without any audit work being carried out.

The principles are:

- (a) The purpose of an engagement letter is to define clearly the extent of the auditor's responsibilities and so minimise the areas of misunderstanding between the client and the auditor.
It also provides written confirmation of the auditor's acceptance of his appointment, the scope of the audit and form of his report;
- (b) It is in the interest of both the auditor and the client that the contents of the engagement letter be agreed. Therefore, the contents of the letter should be discussed and agreed with management before it is sent and preferably prior to the commencement of the audit;
- (c) The engagement letter should be addressed to the Board of Directors of a client company;
- (d) Where the company has subsidiary companies, a separate engagement letter should be sent by the auditor to the Board of Directors of each company in the group which he/she is auditing;
- (e) Where more than one firm of auditors are involved in the audits of the group, the respective responsibilities of the holding company auditor and the subsidiary companies' auditors should be clearly defined in the engagement letter;
- (f) Where there are joint auditors, the audit engagement should be explained in similar terms by each auditor. The auditors should agree whether a joint letter or separate letters should be sent to the client. Where other services are provided by one of the firms, separate letters would normally need to be sent on the joint audit engagement;
- (g) The auditor should request confirmation from the Board of Directors that the terms of the engagement letter have been accepted; and

- (h) Once it has been agreed by the client, an engagement letter will, if it so provides, remain effective from one audit appointment to another, until it is replaced. However, a revised engagement letter may be necessary to ensure that it continues to reflect the client's circumstances and if there has been a significant change in the client's management, a prior discussion and agreement with the client may also be necessary.

An engagement letter should contain the following:

- (a) Responsibilities and scope of the audit;
- (b) Reference to special arrangements, for example, internal auditors, other auditors, overseas subsidiaries;
- (c) Representation by Management, if required before the completion of the audit;
- (d) Irregularities and fraud – the responsibilities of the Management vis-à-vis the auditors on this should be specified clearly;
- (e) Accounting and Taxation services, if any;
- (f) Fees and the basis of calculation or estimation; and
- (g) Agreement of terms to be in written form.

A specimen engagement letter is shown in **Appendix V**, page 349.

The Practical Aspects of an Engagement Letter

Most Accountants do not see any need to send an engagement letter. This is borne out of the fact that it occasions delays and in any event, most clients do not understand nor do they expect the letter and even when one is written they rarely send a reply. This is also the result of ignorance on the part of most clients, who would view a letter of engagement with suspicion as most of them, (the clients) would consider the appointment of an auditor as all inclusive; keeping the accounting records, preparing the financial statements, dealing with the tax matters and of course discovering fraud and error; in fact stamping them out. The client in most cases, at best will be disappointed to read in the first letter from the auditor that he will not discover fraud and errors. Nevertheless, it is the duty of the auditor to send the letter at the most appropriate time when the client is better disposed to understand its relevance. But regardless of the disposition of the client, it is still in the interest of the auditor to send a letter of engagement at any new engagement in line with the recommendations of IAG 2.

A letter of engagement serves to define clearly the extent of the responsibilities of the auditor by documenting and confirming the:

- ◆ Auditor's acceptance of his appointment;
- ◆ Objective and scope of the audit;
- ◆ Extent of the auditor's responsibilities; and
- ◆ Form of his report.

The client should be encouraged to send a reply to the letter of engagement. The best procedure will be to discuss the terms of the engagement before sending the letter.

2.7.7 Consultation

This is one of the several factors involved in engagement performance, as indicated under Quality Control Practices and Procedures discussed earlier in this chapter. The International Auditing Standard on Quality Control states that “the firm should establish policies and procedures designed to provide it with reasonable assurance that:

- (a) Appropriate consultation takes place on difficult or contentious matters;
- (b) Sufficient resources are available to enable appropriate consultation to take place;
- (c) The nature and scope of such consultations are documented; and
- (d) Conclusions resulting from consultations are documented and implemented.” (ISQC 1.51)

The above requirements may involve external consultation, for example, with other experts, or other firms or with the Institute. Whenever there is any difference in opinion within the engagement team or between the engagement partner and the quality reviewer, such differences must be resolved before the report is issued by the engagement partner.

The audit firm should have in place policies and procedures to determine when a quality control reviewer will be necessary for an engagement. For instance a quality control reviewer will be necessary for all audits of financial statements in respect of listed companies.

2.7.8 Performance and Reporting Standards

When all the quality control procedures in respect of an audit assignment have been concluded, the audit engagement partner will be in a position to form the audit opinion as to the truth and fairness of the financial statements against the existing accounting standards/law. This is the main crux of the report.

At this level, readers should have been familiar with the different types of audit opinion that can be given and the circumstances leading to each type. This is however stated below:

- (a) Unqualified audit opinion — when the accounts show a true and fair view.
- (b) Modified audit report, for example, “Accounts show a true and fair view except for” — when material item(s) in the accounts do not show a true and fair view.
- (c) Adverse audit opinion — when a true and fair view is not shown because of extensive disagreement on the accounts.

- (d) Modified audit report for example, “Accounts show a true and fair view except for, plus any implied opinion” — when the auditor cannot confirm a true and fair view in respect of material item(s), due to limitations in scope.
- (e) Disclaimer of opinion plus any implied opinions — when the auditor cannot confirm whether a true and fair view is given at all, due to a limitation in scope.

The audit report should be addressed to the shareholders to whom the auditors have their primary and statutory responsibilities. It should, however, be noted that audited accounts are usually used by many groups of accounting information users, regardless of whether they are shareholders or not.

Readers should be familiar with standard unqualified audit report by now. ISA 700 on “The Auditor’s Report on Financial Statements” outlines the standard audit report.

This report has certain elements designed to remove common misconceptions by the users of audited accounts. These elements include:

- (a) The report is clearly addressed to the members of the company (that is, the shareholders);
- (b) The report contains an introductory paragraph stating what the report refers to;
- (c) The report contains paragraphs indicating the respective responsibilities of directors and auditors;
- (d) The report contains paragraphs explaining the basis of the auditors’ opinion (the basis on which they have come to their conclusions);
- (e) The report contains a paragraph expressing the auditors’ opinion (the opinion paragraph);
- (f) In the case of the audit of financial statements of banks, there is usually a paragraph preceding the opinion paragraph, stating contraventions of BOFIA and/or CBN circulars, if any. This paragraph will also refer to where in the financial statements the particulars of such contraventions can be found;
- (g) The report must be signed and dated by the auditors; and
- (h) The auditor must not sign the report until the Board has approved the financial statements.

Examples of standard unqualified audit reports and the other types of report (of various categories) are given in **Appendix VI, page 355** of this study pack.

2.8 EXPECTATION GAP

The role of an auditor is usually misconstrued by the public including the investment community. While some people think that the auditor is responsible for preparing the accounts and/or dealing with tax and/or keeping the books,

only very few people really understand how restricted the role of the auditor is. People generally expect more from an auditor than what he/she is actually statutorily required to do and that is really the cause of the expectation gap.

ISA 200 makes an essential point on this issue by stating that:

“While the auditor is responsible for forming and expressing an opinion on these financial statements, the responsibility for preparing and presenting the financial statements in accordance with the applicable financial reporting framework is that of the management of the entity with oversight from those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities”.

It is also important to note the fact that contrary to public expectation, the auditor is merely a watch-dog rather than a bloodhound. (Re Kingston Cotton Mill Co., 1896). In other words, the auditor does not have primary responsibility as regards prevention and detection of fraud; though the detection of fraud may be incidental to his duties. It is management and those charged with governance that are primarily responsible for prevention and detection of frauds.

Frauds

Fraud consists of both the use of deception to obtain an unjust or illegal financial advantage and intentional misrepresentations affecting the financial statements by one or more individuals among management, employees or third parties.

Errors

Errors are unintentional mistakes in financial statements resulting in material mis-statement. The mistake may be committed at any stage in the accounting cycle and may be mathematical, clerical, or simply in the application of accounting policies.

Types of Fraud

There are two types of fraud that can cause material misstatement in financial statements. These are:

- (a) Fraudulent financial reporting such as:
 - (i) Misrepresentation or omission of events or transactions in the financial statements;
 - (ii) Intentional misapplication of accounting principles; and
 - (iii) Manipulation, falsification or alteration of accounting records/ supporting documents.
- (b) Misappropriation of assets such as:
 - (i) Stealing of physical assets or intellectual property (cash, inventory or selling data);
 - (ii) Causing an entity to pay for goods not received;

- (iii) Embezzling receipts of cash and cheques (diverting same to private bank accounts); and
- (iv) Using entity's assets for personal purpose.

It should be noted that fraudulent financial reporting usually involves management when embarking on window dressing or creative accounting in their bid to have aggressive earnings.

ISA 240 deals with "Fraud and Error". It gives guidelines on how the auditor is to handle the possibility of the occurrence of fraud. Some of the key guidelines in the audit standard include the following:

- (a) In planning and performing the audit to reduce audit risk to an acceptably low level, the auditor should consider the risks of material misstatements in the financial statements due to fraud (ISA 240.3);
- (b) The auditor should maintain an attitude of professional scepticism throughout the audit, recognising the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor's past experience with the entity about the honesty and integrity of management and those charged with governance (ISA 240.24);
- (c) Members of the engagement team should discuss the susceptibility of the entity's financial statements to material misstatements due to fraud (ISA 240.27); and
- (d) When obtaining an understanding of the entity and its environment, including its internal control, the auditor should make enquiries of management regarding:
 - (i) management's assessment of the risk that the financial statements may be materially misstated due to fraud;
 - (ii) management's process for identifying and responding to the risks of fraud in the entity including any specific risks of fraud that management has identified or account balances, classes of transactions or disclosures for which a risk of fraud is likely to exist;
 - (iii) management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity; and
 - (iv) management's communication, if any, to employees regarding its views on business practices and ethical behaviour (ISA 240.34);
- (e) The auditor should make enquiries of management, internal audit and others within the entity as appropriate, to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity (ISA 240.38);

- (f) The auditor should obtain understanding of how those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks (ISA 240.43);
- (g) The auditor should make enquiries of those charged with governance to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity (ISA 240.46);
- (h) When obtaining an understanding of the entity and its environment, including its internal control, the auditor should consider whether the information obtained indicates that one or more fraud risk factors are present (ISA 240.48);
- (i) When identifying and assessing the risks of material misstatements at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures, the auditor should identify and assess the risks of material misstatement due to fraud. Those assessed risks that could result in a material misstatement due to fraud are significant risks and accordingly, to the extent not already done so, the auditor should evaluate the design of the entity's related controls, including relevant control activities, and determine whether they have been implemented (ISA 240.57);
- (j) The auditor should determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level and should design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks at the assertion level (ISA 240.61);
- (k) In determining overall responses to address the risks of material misstatement due to fraud at the financial statement level, the auditor should:
 - (i) consider the assignment and supervision of personnel;
 - (ii) consider the accounting policies used by the entity; and
 - (iii) incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures (ISA 240.66).
- (l) To respond to the risk of management override of controls, the auditor should design and perform audit procedures to:
 - (i) test the appropriateness of journal entries in the general ledger and other adjustments made in the preparation of the financial statements;
 - (ii) review accounting estimates for biases that could result in material misstatements due to fraud; and
 - (iii) obtain an understanding of the business rationale of significant transactions that the auditor becomes aware of that are outside of the normal course of business for the entity, or that otherwise appear to be unusual given the auditor's understanding of the entity and its environment (ISA 240.76).

- (m) If the auditor has identified a fraud or has obtained information that indicates a fraud may exist, the auditor should communicate these matters as soon as practicable to the appropriate level of management (ISA 240.93);
- (n) If the auditor has identified fraud involving:
 - (i) Management;
 - (ii) Employees who have significant roles in internal control; or
 - (iii) Others where the fraud results in a material misstatement in the financial statements;
 the auditor should communicate these matters to those charged with governance as soon as practicable (ISA 240.93).

In all the above guidelines, the engagement partner should ensure that all the procedures are adhered to. As he is the one responsible for the entire engagement, he should make the engagement team carry out all the procedures.

In addition to the above, it is necessary to note that the need for documentation cannot be over-emphasised. The following should be properly documented:

- (a) The important decisions of the audit engagement team emanating from their discussions with regard to fraud;
- (b) The identified and assessed risks of material misstatement due to fraud;
- (c) The overall responses to assessed risks;
- (d) Results of specific audit tests; and
- (e) Any communications with management.

An important communication with management is obtaining a written representation that management accepts its responsibility for the prevention and detection of fraud and that it has made all relevant disclosures to the auditors. The auditor should consider seriously the need to withdraw from the engagement if he uncovers exceptional circumstances with regard to fraud.

2.9 NEGOTIATION SKILLS

Negotiation is simply a discussion entered into with a view to reaching an agreement. It is the process by which two or more parties exchange goods or services and attempt to agree upon the exchange rate for them. It may just be a case of services being exchanged for a consideration.

The process of negotiation provides the interactions of almost everyone in groups and organisations. Circumstances requiring negotiations are sometimes obvious, while in some cases they are subtle.

As regards auditors, negotiation becomes necessary for the purpose of agreeing fees with prospective clients, or agreeing increases in fees with their existing clients, or in cases when they need to act on behalf of their clients. In whatever situation it is, the auditor has to be an effective negotiator.

There are two general approaches to negotiation, that is, distributive bargaining and integrative bargaining:

- (a) Distributive bargaining operates under zero-sum conditions and has the following characteristics:
 - (i) The amount of resources to be divided is fixed;
 - (ii) The primary motivation is “I win, you lose”;
 - (iii) The primary interests of the two parties are opposed to each other; and
 - (iv) The focus of relationships is short-term.
- (b) Integrative bargaining operates under the assumption that there exists one or more settlements that can create a win-win solution. It involves the following characteristics:
 - (i) There is a variable amount of resources to be divided;
 - (ii) The primary motivation is “I win, you win”;
 - (iii) The primary interests are convergent and congruent with each other; and
 - (iv) The focus of relationships is long-term.

In terms of inter-organisational behaviour, all things being equal, integrative bargaining is preferable to distributive bargaining. This is because the former builds long-term relationships and facilitates working together in the future. It bonds negotiators and allows each party to leave the negotiation meeting with a feeling of victory.

On the other hand, distributive bargaining leaves one party a loser. It tends to develop animosities and deepen divisions when people have to work together on a continuing basis (as is the case of auditors and their clients). However, there is a tendency to see more of distributive bargaining within organisations because of the fact that the conditions required for integrative bargaining seldom exist within organisations.

2.9.1 The Negotiation Process

The process of negotiation can be viewed as being made up of five steps. These are:

- (a) Preparation and Planning:
 - (i) Do your homework thoroughly;
 - (ii) Find out the nature of the conflict;
 - (iii) Investigate to know the history leading to the negotiation;
 - (iv) Find out who is involved and what their perceptions of the conflict are;
 - (v) Identify what you want to achieve from the negotiation, that is, your goals;
 - (vi) Prepare an assessment of what you think the other party’s goals are, i.e.
 - ◆ What are they likely to demand?

- ◆ What are they likely to settle on?
 - ◆ What are their strengths and weaknesses?
 - ◆ Then develop a strategy.
- (b) Definition of ground rules, i.e.
- (i) Who will do the negotiation?
 - (ii) Where will it take place?
 - (iii) What time constraints, if any, will apply?
 - (iv) To what issues will the negotiation be limited?
 - (v) In the case of an impasse, will there be a specific procedure to follow?
 - (vi) Exchanging initial proposals or demands.
- (c) Clarification and justification:
- (i) Explanation/Clarification and justification of initial position should be made.
 - (ii) Documentation may be exchanged to support each party's position.
- (d) Bargaining and Problem Solving:
- (i) Begin with a positive overture, for example, a small concession;
 - (ii) Address problems, not personalities; that is, discuss issues, not the other parties' personal characteristics;
 - (iii) Emphasise win-win solutions; and
 - (iv) Create an open and trusting climate.
- (e) Closure and Implementation:
- (i) Ensure that the agreement that has been worked out is well formalised;
 - (ii) Develop any procedures that are necessary for implementation and monitoring; and
 - (iii) Spell out the specifics in a formal contract.

2.9.2 Issues to Note in Negotiation

There are four contemporary issues in negotiation:

- (a) The role of personality traits is insignificant
Personality traits have no significant direct effect on either the bargaining process or negotiation outcomes. You may not be able to predict the other party's negotiating tactics by virtue of your knowledge of his/her personality.
- (b) Gender differences are not significant in negotiating
Women are "neither worse nor better negotiators, neither more cooperative nor open to the other, and neither more nor less persuasive nor threatening than are men" (Robbins, p.454).
- (c) The effect of cultural difference is significant in negotiating styles.
Negotiating styles clearly vary across national cultures, even

across tribal culture in some countries. Different cultures have their own norms on the appropriate way to negotiate.

- (d) The use of third parties could be significant in helping to resolve differences. In some cases, direct negotiation may result in a stalemate, whereby the parties may have to turn to a third party to help them find a solution. In such a situation, the third party may play any of four roles, namely:
 - (i) A mediator - This is a neutral third party who facilitates a negotiated solution by using reasoning, persuasion and suggestions for alternatives.
 - (ii) An arbitrator - This is a third party to a negotiation who has the authority to dictate an agreement.
 - (iii) A conciliator – This is a trusted third party who provides an informal communication link between the negotiator and the opponent.
 - (iv) A consultant – This is an impartial third party, skilled in conflict management, who attempts to facilitate creative problem solving through communication and analysis.

2.9.3 An Effective Negotiator

Having considered the meaning of negotiation and its other attributes, one could then deduce that an effective negotiator should be a skilled negotiator. He/she should:

- (a) Be conversant with the meaning of negotiation.
- (b) Be knowledgeable about negotiation process.
- (c) Be familiar with the contemporary issues in negotiation.
- (d) Be committed to the goals of his /her organisation.

An effective negotiator should be a good listener, who focuses his/her arguments more directly and asks more questions, is less defensive and has learnt to avoid words and phrases that can irritate the other party. The goal should be to reach an integrative settlement, whereby the two parties to the negotiation can be in a position to declare a victory.

2.10 AUDITOR'S LIABILITY

Section 368 of CAMA provides the liability of auditors for negligence as follows:

- (a) “A company’s auditor shall in the performance of his duties, exercise all such care, diligence and skill as is reasonably necessary in each particular circumstance;
- (b) Where a company suffers loss or damage as a result of the failure of its auditor to discharge the fiduciary duty imposed on him by subsection (1) of this section, the auditors shall be liable for negligence and the directors may institute an action for negligence against him in the court; and
- (c) If the directors fail to institute an action against the auditor under subsection (2) of this section, any member may do so after the expiration

of thirty days notice to the company of his intention to institute such action”.

The auditor does not owe his duty of care only to the company or the members of the company; he also owes it to third parties who may rely on his special skill and judgement. In view of the fact that third parties do not have any contract with the audit firm, they will need to prove to the court that a duty of care which is enforceable at law existed as at the time the negligence was committed by the auditor.

Negligence is a legal concept that seeks to provide compensation to a person who has suffered loss due to another person’s wrongful neglect. In the case of auditors, a negligent misstatement would constitute negligence.

The parties that can bring an action for negligence against the auditors if the latter have given negligent misstatement through lack of care, include:

- (a) The company;
- (b) The shareholders of the company as a body;
- (c) The bank as a key financier of the company;
- (d) Other lenders; and
- (e) Other interested third parties, (individual shareholders in the company or any potential investor).

In order to succeed in an action for negligence, an injured party must prove the following:

- (a) A duty of care which is enforceable at law existed;
- (b) This duty of care was breached by the auditor; and
- (c) The breach caused the injured party loss.

Note:

A duty of care exists between a company and its auditor, so this does not need to be proved by a company bringing an action for negligence against an auditor:

- (a) Where loss has arisen, but no negligence can be attributed to the auditor, he cannot be held liable for damages. On the other hand, where negligence has been proved against the auditor, liability for damages will arise only if an actual loss has arisen as a result of the negligence;
- (b) Any provision in the Articles of Association of a company or in any contract with a company for exempting an auditor from liability for the consequence of his negligence or breach of duty is void;
- (c) In spite of the provisions of section 368 (2) of CAMA, if the court thinks that the auditor, though liable, had acted honestly and reasonably and ought fairly to be excused, the court may relieve him from liability on such terms as it thinks fit;

- (d) Banks and other major lenders may include a clause in loan agreements referring to audited accounts and requesting that they have access to such accounts on a regular basis or whenever the loan facility is being reviewed. This is with a view to creating a “relationship” with the auditors in order to be able to establish that a duty of care does exist after all; and
- (e) In a negligence action, audit firms always prefer to settle out of court to avoid bad publicity and save time and costs.

2.10.1 Auditors’ Professional Liability Under Statute

Auditors may be found guilty of certain offences under certain circumstances as:

- (a) Under insolvency legislation, auditors may be found as fiduciary officers of the company and be charged with criminal offences or found liable for civil offences in connection with the winding up of the company;
- (b) Under Money Laundering Act, if they fail to report a person (whom they know or suspect of laundering money) to the appropriate authority; and
- (c) Insider dealing, which is a criminal offence, as they are by virtue of their position always privy to insider information.

2.10.2 Litigation Avoidance

Apart from preferring to settle negligence actions out of court, audit firms also try to avoid litigation by any of the following actions:

- (a) At the stage of accepting a new engagement - the procedure is followed carefully, especially when new clients are to be screened to decide whether to accept the nomination or invitation to tender or not. This can be further enhanced by a proper use of the engagement letter;
- (b) At the stage of performing the audit work - the audit firm should ensure that all audits are carried out in accordance with professional auditing standards, guidelines and best practice.
- (c) Quality control should be applied both at the level and also at the level of each individual audit; and
- (d) Issuing of appropriate disclaimers whenever it is considered necessary.

2.10.3 Professional Indemnity Insurance

This is insurance against civil claims made by clients and third parties arising from work undertaken by the firm. It is in the interest of Chartered Accountants to take up an insurance policy, so as to be in a position to compensate clients for any error made by the accountant and also to prevent the burden of such compensation leading to their own bankruptcy.

The Institute requires that its members who are in public practice, that is, those holding practicing licence, take up an insurance policy with a reputable insurer.

2.11 SUMMARY AND CONCLUSIONS

In this chapter, we have discussed the management of a professional audit firm under five main sub-sections as follows:

- (a) Office and Office Facilities;
- (b) Partners' Relationship;
- (c) Staff Management;
- (d) Quality Control;
- (e) Training;
- (f) Standards for Assurance Engagement;
- (g) Expectation Gap;
- (h) Negotiation skills; and
- (i) Auditor's Liability.

Refer to Comprehensive Questions and Suggested Solutions in Appendix II, page 303.

2.12 REVISION QUESTIONS

1. Which of these sections is NOT normally found in an audit firm?
 - (A) Taxation.
 - (B) Audit/Assurance.
 - (C) Production.
 - (D) Management Consultancy.
 - (E) Insolvency.
2. In exercising quality control in an audit firm, there is no need to:
 - (A) Have a monitoring unit.
 - (B) Have an engagement partner.
 - (C) Comply with regulatory and legal requirements.
 - (D) Comply with professional standards.
 - (E) Prepare the financial statements of the client.
3. The purpose for which all the partners in an audit firm should embrace a system of effective management does not include ensuring that their firm through them can:
 - (A) Use their resources wisely.
 - (B) Grow and thrive.
 - (C) Continuously and consistently earn profits.
 - (D) Consistently satisfy their competitors.
 - (E) Meet their challenges and turn them to their advantages.
4. The Staff Partner in an audit firm is primarily responsible for:
 - (A) Seeking publicity for and advertising the services, achievements and products of all the partners.
 - (B) Acquiring the appropriate human resources through human resource planning, recruitment and selection.
 - (C) Referring to the results of monitoring the firm's quality control systems.
 - (D) Ensuring that the work done by the audit staff is in accordance with Auditing Standards and Guidelines.
 - (E) Advising on the raising of venture capital for all staff.

5. The process for designing effective training systems could follow all the steps listed below except
 - (A) Assessment of training needs.
 - (B) Creation of a learning environment.
 - (C) Assessment of employee readiness for learning.
 - (D) Establishment of an appropriate training institution.
 - (E) Selection of appropriate training methods.

6. In order to ensure adequate, relevant and effective quality control, monitoring activities should be either on a _____ or _____ basis.

7. Training should always be accompanied with _____ of human resources in order for an audit firm to be able to enhance the skills of its personnel.

8. The training methods from which an audit firm may select could either be _____ or _____.

9. The various elements which are peculiar to an assurance engagement do not include the following:
 - (A) Existence of a three party relationship involving the practitioner, the responsible party and the intended users.
 - (B) Non-existence of suitable criteria.
 - (C) Identification of the subject matter.
 - (D) Written assurance report in appropriate form to include appropriate conclusion.
 - (E) Availability of sufficient appropriate evidence.

10. Which of the following is not an example of assurance engagements?
 - (A) A statutory audit
 - (B) Reports and statements of Accounting Policies
 - (C) Reports on Corporate Social Responsibility Performance
 - (D) Reports on Environmental Performance
 - (E) Reports for Lenders and Other Investors.

11. The Audit Engagement Partner is responsible for:
 - (A) All the audit engagements of his firm
 - (B) The audit engagement assignments at the end of each month
 - (C) The first audit engagement assigned to him for each month
 - (D) Each audit engagement assigned to him right from the beginning to the conclusion
 - (E) Each audit engagement assigned to the firm from the beginning to the conclusion.

12. Where there is no agreement on the basis of the fee payable by a client, a member of ICAN should charge a fee which is fair and reasonable, having no regard to the following:
 - (A) All the expenses incurred by the firm on all assignments during the period of the client's assignment
 - (B) The seniority and professional expertise of the persons necessarily engaged on the work.
 - (C) The degree of risk and responsibility which the work entails.
 - (D) The time expended by the persons necessarily engaged on the work.
 - (E) The priority and importance of the work to the client.

13. One of the important matters which should be included in a tender submitted for obtaining a professional work is:
- (A) The assumptions made by the client in inviting the member to submit a tender
 - (B) A brief outline of the client's organisation
 - (C) The fee and the basis on which it has been calculated
 - (D) The approach of the client to its usual operations
 - (E) The assumptions made by the client in support of its approach to its normal operations.
14. What are the two basic types of an assurance engagement?
15. One of the peculiarities of assurance engagements is that which depends on the subject matter, which may fall into any of three categories. Identify these three categories.
16. In relation to audit or other financial reporting work, a member of ICAN should not make an _____ personal visit or telephone call to a person who is not yet a _____ with a view to obtaining professional work from the person.
17. The purpose of an _____ is to define clearly the extent of the auditor's responsibilities and so _____ minimise the areas of misunderstanding between the client and the auditor.
18. In the case of the audit of financial statements of banks, there is usually a paragraph, stating _____ of BOFIA and/or CBN circulars, if any.
19. If the auditor has identified fraud involving _____ and _____ who have significant roles in internal control, the auditor should communicate these matters to those charged with governance as soon as practicable.
20. A company's auditor shall in the performance of his duties, exercise all such _____, and _____ as is reasonably necessary in each particular circumstance.

Refer to Suggested Solutions in Appendix I, page 297.

PUBLIC SECTOR AUDIT

3.0 LEARNING OBJECTIVES

After studying this chapter, readers should be able to:

- ◆ Understand the audit procedures in the public sector.
- ◆ Assess how to conduct the audit of statutory corporations and parastatals.
- ◆ Understand the nature of specialised audits in the public sector.
- ◆ Know specifically how to conduct the audit of contracts, pensions, and defence and security agencies.
- ◆ Know how to conduct the audit of Nigerian foreign missions and agencies.
- ◆ Understand the type of public sector audit referred to as Value for Money Audit.
- ◆ Know the techniques for carrying out a Value for Money Audit.
- ◆ Explain what has been generally referred to as Due Process Review in Nigeria.
- ◆ Understand the circumstances under which investigations are carried out in the public sector.
- ◆ Demonstrate knowledge of the procedure for conducting investigations in the public sector.
- ◆ Understand the use of probe panel in investigating fraud and corruption.
- ◆ Demonstrate the knowledge of the recent developments on investigations in the public sector.

3.1 INTRODUCTION

Auditing is as essential in the public sector as it is in the private sector. Section 85 of the 1999 Constitution states that there shall be an Auditor-General for the Federation. The role of the Auditor-General is to ensure that there is accountability by the Executive arm of the Government to the Legislative arm, for the proper administration of the activities, functions, operations and programmes of the government and its various agencies. Government auditing can be divided into three major categories, namely:

- (a) Audit of the Treasury Accounts, as prepared by the Accountant - General of the Federation;
- (b) Audit of Ministries/Departments and Agency Accounts; and
- (c) Audit of accounts of parastatals.

Apart from the provisions of the 1999 Constitution, the Audit Act, 1958 also provides that the Accountant-General of the Federation should furnish the Auditor-General for the Federation with the country's financial statements within **seven** months after the close of each financial year.

The institutional arrangements put in place to enhance planning, budgeting, funding, accounting, reporting, auditing and reviewing of the revenue and expenditure of the Federal Government consist of the following:

- (a) Minister of Finance who issues financial warrants with which the Accountant-General releases funds to the Ministries and Extra-Ministerial Departments, after approval by the legislature. The Minister can withhold any item of expenditure on which he/she so desires to exercise control.
- (b) Accountant-General of the Federation who is the only officer authorised to deal directly with the Central Bank of Nigeria. He/she releases funds to the Ministries and Extra-Ministerial Departments, based on the amount stated on the financial warrant signed by the Minister of Finance. He is also responsible for supervising all the treasury accounts and preparing all the necessary financial statements.
- (c) Auditor-General for the Federation is responsible for auditing the Accounts of the Federal Government and reporting to the National Assembly.
- (d) Public Accounts Committee (PAC) which is a committee of the National Assembly, is responsible for public accounts in accordance with Section 85 (5) of the 1999 Constitution. The PAC is required to deliberate on the Auditor-General's report, consider all the queries raised by him in his report, compile a comprehensive report and recommendations for submission to the whole House.

At the State level, a similar arrangement is also in place with the Commissioner for Finance, Accountant-General of the State, Auditor-General for the State and the Public Accounts Committee of the State House of Assembly performing similar roles as their counterparts at the Federal level. The State Governor is empowered to appoint the Auditor-General for the State on the recommendation of the State Civil Service Commission, subject to confirmation by the State House of Assembly (Section 126 of the 1999 Constitution).

3.2 AUDITOR-GENERAL FOR THE FEDERATION

The Auditor-General for the Federation shall be appointed by the President on the recommendation of the Federal Civil Service Commission, subject to confirmation by the Senate (Section 86 of the 1999 Constitution).

The Audit Act, 1958 provides that the Auditor-General for the Federation shall audit the accounts of all accounting officers and of all persons entrusted with the collection, receipt, custody, issue or payment of Federal Public monies or with the receipt, custody, issue, sale, transfer or delivery of any stamps, securities, stores or other property of the Government of the Federation.

He is responsible for carrying out surveys of the cash, stamps, securities, stores or other properties of government that are held by such officers or persons.

The Auditor-General shall examine the accounts relating to public funds and property, ascertain whether the objectives of government auditing are met, and ascertain whether in his opinion:

- (a) The accounts relating to public funds have been properly kept;
- (b) All public monies have been fully accounted for and the rules and procedures applied are sufficient to secure effective check on the assessment, collection and proper allocation of revenue;
- (c) Essential records have been maintained and the rules and procedures applied are adequate to safeguard and control public property and funds; and
- (d) Monies have been expended for the purposes for which they were appropriated and the expenditures have been made as authorised.

In addition to being responsible for the auditing of the accounts of the accounting officers and all persons entrusted with various assets of government, the Auditor-General may also undertake the examination of the accounts of any organisation that receives funds from the government, such as statutory corporations, parastatals and voluntary agencies. For the purpose of performing such functions, the Auditor-General or any person authorised by him shall have access to all the books, records, returns and other documents relating to those accounts. In the exercise of his functions under the 1999 Constitution, the Auditor-General shall not be subject to the direction or control of any other authority or person.

3.2.1 Functions of Auditor-General for the Federation

The functions of the Auditor-General for the Federation include the following:

- (a) Auditing and reporting in respect of treasury accounts, accounts of Ministries/Extra-Ministerial Departments and accounts of Parastatals;
- (b) Detection and prevention of fraud;
- (c) Control of loss of funds by ensuring that effective internal control systems are in place;
- (d) Serving as Chairman of the Audit Alarm Committee and Chairman of the Losses Committee; and
- (e) Being in attendance during Public Accounts Committee sessions as an adviser.

3.2.2 Departments under Auditor-General's Office

The Auditor-General's office is organised in such a way as to enhance the performance of his numerous functions. Consequently, the office is divided into the following departments:

- (a) Ministerial Department: This consists of divisions to take care of Treasury Accounts, Self-accounting ministries and offices, States and Abuja, Defence and Security, Revenue, Losses and

Investigation, Pensions (Civil/Military) and Annual Report/Public Accounts Committee.

- (b) Extra Ministerial Department: This comprises divisions to handle public enterprises, Universities and Polytechnics, Research Institutes, River Basins and Rural Development Authorities, Teaching Hospitals and Financial Houses, Mines and Power and Miscellaneous, and property and other voluntary organisations;
- (c) Personnel Management Department: This handles recruitment of staff, establishment, staff discipline, promotion, staff welfare, staff training and development;
- (d) Finance and Supply Department: This takes care of Accounts, Budgets, Stores and Protocol and Miscellaneous;
- (e) Project Monitoring and Evaluation Department and Internal Audit Unit; and
- (f) Planning, Research and Statistics Department: This comprises Planning, Research, Records and Statistics, Library and Efficiency Units.

The Auditor-General shall, within **ninety** days of receipt of the Accountant-General's financial statements, submit his reports under Section 85 of the 1999 Constitution to each House of the National Assembly and each House shall cause the Public Accounts Committee to consider the reports.

3.3 AUDIT OF THE TREASURY ACCOUNTS

The Treasury Department is headed by the Accountant-General of the Federation, who is regarded as the Chief Accounting Officer of the Federation. He is also the Treasurer and the Financial Adviser of the Federal Government [Finance (Control and Management) Act, 1958].

The functions of the Treasury Department include the following:

- (a) It is the custodian of the Consolidated Revenue Fund, Development Fund, Contingency Fund and other Public Funds of the Federation;
- (b) It is responsible for recording the financial transactions of the government and reporting thereon through the production and publication of the annual financial statements of the Federal Government in a manner that will show a true and fair view of the financial position of the Federal Government;
- (c) It manages the Federation Accounts and their disbursements to the three tiers of government;
- (d) It supervises the accounts of all the Ministries and Extra-Ministerial Departments and issues circulars to them on government accounting and financial control matters;

- (e) It is responsible for staff training and development of accountants, accounting and auditing personnel from the three tiers of government;
- (f) It is responsible for revenue monitoring and accounting in Ministries and Extra-Ministerial Departments to ensure that the necessary internal controls are in place; and
- (g) It initiates and formulates financial and accounting policies for the Federal Government.

The Accountant-General's financial statements consist of eleven (11) Main Financial Statements and twenty-five (25) supporting and sub-supporting statements. The eleven (11) Main Financial Statements are on the following:

Statement No.	Description of Statement
1.	Public Debt
2.	Assets and Liabilities
3.	Consolidated Revenue Fund
4.	Development Fund
5.	Treasury Funds
6.	Special and Trust Funds
7.	Other Loans and Investments
8.	Losses of Government Funds and Stores
9.	Revenue Abandoned during the Year
10.	Guarantees of the Federal Government of Loans to Statutory Corporations, etc
11.	Arrears of Revenue as at the end of the year.

The main objectives of auditing of Treasury accounts are to ascertain whether:

- (a) The financial statements have been prepared in accordance with generally accepted government accounting principles; and
- (b) The information contained in the Financial Statements are properly classified, reliable, accurate and complete.

The audit of the accounts and financial statements prepared by the Accountant-General is carried out through the Federal Sub-Treasury as a function under the Treasury Accounts Division of the Ministerial Department in the Office of the Auditor-General for the Federation.

3.4 AUDIT OF MINISTRIES/DEPARTMENTS AND AGENCY ACCOUNTS

The Minister or Commissioner (at the State Level) is the Chief Executive of each Ministry while the Permanent Secretary is the Accounting Officer who is empowered to deputise for the Chief Executive whenever the former is away from office.

In the extra-ministerial departments and agencies, the head of department is the accounting officer. Each ministry or extra-ministerial department also has a Finance and Supplies Department (now Finance and Accounts from October 2001, headed by a Director) and sub-divided into two divisions (Accounts

Division and Supply Division). One of the functions of the Accounts Division is the submission of financial statements to the Treasury in the form required and reconciliation of the Ministry's Below-the-line accounts, that is, Non-budgetary accounts balances with Treasury's corresponding balances.

Each Ministry or extra-ministerial department is regarded as an Accounting Unit for the purpose of processing accounts in the public sector. Accounting Units are classified into the following three groups:

- (a) Self-Accounting Units;
- (b) Non-Self Accounting Units; and
- (c) Sub-Accounting Units.

3.4.1 Self-Accounting Units

These are ministries or extra-ministerial departments where the accounting functions are delegated to the Accounting Officer and are, therefore, required to:

- (a) Be approved by the Ministry of Finance to be a Self-Accounting Unit;
- (b) Write an Accounting Manual or Code which must be approved by the Accountant-General and Auditor-General;
- (c) Establish an Internal Audit Department;
- (d) Operate a Central Pay Office; and
- (e) Operate two current bank accounts with the Central Bank of Nigeria, one for Revenue account and the other for Capital expenditure.

The documents to be submitted to the Accountant-General of the Federation by a self-accounting unit consist of the following:

- (a) Transcripts, that is, Monthly accounts by way of Control Sheets;
- (b) Voucher Schedules;
- (c) Duplicate Copies of Vouchers;
- (d) Duplicate Copies of Vouchers relating to other ministries where original copies are for State Government;
- (e) Certificate of Cash and Bank Balances; and
- (f) Bank Reconciliation Statement.

Examples of self-accounting units are all Federal and State Ministries.

3.4.2 Non-Self Accounting Units

These are ministries or extra-ministerial departments which are required to maintain complete records of 'Below-the-line' payments and receipts (Salary Advance Accounts) but incomplete records of the 'Above-the-line' (Budgetary account) payments and receipts. Consequently all the financial transactions of this type of unit are conducted through the Federal Sub-Treasury or Federal Pay Office in the State; to which payment vouchers are presented for checking and payment. Revenue received by this type of unit is paid into the account of the Sub-Treasurer or Federal

Pay Officer and it is the latter who renders his accounting return (including those of the non self-accounting units) to the Accountant-General of the Federation. In other words, non self-accounting units do not render transcripts to the Accountant-General.

Examples of non self-accounting units are the Federal Ministries located in any state of the Federation.

3.4.3 Sub-Accounting Units

These are Ministries and Extra-Ministerial Departments where the accounting functions are delegated to the accounting officer but the officer is required to render monthly accounts to the Accountant-General not in details but in Sub-head aggregate form, accompanied by the original vouchers. These units are also required to:

- (a) Be approved by the Ministry of Finance to be a Self-Accounting Unit;
- (b) Write an Accounting Manual or Code which must be approved by the Accountant-General and Auditor-General;
- (c) Establish an Internal Audit Department;
- (d) Operate a Central Pay Office; and
- (e) Operate two current bank accounts with the Central Bank of Nigeria, one for revenue and the other for capital expenditure.

However, the documents to be submitted by these units include the following:

- (a) Transcripts;
- (b) Vouchers in support of the transcripts in original and duplicate;
- (c) Copies of Vouchers relating to its own Head in support of monthly Transcripts; and
- (d) Schedule of Expenditure not in details but in Sub-head aggregate form.

Examples of sub-accounting units are Federal Pay Offices, Customs Area Offices and Police Pay Offices.

Monthly Transcripts should be audited by the Auditor-General's staff before being sent to the Treasury.

Objectives of Auditing Ministries, Departments and Agencies

The main objectives of auditing the accounts of Ministries/Departments and Agencies are to ascertain whether:

- (a) All receipts of money emanating from the operations of the period under review are collected and properly accounted for;
- (b) The accounting system in operation provides financial information that is reliable and free from material errors to facilitate the preparation of the accounting and financial statements required by law;

- (c) The activities and programmes are conducted and expenditure are made in an effective, efficient and economical manner and in compliance with the requirements of applicable laws and regulations;
- (d) The Ministry/Department or Agency under focus is carrying out only those activities or programmes authorised by the National Assembly and is conducting them in the manner contemplated to accomplish the objectives intended;
- (e) The resources of the Ministry/Department or Agency, including funds, property and personnel are adequately controlled and utilised in an effective, efficient and economical manner; and
- (f) The accounting and financial statements presented to the prescribed authorities, that is, the Accountant-General, disclose properly the information required to various groups of both internal and external users.

There are appropriate divisions in the Office of the Auditor-General for the Federation to handle the audit of various types of Ministries/ Departments and Agencies.

These include the following:

- (a) Revenue Audit Division to handle the audit of all revenue earning Ministries/Departments; for example, Federal Ministry of Petroleum Resources, Customs and Excise, Federal Inland Revenue Service;
- (b) Self-Accounting Ministries/Departments Division of the Auditor-General's Office. This Division is responsible for the audit of the transactions and accounts of self-accounting Ministries/ Departments. Examples are Ministry of Education, Ministry of Communications; and
- (c) Defence and Security Division responsible for the audit of the transactions and accounts relating to the Ministry of Defence, the Armed Forces of the Federation, Police and other Security agencies of Government.

The Internal Audit Department/Unit of any Ministry/Extra-Ministerial Department or Agency (depending on whether they are self-accounting or sub-accounting units) is responsible for the pre-payment audit of all the financial transactions of the organs of Government. The Chief Internal Auditor of the self-accounting organ is responsible to the Accounting Officer; he is required to submit to him and the Auditor-General for the Federation, the following documents:

- (a) Detailed audit programme;
- (b) Monthly Internal Audit Report; and
- (c) Half-yearly Internal Audit Report.

The third type of report should also be submitted to the Accountant-General of the Federation.

The Accounting Officer of each Ministry or Extra-Ministerial Department is required, by the provisions of Financial Regulations 2201, to ensure that subject to the availability of staff, an Internal Audit Unit is established to provide a complete and continuous audit of the accounts and records of revenue, expenditure, plant, allocated stores, and unallocated stores where applicable.

Duties and Responsibilities of Government Internal Audit Units

The general responsibilities of the Internal Audit Units at the various levels of Government, as contained in the existing Financial Regulations are to:

- (a) Carry out continuous examination of all accounting books and records maintained by the Ministry/Department;
- (b) Determine the adequacy of the internal control system;
- (c) Ensure that an adequate system of securities exists in the Ministry/Department;
- (d) Check all payment vouchers originating from any section of the ministry/department before payments are made;
- (e) Check the reliability of the accounting and reporting systems;
- (f) Carry out any special review or assignment which may be required by management; and
- (g) Co-operate with and assist the Office of the Auditor-General for the Federation in making available necessary documents for the final audit of the establishment.

Note:

- (a) In each State, the Office of the Accountant-General of the Federation has either a Federal Sub-Treasury or a Federal Pay Office;
- (b) The Office of the Auditor-General for the Federation has a branch office in each State of the Federation; and
- (c) The officers of the Auditor-General for the Federation at the State level are referred to as the Federal Auditors to distinguish them from the Internal Auditors who are the staff of the Internal Audit Department of the Ministry/Department or Agency.
The Officers audit Federal Establishments at the various States, such as Federal Pay Office.

3.5 AUDIT OF FEDERAL GOVERNMENT PARASTATALS

Federal parastatals or public sector enterprises originated from public authorities, which are governmental units, “created to perform a single function or a restricted group of related activities. Usually such units are financed from service charges, fees and tolls, but in some instances they also have taxing powers” (Hay, 1980). They are organisations set up by government for different reasons, most importantly to perform social tasks. Some of them are set up to accomplish some purposes which ministries/extra-ministerial departments and

agencies are not adequately equipped to accomplish. Examples of this type are water, sewage, electric and gas utilities, airports, seaports, hospitals, schools, transportation systems, public housing projects and in Nigeria such organisations include PHCN, NIPOST, NITEL, Nigerian Railway Corporation, Federal Housing Authority and Nigerian National Petroleum Corporation.

Other types of parastatals are industrial core projects which are capital intensive enterprises, established predominantly by Government to produce basic inputs for downstream industries. These include Refineries and Petrochemical plants, Fertilizer Plants, Steel Plants, Cement Plants and Liquefied Natural Gas (LNG) Project.

Government parastatals are referred to variously as Corporations, for example, Nigerian Railway Corporation, Nigeria Ports Authority, Boards (State Waste Disposal Boards), Commissions such as Independent National Electoral Commission and National Population Commission. Each of the parastatals was created by an enabling Act that provides for its statutory duties and functions. In cases where they are floated as limited liability companies, they are either wholly owned or partly owned by Government. In the latter case, Government has majority or controlling interest in such limited liability companies. Some of the Government parastatals have been or are in the process of being privatised or commercialised.

Objectives of Auditing Government Parastatals

The objectives of auditing the accounts of Government parastatals are to ascertain whether:

- (a) Proper accounting records are being kept;
- (b) All revenue items are duly collected and properly accounted for;
- (c) Adequate controls exist to ensure the safety and proper use of the organisation's funds and assets;
- (d) The organisation's management comply reasonably with the general level of probity and public accountability;
- (e) The organisation's Chief Executive and other top management carry out only those functions and operations for which the corporation is established;
- (f) Proper accounts are being prepared in accordance with the financial and accounting clauses as provided for in the respective legal instruments setting up the corporation; and
- (g) The audited financial statements reflect a true and fair picture of the activities of the Board or Corporation for a particular period.

Section 85(3) of the 1999 Constitution provides that the Auditor-General for the Federation shall not audit the accounts of or appoint auditors for Government statutory corporations, commissions, authorities, agencies, including all persons and bodies established by any Act of the National Assembly, but the Auditor-General is authorised to:

- (a) provide such bodies with:
 - (i) a list of auditors qualified to be appointed by them as external auditors and from which the bodies shall appoint their external auditors, and
 - (ii) guidelines on the level of fees to be paid to external auditors;
- (b) comment on their annual accounts and auditors' reports thereon.

The Auditor-General, however, shall have power to conduct periodic checks of all these Government parastatals [Section 85(4)]. It is clear, therefore, that the audits of the parastatals are carried out by the firms of professional accountants in accordance with the 1999 Constitution. Such audited accounts, signed by the Board of the parastatals, along with the auditor's domestic reports on them are forwarded to the Auditor-General for the Federation for vetting. Thereafter, he certifies the accounts which are subsequently submitted to the National Assembly, with his certificate and report known as "Auditor-General's Certificate" and "Auditor-General's Report" respectively.

The parastatals prepare accounts in accordance with the applicable generally accepted accounting principles relating to their forms. Thus, if they are outright limited liability companies, their accounts are prepared in accordance with the provisions of the Companies and Allied Matters Act Cap. C 20, LFN 2004 and the audit of their financial statements is carried out as in the case of other companies. However, for the other types of parastatals, fund accounting system is reflected in their accounts, as they receive subventions or grants from Government.

The parastatals are self-accounting units. The main accounts prepared by them consist of:

- (a) *Receipts and Payments Account*
This is similar to the Cash Account in the private sector;
- (b) *Income and Expenditure Account*
This is similar to the Profit and Loss Account in the private sector. It reflects all the internally generated funds the subventions and grants received from Government. The account records all expenditure incurred by the Corporation;
- (c) *Balance Sheet*
It shows the financial position of the parastatal as at the end of a specified financial period. The balance sheet is also referred to as a statement of assets and liabilities;
- (d) *Notes and Schedules to the Accounts*
These are meant to explain or give additional information on the items in the Income and Expenditure Account and Balance Sheet.

3.6 PUBLIC SECTOR AUDIT PROCEDURES

The peculiarities of public sector accounting make the procedures required for the audit to be peculiar to some extent. There are certain procedures of auditing in the public sector which are similar to those in the private sector, such as the verification of assets and store audit. However, some procedures are peculiar to the public sector accounts. Examples of these peculiar procedures are in respect of the following:

- (a) Revenue;
- (b) Vote Book;
- (c) Contract;
- (d) Cash Book; and
- (e) Control of Security Documents.

As documented by Daniel (1999), audit procedures in respect of each of the above are briefly outlined below:

3.6.1 Revenue:

The following steps should be taken to audit the revenue collected on behalf of Government:

- (a) Conduct a cash survey on the revenue collector, who is an officer entrusted with official receipt or licence book for the regular collection of a particular form of revenue from the public and is required to keep a cash book.
(The prescribed receipt to be issued by him is Treasury Receipt Book 6 – TR. 6).
- (b) Obtain and ascertain all receipts issued to the revenue collector after the last audit.
- (c) Trace all the triplicate copies of receipts into the revenue cash book maintained by the revenue collector.
- (d) Cast the cash book to ensure that no mistake has been made.
- (e) Verify the total collection as recorded in the revenue cash book with the TR 6 pasted on the cash book for evidence of payment to the main cashier.
- (f) Examine the bank tellers and confirm at the Central Pay Office (CPO) that all cheques received have been correctly and completely recorded.
- (g) For tenement rates, obtain copies of the latest assessment notice and list of outstanding from the previous year.
- (h) Evaluate the system of internal control for the handling of all receipts of revenue.
- (i) Ensure generally that:
 - (i) The classification of revenue is in accordance with the year's Estimates;
 - (ii) Receipts are issued for all money collected and such receipts bear the stamp of the office of issue;

- (iii) All entries in the cash book include the dates and numbers of all receipts;
- (iv) Revenue collectors do not make any payment out of the money collected by them;
- (v) Revenue collectors submit their cash books and receipt books for examination to the Sub-Treasurer;
- (vi) The Accounting Officer prepares regular returns of revenue arrears; and
- (vii) Where paper money (bank notes, cheques, postal order and money order) is received by post, such should be entered in a paper money register under the supervision of the officer opening incoming mails in the Ministry. Thereafter, the register together with the remittance should be passed to the cashier who will issue the receipts or licences in respect of the amount and record them in his cash book.
- (viii) Spot audit checks of revenue collected are conducted.

3.6.2 **Vote Book:**

The audit procedures for Departmental Vote Allocation Books (Vote Books) in the public sector are stated below:

- (a) Obtain the approved estimates for various Heads and Sub-heads;
- (b) Obtain copies of the Financial Warrants/Authority to incur Expenditure (AIE) issued to the Ministry/Department;
- (c) Post the Warrants to the Vote Book to ensure that there is authority for the entries made;
- (d) Ascertain the officers who are authorised to control and spend the Votes;
- (e) Ensure that all vouchers, including the liabilities, are posted to the Vote Book;
- (f) Ensure that correct adjustments are made in the "balance available" column whenever the actual cost is greater or less than the liability figure already noted;
- (g) Ensure that no unauthorised liability or expenditure is incurred and that over-expenditure is avoided;
- (h) Ensure that each entry is initialled by the authorising officer;
- (i) Check all the various instruments of virements;
- (j) Ensure that where there is a mistake, the entry is reversed in red or black ink as applicable; and
- (k) Ensure that all outstanding liabilities at the end of the financial year are cleared as indicated in Financial Regulation 521.

3.6.3 **Contract:**

The procedures for the audit of contract accounts are as follows:

- (a) Check contract agreements with the minutes of the Tenders Board meetings;

- (b) Open the contract register and update it for control purposes;
- (c) Ensure that interim payments are in accordance with the contract agreements;
- (d) Examine the completion certificates to ensure that payments are made on the appropriate certificates given;
- (e) Conduct physical inspection of work done to ensure compliance with terms of contract and completion of work certificates given;
- (f) Ensure that the correct retention fee is retained; and
- (g) Ensure that all necessary deductions are made before payments are made on each occasion that they are authorised.

3.6.4 Cash Book

The following procedures shall apply when auditing the Cash Book of the Pay Office, Central Pay Office or Cashier in the Treasury of a Local Government:

- (a) Conduct a cash survey to verify if the cash book (cash column) agrees with the physical cash produced for survey;
- (b) Trace the receipt vouchers (TR 6) to the cash book and ensure that all of them have been correctly posted;
- (c) Verify revenue collected and paid to bank by reference to the bank tellers;
- (d) Ensure that the cash book contains individual Treasury Receipt numbers;
- (e) Trace the payment vouchers to the cash book serially and ascertain that all postings are accurate and complete;
- (f) Ensure that all the cheque numbers (where applicable) are correctly indicated in the cash book;
- (g) Ensure that the amount on each cheque is equal to the corresponding voucher and that the cheque number is written on the corresponding voucher; and
- (h) Cast the cash book, ensuring that every brought-forward and carry-forward balances from one folio of the cash book to the other are correctly transferred and cover the entire audit period.

3.6.5 Control of Security Documents:

The following steps should be taken to audit the security book register in order to ensure control of the various types of security documents used by government:

- (a) Check if orders for new supplies of cheques or printing of receipts are authorised by the designated officer in the Finance Department;
- (b) Ensure that all deliveries of new supplies are recorded in the appropriate register, for example, cheque stock register or security book register;
- (c) Check that all issues from stock are recorded in the appropriate security book register and signed by authorised recipients;
- (d) Request to see all cancelled cheques for audit inspection;

- (e) Ensure that all the security documents whether currently in use or not are kept in a safe under lock and key; and
- (f) Ensure that there is a prior written approval/consent of the Accountant-General of the Federation for the transfer of receipt books between any two Sub-Accounting Officers.

3.7 SPECIALISED PUBLIC SECTOR AUDITS

The public sector consists of various areas needing special attention by virtue of the mode of operations involved in their activities. This section covers the audit of such areas as:

- (a) Pensions audit;
- (b) Audit of Defence and Security Agencies;
- (c) Audit of Nigerian Foreign Missions and Agencies; and
- (d) Audit of Contracts or Projects.

3.7.1 Pensions Audit

The audit of the payment of benefits to qualified officers is primarily aimed at ensuring that the claims of retiring officers such as gratuities and pensions for both civil servants and military personnel are carefully monitored and approved for payment by the office of the Auditor-General for the Federation before such claims are paid. Hence it takes a fairly long time to get all the documentations completed and payments authorised.

This audit is handled by the Pensions Division of the Ministerial Department in the office of the Auditor-General for the Federation. The first stage of payment of gratuity is approved after the Federal Audit, on receipt of the retiring officer's file and computed benefits from the Pensions Office has:

- (a) verified the debt statement from the details of the officer's indebtedness to Government; and
- (b) examined the benefit payable to check if it is in compliance with the relevant latest schedule.

Thereafter, for the commencement of the payment of monthly pension, the Pensions Section forwards the following documents to the Federal Ministry of Establishments and Management Services:

- (a) Completed Pension Forms;
- (b) Certified True Copy of Record of Service;
- (c) Debt Clearance Certificate;
- (d) Photocopy of Letter of Promotion to the last grade;
- (e) Photocopy of Letter of notice of retirement and acceptance;
- (f) Quadruplicate copy of payment voucher;
- (g) Quadruplicate copy of Computation Sheet examined by the Federal Audit; and
- (h) Three recent passport photographs.

The essential point here is that once the Federal Audit had examined the retiring officer's computation sheet and approved, it is certain that adequate measures have been taken to prevent overpayment of benefits to such an officer.

It is worthy of note that Section 173 of the 1999 Constitution provides that pensions shall be reviewed every five years or together with any Federal civil service salary reviews, whichever is earlier; and that pensions in respect of service in the public service of the Federation shall not be taxed.

3.7.2 Audit of Defence and Security Agencies

The transactions and accounts of the Ministry of Defence and Security Agencies (such as the Nigerian Police Force and the Armed Forces of the Federation) are audited by the Defence and Security Division under the Ministerial Department of the Office of the Auditor-General for the Federation. The affairs of these offices have been covered under the audit of the accounts of Ministries/Extra-Ministerial Departments and agencies. The affairs of these offices are also applicable to the audit of Defence and Security Agencies. The provisions of the 1999 Constitution on the Police (Sections 214-216) and the Armed Forces (Sections 217-220) are pertinent for all audit staff to note.

3.7.3 Audit of Nigerian Foreign Missions and Agencies

In view of the economic and political interdependence of Nations, each country has adopted foreign policies to guide its relationship with others. This gives way to the need to have foreign Missions and Agencies in these other countries. These foreign missions and agencies are used to aid the relationship of each Nation with another.

In Nigeria, there are various Embassies and High Commissions headed by Ambassadors and High Commissioners respectively. The latter is used to describe the offices in countries that are members of the Commonwealth of Nations. In return, Nigeria also has Embassies and High Commissions abroad. In addition, Nigeria also has foreign Missions, for example, Permanent Mission of Nigeria to the United Nations (based in New York).

These foreign Missions and agencies are supervised by the Federal Ministry of Foreign Affairs. Therefore, the Head of the Internal Audit in the Federal Ministry of Foreign Affairs is charged with the responsibility of conducting the audit of the foreign Missions and agencies. He/she organises trips abroad to audit all the foreign Missions and agencies from time to time. In addition to the activities of the Internal Audit department of the Federal Ministry of Foreign Affairs, the office of the Auditor-General for the Federation also sends audit staff to these foreign Missions and agencies for the purpose of conducting the audit of their financial operations and accounts.

3.7.4 Audit of Contracts or Projects

Though, the procedure for the audit of contracts has been covered under Section 15.6, the current attention being given to audit of contracts is to emphasise that there is a division (Project Audit Division) under the Project Monitoring and Evaluation Department of the Office of the Auditor-General for the Federation. This division embarks on a comprehensive or value-for-money audit of some selected large government contracts or projects. The audits carried out on these selected projects are usually detailed and inclusive of investigations with a view to ascertaining whether government has derived value for the money spent on them.

3.8 TYPES OF PUBLIC SECTOR AUDIT

The functions and scope of responsibilities of the Auditor-General for the Federation and those of his counterparts in other parts of the world have shown that there are about three main types of audit in the public sector. These three types emanated from the fact that the primary objective of the public sector is not to generate profit but to render services. These audit types are:

- (a) Regulatory Audit;
- (b) Financial Audit; and
- (c) Value-for-Money Audit.

3.8.1 Regulatory Audit

This type of audit (otherwise referred to as Compliance Audit) is conducted with a view to ensuring that expenditure have been incurred on approved services and in accordance with the enabling statutory provisions and regulations governing the particular expenditure. The following are the documents that the auditor of a public sector organisation may require in conducting a compliance audit:

- (a) The Nigerian Constitution (latest edition);
- (b) Civil Service Rules;
- (c) Treasury Circulars;
- (d) Establishment Circulars;
- (e) Official Gazettes of Government;
- (f) Financial Instructions;
- (d) Budgets; and
- (e) Financial Acts.

An example of this type of exercise is the audit conducted on each project or contract.

3.8.2 Financial Audit

Financial Audit is one that is conducted in order to ensure that the accounting and financial control systems are efficient and cooperating properly; and that financial transactions have been correctly authorised and accounted for. In other words, it is to ensure that the financial

statements and accounts have been prepared to present a true and fair view of the state of affairs of the establishment concerned and in respect of the period covered by the audit.

This is the type of audit conducted on the treasury accounts of the Federation from time to time.

3.9 VALUE-FOR-MONEY AUDIT

The scope of governmental auditing has been widened over the years by the demand for independent verification of information to the extent that it can no longer be limited to the audit of financial operations. As far back as 1972, the Comptroller-General of the United States had stated that:

“Instead, governmental auditing now is also concerned with whether governmental organisations are achieving the purposes for which programs are authorised and funds are made available, are doing so economically and efficiently, and are complying with applicable laws and regulations” (Comptroller-General of the U. S., 1972, p.3).

In the same vein, the Green Paper on the Role of the Comptroller and Auditor-General (Cmnd 7845) in the United Kingdom had stipulated as far back as 1980 that government auditing can be categorised into financial audit, regulatory audit, economy and efficiency audit, and effectiveness audit.

The audit objective has been viewed traditionally as an independent examination of the financial statements of an entity followed by the expression of opinion as to the truth and fairness of the financial statements against the criteria of generally accepted accounting principles and standards. However, in the case of government accounting, the general absence of the profit motive and the presence of the provision of social and economic services have combined to extend the audit objective to include an ascertainment of whether the establishment being audited is achieving the purposes for which its programmes are authorised and whether it is doing so economically, efficiently and effectively.

Value-for-money is the concept that seeks the maximisation of the use of scarce resources for the welfare of the public by ensuring that activities and programmes are carried out at low cost and to high standard. In order to achieve this phenomenon, three elements are usually covered and these are: economy, efficiency and effectiveness. These were the key elements of the views expressed by both the United States Comptroller-General and the United Kingdom Comptroller-General and Auditor-General about three decades ago.

The Value-for-Money audits suggest those procedures designed to assist management establish necessary controls to ensure that the desired objectives are met at the desired level of efficiency and effectiveness. Though this emphasises cost savings but that may not be the overriding objective. VFM

may be applied to both private and public enterprises, but it is particularly relevant in the public sector. Its application in the public sector is designed to provide to the oversight bodies an assessment of the performance of the operating arm with information, observations and recommendations designed to promote answerable, honest, and productive government. It encourages accountability and best practices.

The procedure for VFM is to assess the economy, efficiency and effectiveness with which government acquires and applies resources to benefit and well being of the citizens. Economy does not necessarily imply the cheapest price while the measure of effectiveness is subjective, often involving the perception of the recipients of Government services. The value-for-money audit may be sensitive to certain political realities such as labour agitation. For instance, where the VFM review clearly reveals overstaffing in public service, some other non-financial considerations may shape Government's reaction to a recommendation to down-size staff strength. However, a VFM review will certainly focus on the areas of:

- (a) corporate structure;
- (b) information systems;
- (c) management style;
- (d) authorisation procedures;
- (e) segregation of duties;
- (f) resource utilisation; and
- (g) effective supervision.

Elements of Value for Money

According to Afemikhe (2003), the three elements of value-for-money, i.e. economy, efficiency and effectiveness can be described as follows:

- (a) *Economy*
This is the practice by management of the virtues of thrift and good housekeeping. An economical operation acquires resources in appropriate quality and quantity at the lowest cost.
- (b) *Efficiency*
This is make sure that the maximum useful output is gained from the resources devoted to each activity, or, alternatively, that only the minimum level of resources are devoted to achieving a given level of output. The efficiency of an operation could be said to have increased if either lower costs were used to produce a given amount of output, or a given level of cost has resulted in increased output.
- (c) *Effectiveness*
This ensure that the output from any given activity is achieving the desired results. There is, therefore, the need to establish that the desired goals are being achieved in order to evaluate effectiveness.

The type of interrelationship among these three elements is that all of them should be in place before the assessment of value-for-money can be said to be complete. Right things should be done, using the right method and at minimum cost. For instance, as much as effectiveness is linked with the achievement of set objectives, it is also important to expect that the objectives are achieved by the application of the right methods, that is, efficiently – the use of a sledgehammer to kill a housefly, though effective, is not efficient!

The application of value for money concept to auditing leads to the concept of value-for-money (VFM) audit. It is applicable to both the private and public sector, but more emphasis has been placed on its application to the public sector. VFM audit recognises that the primary responsibility for securing value for money lies with the management of the spending agency or establishment. Developed countries have given legislative backing to VFM audit while such backing is found to be lacking in developing countries. For instance in Nigeria, Johnson (1999) stated that:

“Value-for-money audit is currently the subject of much discussion in the public sector, some taking the view that it represents a new concept...” (Johnson, 1999, p. 83)

In seeking if the 1999 Constitution has made any legislative commitment to the concept of VFM audit, Afemikhe (2004) concluded that:

“It can be seen from the above that the 1999 Constitution did not expressly empower the Auditor-General to carry out value for money audits” (Afemikhe, 2004, p. 40)

In spite of the poor state of legislative commitment to VFM audit, it has been observed that the Auditor-General for the Federation has included it in his scope of responsibilities. VFM audit is carried out with a view to ascertaining whether the establishment pursues optimal values with adequate consideration for economy, efficiency and effectiveness in its quest for resource management. It is related to the extent to which funds are spent economically, efficiently and effectively. It is also referred to as Comprehensive Audit or Efficiency Audit.

Johnson (1999) opined that VFM auditing is a blend of both conventional auditing, that is, as far as economy and efficiency are concerned and management consulting (in the area of effectiveness audit). In countries where there are specific statutory provisions, on the functions of the government auditor, the responsibilities of the Auditor-General are well stated to include VFM, whereas in the absence of such provisions, the Auditor-General will at best be doing what he understands to be his responsibilities. Consequently the audit queries issued to the Accounting Officers may be misconstrued and not treated in the most appropriate manner.

3.9.1 VFM Audit Techniques

The techniques for carrying out a VFM audit can be outlined as follows:

- (a) Analysis of performance indicators such as financial ratios and unit costs of the establishment, with comparative figures for the previous periods and in respect of similar establishments. A trend analysis should be done, and significant differences highlighted through the trend analysis should be investigated further. This initial analysis is aimed at identifying the areas that need specific attention.
- (b) Management and Systems Review for the purpose of investigating the ways in which objectives are established, policies implemented and results monitored. This will enable the VFM auditors ascertain how efficiently these processes have been carried out without necessarily having to concern themselves with the review of the objectives and policies themselves.
- (c) Analysis of Planning and Control Processes for the purpose of ascertaining how the establishment has been monitoring performance against the plan, reviewing and reporting its operating results, and how members and officers have been alerted of the need for remedial action whenever required. An example is checking how the Vote Book has been used in controlling planned expenditure.
- (d) Efficiency Assessment may involve specific investigation into a few activities with high unit cost, or poor performance measures or suspected poor management with a view to ascertaining the reasons for the adverse performance indicators and identifying the appropriate remedial action.
- (e) Effectiveness Review for the purpose of ascertaining whether or not the activities or programmes are achieving the objectives for which they have been undertaken. This usually involves discussions with service managers and committee members on the details of each particular activity especially regarding why the activity is undertaken, why it is done in the way it has been done, what other alternatives have been considered and why such other alternatives have been rejected and how performance is measured.
- (f) Reporting on the VFM audit – it is very important to discuss the draft report in detail with the officers (service managers) and committee members before it is finalised and presented.

(Adapted from Johnson, 1999, pp. 85-6)

3.9.2 Value-for-Money Review Teams

Value-for-money review teams can be used to conduct performance review in government offices and parastatals. These teams are either

on full-time or part-time basis. Though the large organisations may have adequate resources to justify a full-time VFM review team, there are arguments against having such a team. For instance, one major disadvantage of having a full-time VFM Review Unit is that the staff are often reluctant to submit recommendations that could affect the career of their colleagues negatively, that is, fellow officers or on sensitive issues.

An example of an organisation that has an in-house value-for-money committee structure is the Nigerian National Petroleum Corporation (NNPC). This corporation has a three-tier VFM committee structure in the review of its upstream joint venture companies. As reported by Afemikhe (2004, pp.232-3), these committees are:

- (a) An Operational Value-for-Money Committee within National Petroleum Investment Management Services (NAPIMS) – an NNPC Strategic Business Unit that works on a day to day basis with the joint venture companies. This committee reports directly to NAPIMS chief executive;
- (b) A Technical Value-for-Money Committee at the Corporate level which liaises with the NAPIMS Value-for-Money Auditors on technical value for money matters and reports to the Corporate Value for Money Audit Committee; and
- (c) A Corporate Value-for-Money Audit Committee which is headed by a Group Executive Director and reports directly to the Group Managing Director and the Group Executive Committee.

There is an increasing use of external consultants to serve as independent value for money evaluators or auditors. The advantage of this is the possibility of drawing from a wide range of specialists, non-inhibition about drawing attention to sensitive issues or negative impact on colleagues' career, and provision of an objective viewpoint anchored on a diversity of experience.

3.9.3 Areas of Waste in the Public Sector

There are numerous areas of waste in the public sector which require elimination if value-for-money is to take a deep root in the affairs of government. These areas will serve as a guide for VFM auditors as they will be able to identify where to pay attention when undertaking efficiency assessment and effectiveness review. The areas include but are not limited to the following:

- (a) **Manpower**
 - (i) Employment of more staff than required for the operational needs of the organisation;
 - (ii) Employment of wrong persons for the right job;
 - (iii) Employment of the right person for the wrong job thereby leading to manpower underuse; and

- (iv) Retention of redundant staff.
- (b) **Purchasing and Materials Management**
- (i) Overpricing of purchases;
 - (ii) Purchasing of poor quality materials through deliberate adulteration of materials or deliberate wrong definition of specification;
 - (iii) Procurement of obsolete materials and equipment; and
 - (iv) Dumping by export companies of substandard equipment and materials with the connivance of top management staff;
 - (v) Procurement of spare parts for items of equipment that have been phased out, resulting in difficulties with subsequent maintenance;
 - (vi) Issuance of incorrect inspection certificate by procurement or import supervision officers;
 - (vii) Deliberate refusal to maintain sound inventory control procedures, even when the procedures are in place; and
 - (viii) Existence of surplus or obsolete materials in every site or store.
 - (ix) Additional purchases of stock lines with no historical evidence of usage;
 - (x) Holding of stock of materials transferred to operational stock from construction parts leftovers, commissioning parts leftovers, and bulk parts left unused; and
 - (xi) Continuous procurement of spares for an item of equipment that has long been scrapped resulting in acquisition of materials that the organisation has no need for.
- (c) **Motor Vehicles and Transport**
- (i) Not taking advantage of fleet discount resulting from the use of unnecessarily wide range of vehicle types and suppliers;
 - (ii) Not having a clear policy on boarding of vehicles resulting in excessively high maintenance cost being incurred on vehicles;
 - (iii) Idle fleet of vehicles and misuse of vehicles as a result of having too many vehicles;
 - (iv) Lack of vehicle maintenance policy that leads to uncontrolled maintenance costs; and
 - (v) Not taking full advantage of fleet insurance.
- (d) **Landed Property**
- (i) Owning more landed property than required for operations and not taking any steps to enhance the earning capacity of the excess property;

- (ii) Having government officials on transfer staying in hotels and guest houses for an unduly long period of time; and
 - (iii) Simultaneous occupation of multiple official accommodation by some senior government officials in different locations of the Federation.
- (e) **Fund Management**
- (i) Poor treasury management, for example, surplus cash and investment;
 - (ii) Lack of asset management policies, for example, credit policy, policies on debt recovery and on monitoring of the age profile of overdue debts; and
 - (iii) Lack of borrowing policy to provide for negotiation of loans and overdrafts in order to reduce the overall interest burden on the organisation's total borrowing.

3.9.4 Problems of VFM Audit in the Public Sector

The following problems have generally been associated with the application of VFM audit in the public sector:

- (a) Inadequacy in the means of measuring the corporate objectives in the public sector. To what extent is the welfare of the public maximised?
- (b) Lack of a complete view of the report of activities and state of affairs in the public sector resulting from the non-use of accrual basis of accounting.
- (c) Continuous gap in professional skill requirements for the Auditor-General's office.
- (d) Inadequacies in the accounting and internal control systems in the public sector.
- (e) Lack of commitment to the overall achievement of goals by the managers in the public sector.

3.10 DUE PROCESS REVIEW

On a continuous basis and in both the private and public sectors, efforts are usually made, to seek improvement on the way activities are carried out, if there is to be progress in the results being sought to be achieved. More importantly, in the public sector, those at the helm of affairs should make deliberate efforts to improve on the systems already put in place in all the three tiers of government if they must remain relevant in the global village which the world is turning into.

The concept of control as applicable to the public sector has been undergoing various changes from one country to the other and in the recent past. Each nation has been formulating policies aimed at improving resource utilisation at the budget implementation stage. Considerable efforts have been made to find new techniques of control and to introduce institutional changes and improvements to the types of controls applied.

In an effort to exercise control on the expenditure of Government, it is not sufficient to rely on the fact that the expenditure items have been provided for in the approved budget (via the Appropriation Act). At the implementation stage, approval for releasing the money should be tied to availability of funds through the extent to which the revenue budgeted for has been earned. Therefore, the process of controls involved under the overall expenditure control structure should cover monitoring of the activities, for example, contract, approval for payment and release of funds. There should be commitment by the top management staff at the relevant tier of government to the new ways of doing things.

In Nigeria, the relatively long period of military rule had almost eroded the basic economic structures that had been developed since independence. Consequently, the Federal Government was faced with the task of seeking ways of reversing the trend of decadence in the Nation. With the return to democratic rule in 1999, the Federal Government emphasised that the administration had adopted transparency, equity, justice and accountability as its guiding principles and policy imperatives. These principles are to ensure commitment to public policies and good governance. There has been a constant effort at applying a new approach to financial management in the public sector. This involves a new managerial outlook to controls, which in turn according to Nwankwo (2004) includes:

- (a) Specification of standards and measures of performance;
- (b) Emphasis on output controls;
- (c) Greater competition in the public sector; and
- (d) More focus on discipline and economy in resource use.

One of the key issues towards which the Federal Government has directed tremendous energy, attention and resources is that of corruption. Conscious of the enormous negative impact of corruption on the Nation, the administration set out to evolve various policies targeted at eliminating corruption, each time supporting such policies with appropriate political will. All the policies adopted against corruption have been “shaped by a thorough appreciation of the root causes of corruption, the factors that nurture it, the forces that support and benefit from it, as well as comparative analysis with other societies and nations which have had similar experiences like ours” (Ekaette, 2001). Ekaette stated further that:

“Yet another source which has been identified as providing a basis for widespread public sector corruption is the massive expansion in public procurement. To control this problem, a battery of new systems and processes have now been introduced. These include a comprehensive system of Due Process to deal with the problem. Major revisions in the Financial Regulations of the Public Service have been made. The objective of the policy in this area is to achieve value-for-money in the area of Public Sector procurement and thereby eliminate rampant corruption which has rendered prices of basic purchases by government in Nigeria as one of the highest in the world.” (Ekaette, 2001)

3.10.1 Establishment of the Budget Monitoring and Price Intelligence Unit (BMPIU)

It has always been a recurrent observation of those reviewing the budgetary performance of Governments in Nigeria that implementation is our problem. The problems experienced during implementation may as well have originated in formulation.

Therefore, the axiom “prevention is better than cure” could be appropriate here. It is on the basis of this view that evaluation of completed programmes and projects was initiated as an ex-post control but with an impact that goes beyond the budget implementation phase. The evaluation consists of an assessment of progress and its impact, so that areas of success and failure in implementation can be identified. It is a process aimed at the following:

- (a) Examining the programme rationale;
- (b) Achievement of objectives;
- (c) Cost of achievement; and
- (d) Exploration of alternatives. (Nwankwo, 2004, p. 32)

Evaluation in the context of the above explanation serves mainly to link formulation and implementation of budgets and is used by the executive. It is also possible to view evaluation as a tool for ensuring both transparency and accountability. It was in recognition of this that President Olusegun Obasanjo formally established the Budget Monitoring and Price Intelligence Unit (BMPIU) in June 2003 and appointed the Senior Special Assistant on Budget Matters, Mrs. Oby Ezekwesili as the Head of the Unit.

The Head of the BMPIU is responsible for the effective implementation of the budgetary due process programme of the Obasanjo administration. This task involves ensuring strict compliance with laid-down rules and procedures guiding the process of contract invitation, contract award and project implementation. This is with a view to ensuring that Government’s resources are managed in such a way that they are not wasted.

The BMPIU has become synonymous with Due Process. In fact, it has come to be known as the Due Process Unit because of the emphasis on the need to follow due process in all the different tiers of Government and all the parastatals. It is noteworthy that the term “due process” simply means the appropriate way or proper method or expected approach or normal way of doing something. It is, therefore, merely an awakening or revival of the application of the procedures already put in place earlier but for some time abandoned due to corruption and moral decadence.

Objectives of BMPIU

The objectives of BMPIU are to:

- (a) Harmonise existing government policies/practices and update same on public procurement;
- (b) Determine whether or not Due Process has been observed in the procurement of services and contracts;
- (c) Introduce more honesty, accountability and transparency into the procurement process;
- (d) Establish and update pricing standards and bench-marks for all supplies to government;
- (e) Monitor the implementation of projects during execution with a view to providing information on performance, output and compliance with specifications and targets; and
- (f) Ensure that only projects which have been budgeted for are admitted for execution.

The BMPIU operates under four main areas as follows:

- (a) Regulatory Functions;
 - (b) Certification Functions;
 - (c) Monitoring Functions; and
 - (d) Training and Advisory Functions.
- (a) The Regulatory Functions consist of the following:
 - (i) Regulating and setting standards, including the enforcement of harmonised bidding and tender documents;
 - (ii) Formulating of the general policies and guidelines related to public sector procurement;
 - (iii) Developing, updating and maintaining a related system wide database and technology;
 - (iv) Undertaking procurement research and survey in order to determine information needs and project costing; and
 - (v) Enforcing professional ethics and sanctioning erring officers and professionals.
 - (b) The Certification Functions include:
 - (i) Certifying all Federal Government procurements under the following guidelines;
 - (ii) Resident Due Process Team Certification for projects below ₦50 million; and
 - (iii) Full Due Process Certification for projects above ₦50 million at various stages such as “contract award certificate” and “payment certificate”.
 - (c) The Monitoring Functions comprise:
 - (i) Supervision of the implementation of established procurement policies;

- (ii) Monitoring of the prices of tendered items;
 - (iii) Performing procurement audits;
 - (iv) Undertaking the monitoring of capital projects that have exceeded 50% of contract sum before release of further funds; and
 - (v) Documentation of all projects at award and completion stages, and publishing same in designated journals.
- (d) The Training and Advisory Functions include the following:
- (i) Co-ordination of relevant training programmes so as to build institutional capacity;
 - (ii) Embarking on regular public enlightenment programmes aimed at sensitising various stakeholders involved in procurement; and
 - (iii) Interacting with Government and parastatal officials, National Assembly members, consultants and relevant professional bodies in order to educate them on all aspects of the work of BMPIU.

3.10.2 Procedure for Due Process Review

The procedures for Due Process Review are as follows:

- (a) *Meeting the requirements for Due Process Review*

The beneficiary Ministry should submit the following documents:

- (i) The Project Policy File;
- (ii) Tender Returns;
- (iii) Tender Evaluation Report;
- (iv) Contract Award Letter and Agreement;
- (v) Original Contract Bills of Quantities, if any;
- (vi) Contract Drawings, if any;
- (vii) Other Contract Documents;
- (viii) Financial Summary and Statements;
- (ix) Progress Reports;
- (x) Variation Requests and Variation Orders arising; and
- (xi) Interim Valuation and Certificates.

- (b) *Preliminary Discussion between BMPIU and Beneficiary Ministries.*

It may become necessary to schedule meeting between BMPIU and beneficiary ministries or parastatals. Such meetings are aimed at clearing issues connected with the report for certification or to obtain more information to facilitate the issuance of certification.

- (c) *Preparation of Draft Report*

The Due Process Certification will require an assessment to ensure that:

- (i) The appropriation is available for the funding requirements of the project upon award; and
 - (ii) The contract awarded by the spending unit/ministry shows that the process complies with open competitive bid standards and that the cost is comparable with national, regional and international standards.
- (d) *Transmission of Draft Report*
The Draft Report from BMPIU shall be transmitted to the beneficiary confirming certification. If certification is not granted, attention of the beneficiaries is drawn to the findings and recommendations in the report.
- (e) *Organisation of "Right of Reply" Meeting*
For a project where certification is denied, BMPIU has made provisions for a "Right of Reply" meeting aimed at clarifying issues leading to the denial of certification. Such a meeting may either lead to reconciling differences or confirming the position of BMPIU.
- (f) *Final Report*
The outcome of a "Right of Reply" meeting will assist in fine-tuning the report and facilitating the issuance of a final report.
- (g) *Granting or Denying Due Process Certification*
The final report may either lead to the project being granted certification or being denied certification. Whatever the outcome, it will be transmitted to the beneficiaries.

The granting of certification may lead to the project being recommended for approval by the Federal Executive Council. In cases where projects are denied certification, the beneficiaries may be advised to repackage the project for fresh procurement.

3.10.3 Impact of Due Process Review

The impact of the Due Process Review has been reportedly felt at all levels of government (Federal, State and Local) and even in the parastatals. Some of the salutary effects are:

- (a) Recognition of only competent contractors who go through the due process;
- (b) Elimination of "middlemen" such as consultants in contract awards;
- (c) Re-instatement of rightful contract winners who had been formerly denied contracts;
- (d) Restoration of confidence to many local and foreign companies that could not carry on in the former corruption-ridden culture that had characterised the award of government contracts;

- (e) Massive savings through the reduction in contract sum of the contracts reviewed by the unit. For example, as much as ₦125 billion in the first two and a half years of operation; and
- (f) Improvement in revenue collecting units of Government. For example, the Federal Inland Revenue Service (FIRS), Nigerian Customs and Excise and other parastatals that have resorted to following the laid down rules and procedures of carrying out their operations.

3.11 PUBLIC SECTOR INVESTIGATIONS

Though the affairs of Government (at the different levels) may have a focus that differs from what the private sector managers consider as their primary objective, when it comes to losses of Government fund or suspected fraud, there are laid down procedures for conducting the required investigation. The main difference between the public and private sectors in this regard is the timing of the investigation in relation to the time of occurrence of the event; it is usually the case that the gap between the occurrence of event and action on investigation is usually longer in the public sector related cases. The main reason for this could be attributed to the bureaucratic structure in the public sector.

3.11.1 Power to Conduct Investigations in the Public Sector

Section 88 of the 1999 Constitution provides that each House of the National Assembly shall have power, by resolution published either in its journal or in the Federal Government official *Gazette*, to direct or cause to be directed an investigation into:

- (a) any matter or thing with respect to which it has power to make laws; and
- (b) the conduct of affairs of any person, authority, ministry or government department charged, or intended to be charged, with the duty of or responsibility for:
 - (i) executing or administering laws enacted by the National assembly; and
 - (ii) disbursing or administering monies appropriated or to be appropriated by the National Assembly.

The purpose for directing such an investigation is to enable the National Assembly to:

- (a) make laws with respect to any matter within its legislative competence and correct any defects in existing laws; and
- (b) expose corruption, inefficiency or waste in the execution or administration of laws within its legislative competence and in the disbursement or administration of funds appropriated by it .

Section 128 of the 1999 Constitution provides each State House of Assembly with similar powers to conduct investigation for purposes similar to those for which the National Assembly can conduct investigation.

In addition to the power of the legislative arm of Government to conduct investigation, the executive arm of Government can also conduct investigation through its public service structure. This can be done by both the Auditor-General for the Federation and the Accountant-General of the Federation.

In the office of the Auditor-General for the Federation, there is the Losses and Investigation Division under the Ministerial Department. This division is responsible for carrying out detailed investigation into suspected cases of loss of funds, monitoring developments in the treatment and procedure followed on confirmation of cases of loss of funds, and supplying information needs of the Losses Committee.

In the office of the Accountant-General of the Federation (who is the Head of the Federal Treasury Department), there is the Treasury Inspectorate Department under which there is an Investigation section. The Treasury Inspectorate Department is responsible for oversight functions of the Treasury on accounting and financial control matters. Investigations handled by this section are, as indicated by Daniel (1999) those that may arise from the following:

- (a) Discoveries from routine examination and inspection of accounting records in Ministries/Departments;
- (b) Internal Audit reports;
- (c) Reports of the Auditor-General for the Federation;
- (d) Newspaper publications and other news media information;
- (e) Direct personal information on suspected or known fraud or requests by Ministries/Departments;
- (f) Suspicion based on alteration or falsification of records; and
- (g) Petitions and anonymous letters.

In addition to the Investigation section, there is also the Permanent Board of Survey and Inquiry section under the Treasury Inspectorate Department. The Accountant-General is empowered to order the Board of Inquiry to be convened on the request of the Accounting Officer. The Board is convened when there is a loss of government fund, for the purpose of carrying out investigation into the circumstances of the loss of the funds as well as the causes and perpetrators of such loss or fraud.

3.11.2 Procedure for Carrying out Public Sector Investigations

The procedure for conducting investigations in the public sector varies according to the type of investigation being conducted. The variation is purely in terms of the extent to which evidence may be taken and the extent of power bestowed on the body set up for conducting the investigation. Some of the procedures are discussed below:

As regards the investigations that could be conducted by the National Assembly, Section 89 of the 1999 Constitution states the power as to

matters of evidence (which brings out clearly the procedure to be followed) as follows:

- (a) The Senate or the House of Representatives or a committee appointed to conduct investigation shall have power to:
 - (i) procure all such evidence, written or oral, direct or circumstantial, as it may think necessary or desirable, and examine all persons as witnesses whose evidence may be material or relevant to the subject matter;
 - (ii) require such evidence to be given on oath;
 - (iii) summon any person in Nigeria to give evidence or produce any document in his possession or under his control; and
 - (iv) issue a warrant to compel the attendance of any person who refuses to attend after being summoned, and order such a person to pay all costs associated with having to compel his attendance.
- (b) Such a warrant or summons issued in this case may be served or executed by any member of the Nigeria Police Force or any person authorised in that behalf by the President of the Senate or the Speaker of the House of Representatives, as the case may be.

Section 129 of the 1999 Constitution contains similar provisions for power as to matters of evidence bestowed on each State House of Assembly or its committee as regards the conduct of investigation.

What is easily discernible from the above is, the fact that there will be appointment of the members of the committee with clearly stated terms of reference. The committee, guided by the terms of reference and supported by the powers bestowed on it, can then proceed to gathering appropriate information and evidence to enable it come to reasonable conclusions. This is followed by the writing and submission of its report.

In the case of the Treasury Inspectorate Department of the Federal Treasury, whenever a case is to be investigated, at least two investigators are appointed in order to allow the report of one investigator to corroborate the report of the other. The investigation will involve:

- (a) examination of records;
- (b) making extracts from relevant documents;
- (c) making visits to various places that are connected with the case;
- (d) interrogating persons that are connected with the case; and
- (e) writing and submission of the Investigation Report.

The investigation report should be comprehensive enough and include recommendations as to whether the case should be referred to the Board of Survey and Inquiry, or where such referral is not necessary, the sanctions to be meted out to the erring officers and possible improvement in the internal control system to prevent a recurrence of similar cases.

Cases that are referred to the Board of Survey and Inquiry are at the instance of the Accountant-General, who is empowered to request the Secretary, Board of Survey and Inquiry to convene the Board of Inquiry on the request of the Accounting Officer. Once requested to convene the Board, the Secretary's convening order is required to contain the terms of reference for the board as may be advised by the Accountant-General.

The Secretary to the Board ensures that he forwards copies of the convening order to the following public officers:

- (a) Accountant-General of the Federation;
- (b) The Federal Ministry of Finance;
- (c) Auditor-General for the Federation;
- (d) Chairman, Federal Civil Service Commission; and
- (e) The relevant Accounting Officer.

The Board is required to do the following:

- (a) Commence the investigation as soon as the Board is convened;
- (b) Hold the meetings of the Board without any delay;
- (c) Direct all its enquiries toward discovering any weakness in the accounting system;
- (d) Inform the Accountant-General and Federal Ministry of Finance of all the facts relating to the circumstances of the loss without delay by means of an interim report; and
- (e) Prepare and submit the final report.

The final report of the Board of Inquiry shall include the following:

- (a) Re-statement of the terms of reference;
- (b) A statement on the exact amount of loss that has been incurred;
- (c) An opinion on whether the operation of the accounting system in the office concerned is faulty or not;
- (d) An opinion on whether the accounting system in the office concerned is appropriate or not, with suggestions on any practicable remedial measures;
- (e) An opinion on whether the physical security measures in place have been considered adequate or not, with suggestions on how to improve them if found inadequate;
- (f) Assessment of the degree of negligence of the officers considered responsible for the loss; and
- (g) Recommendations of the appropriate sanctions for the loss including responsibility for full or partial recovery of the loss.

If in the process of investigation, the matter is reported to the police, the Board shall defer its final deliberation and recommendations until the police investigation is completed.

Thereafter, the Board shall include in its consideration of any relevant police report or court proceedings in its own final report and recommendations.

3.11.3 Use of Probe Panel in Investigating Fraud and Corruption

The 1999 Constitution, as its predecessors, has some provisions on the Code of Conduct expected to be observed and conformed to by all public officers at the three tiers of Government as well as in the parastatals (Sections 172, 209). The Code of Conduct is contained in the Fifth Schedule to the Constitution. The meaning of misconduct as implied in the Code of Conduct and the powers of the Code of Conduct Tribunal are also indicated. Misconduct is stated in the Code of Conduct as meaning:

“breach of the Oath of Allegiance or Oath of Office of a member or breach of the provisions of the Constitution or a misconduct of such nature as amounts to bribery or corruption or false declaration of assets and liabilities.”

In the past, it was usual for the executive arm of Government to set a panel of enquiry (popularly referred to as a Probe Panel) for the purpose of inquiring into a matter with a view to ascertaining the extent of fraud and/or corruption perpetuated and those responsible for it. This is different from the Code of Conduct Tribunal. Such a probe is usually handled by a panel consisting of professional experts, usually involving a judge as chairman and other members including an accountant.

The major characteristics of the use of a probe panel include:

- (a) Appointment of panel members, specifying the Chairman and the Secretary;
- (b) Letter of appointment in which the terms of reference are clearly stated;
- (c) Indication of the scope of the probe assignment and the time frame for carrying out the assignment should be clearly indicated in the brief for the probe, usually in writing;
- (d) Preliminary sittings to set out how to carry out the assignment;
- (e) Call for memoranda from the public, indicating the format, deadline for submission of same and addresses to which they should be sent;
- (f) Requesting the persons suspected of fraud and/or corruption to appear before the Panel with written submissions of their involvement with the case;
- (g) Public Hearings (at places and on dates clearly stated and communicated to the members of the public) during which oral presentations could be taken;
- (h) Invitation of persons, officials, experts and auditors considered relevant to the case being probed to give evidence to the Panel on dates and at places clearly communicated to them;
- (i) Examining the evidence obtained and searching deeply into the areas requiring additional attention; and
- (j) Writing of the Report for submission to the person that appointed the Panel; if it is a body corporate the report should be submitted to its management.

The report of the Probe Panel should include the following:

- (a) Reference to the letter of appointment and the terms of reference;
- (b) The mode of operations of or the method used by the Panel to conduct the investigation or probe;
- (c) The extent of evidence gathered and any limitations encountered;
- (d) The findings especially the fraud or extent of corruption that has been discovered;
- (e) The identity of those found guilty of the fraud or corrupt practices;
- (f) The internal control weaknesses that facilitated the fraud and how the weaknesses can be eliminated from the system concerned;
- (g) The effects of the fraud and/or corruption on the operations of the organisation concerned and the periods affected; and
- (h) The plea made by those found guilty and any amends that they have promised to make or have made.

3.12 RECENT DEVELOPMENTS

In view of the determination of the Federal Government to eradicate corruption from all angles from both the private and public sectors, the Corrupt Practices and Other Related Offences Act, 2000 (Anti-Corruption Act) was enacted, and the Independent Corrupt Practices and Other Related Offences Commission (ICPC) was established.

The duties of the ICPC, as stipulated in Section 3 of the Anti-Corruption Act are to:

- (a) receive and investigate any report and prosecute any person where reasonable grounds exist for suspecting that the person has conspired to commit or has attempted to commit or has committed an offence amounting to corruption;
- (b) examine the practices, systems and procedures of public bodies and where, in the opinion of the Commission, such practices, systems or procedures facilitate fraud or corruption, to direct and supervise a review of such systems;
- (c) instruct, advise and assist any officer, agency or parastatals on ways by which fraud or corruption may be eliminated or minimised by such officer, agency or parastatal;
- (d) advise heads of public bodies of any changes in practices, systems and procedures compatible with the effective discharge of the duties of the public bodies as the Commission thinks fit to reduce the likelihood or incidence of bribery, corruption and other related offences;
- (e) educate the public on and against bribery, corruption and other related offences; and
- (f) enlist and foster public support in combating corruption.

The Anti-Corruption Act has a comprehensive list of types of offences, which are punishable by imprisonment and fine, and their respective penalties. The offences could be summarised as consisting of:

- (a) any public officer giving, asking and receiving bribe/gratification;
- (b) any public officer inflating the price of any goods or services above the prevailing market price or professional standard;
- (c) any public officer awarding or signing any contract without budget provision, approval or cash backing;
- (d) any public officer transferring or spending any sum allocated for a particular project or service to another project or service;
- (e) any public officer failing to report bribery transaction (Sections 23, 24);
- (f) any person who, with the intention of defrauding or concealing a crime or frustrating the Commission in its investigation, destroys, alters, mutilates, falsifies or omits any materials from any book, documents, valuable security, account, computer system, diskette, computer printout or other electronic device of his employer (Section 15); and
- (g) any person, who being an officer charged with the receipt, custody, use or management of any part of the public revenue or property, knowingly furnishes any false statement or return in respect of any money or property received by him (Section 16).

The ICPC since inception has been battling with the performance of its duties, prosecuting some public officials in various courts.

In 2003, the Federal Government established another anti-corruption agency, the Economic and Financial Crimes Commission (EFCC) followed by the enactment of the EFCC Act in year 2004.

The EFCC is charged with the following responsibilities, among others:

- (a) Enforcement and administration of the EFCC Act in the over-all context of preventing, detecting, investigating and prosecuting all cases of economic and financial crimes in Nigeria;
- (b) Enforcement of the provisions of other laws and regulations relating to economic and financial crimes including:
 - (i) Money Laundering Act 1995, as amended;
 - (ii) Advance Fee Fraud and Other Fraud Related Offences Act 1995;
 - (iii) Failed Banks (Recovery of Debts);
 - (iv) Banks and Other Financial Institutions Act 1991, as amended; and
 - (v) Miscellaneous Offences Act 1985.
- (c) Being the key agency of government responsible for fighting terrorism and terrorist financing.

Section 46 of the EFCC Act defines economic and financial crimes to mean:

“the non-violent criminal and illicit activity committed with the objective of earning wealth illegally either individually or in a group or organised manner thereby violating existing legislation governing economic activities of Government and its administration and includes any form of fraud, narcotic drug trafficking, money laundering, embezzlement, bribery, looting and any form of corrupt malpractices, illegal arms deal, smuggling, human trafficking and child labour, illegal oil bunkering and illegal mining, tax evasion, foreign exchange malpractice including counterfeiting currency, theft of intellectual property and piracy, open market abuse, dumping of toxic waste and prohibited goods, e.t.c.”.

Readers are advised to look at the publications on the anti-corruption crusade as well as the ongoing public sector reforms in order to be up-to date in their discussions of this matter.

An example is that of the House of Representatives Committee on the Public Accounts, ordering the Accountant-General of the Federation to probe the ₦25.8 billion pension disbursement in 2002 by the Directorate of Military Pension (DMP). The expenditure was made by the DMP without involving the Office of the Auditor-General for the Federation for proper monitoring as required.

3.13 SUMMARY AND CONCLUSIONS

In this chapter, the various aspects of the audit function in the public sector were discussed. Particular attention was paid to the audits of the Treasury Accounts, Government Parastatals, Ministries, Departments and Agency Accounts. Public Sector Audit procedures, Specialised Public Sector Audits and Types of Public Sector Audit were also examined. The chapter further considered the concept of Value-for-Money (VFM), its audit (in all ramifications) including guides to VFM audit teams so as to curb areas of waste in government spending.

The establishment of the Budget Monitoring and Price Intelligence Unit (BMPIU), also known as the Due Process Office, its procedures for review and overall impact on the economy was mentioned.

Investigations in the public sector and the use of probe panels have also been discussed. Attention has been given to the various attempts that the government has made to draw attention to the menace of misconduct and corruption with a view to curbing them both in the public and private sectors of the nation. Recent developments by Federal Government, especially in the establishment of the two anti-corruption agencies, that is, the ICPC and EFCC, have also been highlighted.

However, it should be noted that the two main issues covered in this chapter are topical issues that are constantly being reviewed and updated. Readers are implored to obtain updated versions of the developments in the two areas of Due Process Review and Value-for-Money audit from the internet publications of government; in order to remain conversant with latest developments.

Refer to Comprehensive Questions and Suggested Solutions in Appendix II, page 303.

3.14 REVISION QUESTIONS

1. The responsibility for auditing the accounts of the Nigeria Police Force lies on
 - (A) The Accountant-General of the Federation.
 - (B) The Auditor-General for the Federation.
 - (C) The Inspector-General of Police.
 - (D) The Comptroller-General of Customs and Excise.
 - (E) The Honourable Minister of Finance.

2. The functions of the Auditor-General for the Federation do not include the following
 - (A) Detection and prevention of fraud.
 - (B) Auditing and reporting in respect of treasury accounts.
 - (C) Auditing and reporting in respect of the accounts of government parastatals
 - (D) Serving as Chairman of the Audit Alarm Committee.
 - (E) Being in attendance during Public Accounts Committee sessions as an adviser.

3. The Accountant-General's Financial Statements include all except the following Statement
 - (A) Assets and Liabilities.
 - (B) Losses of Government Funds and Stores.
 - (C) Consolidated Revenue Fund.
 - (D) Share Capital and Reserves.
 - (E) Development Fund.

4. The following is one of the types of units used to describe a ministry or extra-ministerial department
 - (A) Self-Balancing Unit.
 - (B) Non-Self balancing Unit.
 - (C) Self-Accounting Unit.
 - (D) Sub-Balancing Unit.
 - (E) Non-Sub-Accounting Unit.

5. The following is a type of audit included in the scope of responsibilities of the Auditor-General for the Federation
 - (A) Regulatory Audit
 - (B) Operational Audit.
 - (C) Programme Audit.
 - (D) Management Audit.
 - (E) Computer Audit.

6. The concept of value for money does **not** include the following:
 - (A) Maximisation of the use of scarce resources.
 - (B) High Standard of quality of output.
 - (C) Minimisation of the level of input.
 - (D) Low cost of production.
 - (E) High level of the quantity of input.

7. The techniques for a Value-for-Money Audit do **not** include the following:
 - (A) Management and Systems Review.
 - (B) Review of the Management Objectives and Policies.
 - (C) Effectiveness Review.
 - (D) Efficiency Assessment.
 - (E) Analysis of Planning and Control Processes.

8. Value for money review teams can be used to conduct the following
 - (A) Accounting review in the office of the Accountant-General.
 - (B) Audit review of the financial statements prepared by the Treasury.
 - (C) Performance review in government offices and parastatals.
 - (D) Review of the operations of a self-accounting unit.
 - (E) Review of the operations of the value added tax offices.

9. The following is one of the four main functions of the Budget Monitoring and Price Intelligence Unit
 - (A) Certification Functions.
 - (B) Research Functions.
 - (C) Statutory Functions.
 - (D) Classification Functions.
 - (E) Management Functions.

10. The procedures for Due Process Review do **not** include the following
 - (A) Preliminary Discussion between BMPIU and beneficiary ministries.
 - (B) Preparation of Draft Report.
 - (C) Organisation of "Right of Reply" Meeting Final Report.
 - (D) Codification of Final Report.
 - (E) Granting or Denying Due Process Certification.

11. Each House of the National Assembly is empowered by the 1999 Constitution to direct or cause to be directed an investigation into
 - (A) The conduct of affairs of any person charged or intended to be charged with the duty of disbursing monies appropriated or to be appropriated by the National Assembly.
 - (B) The conduct of affairs of any Ministry charged with the responsibility of recruiting staff.
 - (C) The conduct of any government department that is about to be set up.
 - (D) The conduct of affairs of any agency of government that is operating as a non-self accounting unit.
 - (E) The conduct of affairs of the Accounting Officer of any parastatal.

12. Investigations handled by the Investigation Section under the Treasury Inspectorate Department are those that may **not** arise from the following
 - (A) Internal Audit Reports.
 - (B) Petitions and anonymous letters.
 - (C) New accounting procedures.
 - (D) Newspaper publications and other news media information.
 - (E) Suspicion based on alteration of records.

13. As regards investigation in the public sector, the final report of the Board of Inquiry shall include
 - (A) Memoranda from the Public.
 - (B) Certification from the Due Process Office.
 - (C) A statement of the exact amount of loss that has been incurred.
 - (D) External Auditors opinion statement.
 - (E) Report of the Auditor-General for the Federation.

14. The major characteristics of the use of a probe panel in investigating fraud and corruption include the following:
 - (A) Election into the Senatorial District's panel.
 - (B) Engagement of consultants for the panel.
 - (C) Discussion with the Due Process office.
 - (D) Appointment of panel members, specifying the Chairman and the Secretary.
 - (E) Detention by the Police of the experts and officials considered relevant to the case being probed.

15. The Economic and Financial Crimes Commission is **not** charged with the responsibility of enforcing the following:
 - (A) Banks and Other Financial Institutions Act 1991, as amended.
 - (B) Money Laundering Act 1995, as amended.
 - (C) Miscellaneous Offences Act 1985.
 - (D) Advance Fee Fraud and Other Fraud Related Offences Act 1995.
 - (E) Central Bank of Nigeria Act 1991, as amended.

16. The _____ Committee is responsible for deliberating on the Auditor-General's report and submitting its recommendations on such deliberations to the National Assembly.

17. The Auditor-General for the Federation is appointed by the President on the recommendation of the _____ subject to confirmation by the Senate.

18. The Treasury Department is headed by the _____.

19. The monthly accounts submitted to the Accountant-General of the Federation by a self-accounting unit are known as _____.

20. _____ system is reflected in the accounts of government parastatals that receive subvention or grants from the government.

21. The three elements of a Value-for-Money Audit are: _____, _____, and _____.

22. Value for money review teams can be engaged either on a _____ or a _____ basis.

23. The Budget Monitoring and Price Intelligence Unit in the Presidency is otherwise referred to as the _____ Office.

24. The _____ Division under the Ministerial Department in the office of the Auditor-General for the Federation is responsible for carrying out detailed investigation into suspected cases of Loss of government fund.

25. _____ is empowered to convene the Board of Inquiry on the request of the Accounting Officer.

26. The anti-corruption agency established under the Corrupt Practices and Other Related Offences Act, 2000 is known as _____.

27. The key agency of government responsible for fighting terrorism and terrorist financing is _____.

28. Mention the two major agencies of the Obasanjo Administration established to fight corruption.

Refer to Suggested Solutions in Appendix I, page 297.

4

SPECIALISED AUDITS AND INVESTIGATIONS

4.0 LEARNING OBJECTIVES

After studying this chapter, readers should be able to understand the:

- ◆ Need for specialised audit.
- ◆ General approach to audit, which can be modified for auditing different types of organisations.
- ◆ Specific approach to the audit of special types of organisations.
- ◆ Conduct the audit of specific industries, such as farmers, professionals, hospitals and hotels.
- ◆ Specific audit difficulties relating to financial institutions.
- ◆ Conduct of audit of not-for-profit organisations.
- ◆ Purposes of having joint audits.
- ◆ Distinction between auditing and investigations.
- ◆ Nature, classes and methods of investigations.
- ◆ Auditors' involvement with prospectuses and other offer documents.
- ◆ Main features of the work programme for the examination of financial forecasts and projections included in a prospectus.
- ◆ Concept of forensic investigation and audit.
- ◆ Report appropriate to each type of investigation.
- ◆ Various legal processes that are involved in corporate distress.
- ◆ Effect of receivership and receiver/manager.
- ◆ Effect of bankruptcy as it affects both individuals and partners.
- ◆ Liquidation and the various modes of winding up.
- ◆ Implications of insolvency for corporate governance and going concern threats.

4.1 INTRODUCTION

Specialised audit covers the audit of various types of organisations (profit and non-profit) and the different types of industries in the business group. In some cases, there are auditing standards and guidelines on specific areas, whereas, in other cases the auditor has to rely on his knowledge of the general approach techniques and the peculiarity of the organisation.

It is observed that even when there are auditing standards and guidelines applicable to specific industries, they tend to be long and complex. Consequently, for those using the study pack for professional examinations, detailed knowledge may not be required. It will therefore, be useful for the readers to be familiar with the general approach to the special features and audit difficulties relating to the various types of organisations.

4.2 AUDITS OF DIFFERENT TYPES OF ORGANISATIONS

There are many types of organisations with each one of them having accounts prepared and most of them requiring that they should be audited. Some of these organisations are business organisations while others are non-business (or not-for-profit) organisations. Every type of organisation has its own peculiar audit problems emanating from the nature of business carried on.

Some enterprises are subject to specific statutory and regulatory requirements on how their accounts should be prepared and audited, such as banks, insurance companies, primary mortgage institutions, charities etc. While it will not be feasible to provide detailed discussion of how to do an audit for each and every type of organisation, a general approach which can be adapted to specialised organisations is provided in this section. Subsequent sections will provide hints on the audit of specific types of enterprise.

4.2.1 General Approach

The general approach to an audit which can be modified for handling any special type of organisation, consists of the following:

(a) **Setting up of a permanent audit file**

Permanent audit files contain records that do not change from time to time. Such records include:

- (i) A copy of the rules or regulations, constitution or other document governing the specific enterprise, for example, Memorandum and Articles of Association for an incorporated entity, partnership deed or agreement in the case of a partnership;
- (ii) A copy of any statutory material relating to the conduct of the organisation, its accounts or its audit; for example, Companies and Allied Matters Act (CAMA) for specialist incorporated bodies, CAMA and Banks and Other Financial Institutions Act (BOFIA) for banks, CAMA and Insurance Act for insurance companies, bye-laws for non-governmental organisations;
- (iii) The engagement letter;
- (iv) A copy of the minutes of the meeting at which the appointment of the auditor was approved;
- (v) Notes on the history of the organisation, its background, the industry it belongs to and its prospects;

- (vi) Notes on the internal structure of the organisation, its location(s), personnel, management, production systems, products/services, etc.;
 - (vii) Copies of all past accounts (if any) with notes on accounting policies and significant ratios, together with any auditors' report and qualifications thereto;
 - (viii) Copies of all prospectuses in respect of the organisation; and
 - (ix) A list of the organisation's advisors, that is, bankers, solicitors, etc.
- (b) Planning of the audit, taking into consideration and documenting the following:
- (i) Audit risk;
 - (ii) Reliance on internal control (or not);
 - (iii) Substantive testing; and
 - (iv) Analytical review.

4.2.2 Specific Approach to Each Organisation's Audit

The specific approach to the audit of any of these peculiar organisations could be as follows:

- (a) **Accounting Policies**
Consider any problems of accounting measurement which may affect the organisation's accounts.
- (b) **Assets and Liabilities**
Consider the types of assets and liabilities which are likely to be found and any particular problems which might arise in verifying their existence, ownership, valuation and presentation in the organisation's accounts.
- (c) **Revenue and Expenses**
Consider the types of revenue and expense which should be expected and the particular problems which might arise in controlling and recording them.
- (d) **Internal Control**
Consider any special problems which might arise in respect of any of the transactions of the organization. A likely area that will need attention is the handling of cash transactions (both receipt and payment).
- (e) **Statutory Requirements**
Consider any accounting and/or auditing rules required by statute, that is, the audit of banks and financial institutions is governed not only by CAMA but also by the Banks and Other Financial Institutions Act (BOFIA), 1991.

- (f) **Regulatory Requirements**
Consider the requirement of any regulatory body for the organisation's accounting and auditing, such as, Central Bank of Nigeria (CBN) Act 1991 and Nigeria Deposit Insurance Corporation Act 1988 for banks and other financial institutions.
- (g) **Audit Risk**
Consider any matters which might give rise to greater than normal audit risk. In some organisations, these matters might be in relation to valuation of stock and work-in-progress while in others they might be cash receipts or ascertainment of asset quality by financial institutions.
- (h) **Auditor's Report**
Consider the form of report which should have the following sections:
 - (i) Addressee;
 - (ii) Financial statements audited;
 - (iii) Respective responsibilities of directors and auditors;
 - (iv) Auditing standards followed, for example, Nigeria Standards of Auditing or International Standards on Auditing;
 - (v) The audit opinion, which is usually in terms of "true and fair view";
 - (vi) Any other opinion prescribed by statutory or other requirements, for example, Insurance Act in addition to CAMA;
 - (vii) Identity of the auditor; and
 - (viii) Date of the report.

4.3 AUDIT OF SPECIFIC ORGANISATIONS

As indicated in the ICAN professional examinations syllabus, the following specific industries shall be covered. In some cases, attention is drawn to their special features and specific audit difficulties:

4.3.1 Special Features of Farmers, Professionals, Hospitals and Hotels:

There are some industries that really have special features, which the auditor will need to be familiar with in order to carry out his work.

The special features include the following:

- (a) **Farmers**
Accounts of farmers vary according to the type of business organisations which are run, that is, sole proprietorship or company, the type or variety of products that the farm produces, as well as the extent of records being kept. The well-known types of farming include:

- (i) Arable farming involving growing of crops;
- (ii) Pastoral farming involving livestock;
- (iii) Mixed farming involving both crops and livestock; and
- (iv) Plantation farming involving planting of tree crops such as rubber, plantain, cocoa, palm tree, sugar-cane, etc.

There are also other features of farm accounts, for example, crop rotation resulting to “fallow crops” and “fallow period(s)”, valuation of livestock, government subsidies (if any) in respect of fertilisers and extension workers, and valuation of crops and stores at the end of the financial year.

Farmers usually operate as sole proprietors in which case a lot of the records may not be kept at all. Therefore the auditor may have to treat the farmer’s accounts as those of a small business where he may be involved in converting incomplete records to “complete records”. This exercise involves having to prepare the trial balance and final accounts. On the other hand, if the farm is operated as a company, the provisions of CAMA are applicable in which case, the farmer will keep accounting records and prepare financial statements annually.

The knowledge of columnar and departmental accounts is useful in respect of the variety of farm products that may exist, for example, crops, fruits, poultry, piggery, cattle, and fishery. As regards the valuation of the stocks of the various categories of the farm products as at the end of the financial year, the provisions of SAS No. 4, as discussed in chapter five are applicable.

(b) **Professionals**

There are many types of professionals in business, for example, accountants, lawyers, doctors, engineers, pharmacists and architects. Some professionals carry on businesses as sole practitioners, partnerships and limited liability companies. It should however be noted that some professions are precluded either by law, or professional code of conduct, from being incorporated. Examples are firms of solicitors and accountants, as specified in Section 19 of CAMA.

In carrying out the audit of professionals, the auditor will need to consider the type of business organisational set up, the code of conduct of the particular profession and the statutory guidelines (if any) that may affect the profession.

(c) **Teaching Hospital**

In addition to dispensing drugs and medical services at a price to patients (which would have been an ordinary business concern), a teaching hospital, as a complex organisation,

carries out a lot of other activities and renders other specialised services to patients and the community, most of which are not-for-profit. It may also derive much of its income from diverse sources, some of which may be capital in nature including Government subventions, philanthropic organisations, donor organisations and individuals, research institutes, international agencies and charities. Special funds may also be provided for research and specialist health activities such as AIDS, Tuberculosis or Cancer.

The revenue from the ordinary activities of a teaching hospital may appear under the following headings:

Consultation	Drugs
Surgery	Nursing Care
Bed Fee	Feeding
Delivery Charges	Mortuary Fees
Sale of Cards	Laboratory Tests and
Blood Infusion	Dialysis

The following problems may be associated with the audit of a teaching hospital:

- (i) Apart from analysing the charges to a patient into the appropriate headings, there is also the problem of matching costs with related revenue, especially in cases where a patient's admission extends from one accounting year to another. Hence, where the teaching hospital has the policy of receiving advance payments from patients, there is always the problem of apportioning such advance payments to the different periods to which they relate. The auditor should therefore, review the basis of the apportionment and carry out a recomputation of such accrued revenue in order to confirm the reasonableness and accuracy;
- (ii) There is also the problem of high incidence of bad debts for a hospital establishment especially in cases of patients who die in the course of treatment. There is need therefore, for the auditor to carry out a review of debtors with a view to ensuring that adequate provision has been made for debts that may not be recoverable for whatever cause.
- (iii) Owing to the peculiar nature of the services of a hospital, unavoidable weaknesses may exist in the internal control system. For instance, patients may be admitted at irregular hours like victims of road accidents or armed robbery attack who may arrive at odd hours of the night. It will be necessary, on that account, for the auditor to

assess the procedure for dealing with such emergencies in order that they do not provide the avenue for loss of fund or failure to collect the related revenue.

- (iv) A hospital, being a specialised establishment, is likely to have sophisticated equipment whose value may be out of proportion to the size and whose real value will depend on the condition of the asset. It will require specialised skills to determine the effect of obsolescence on these equipment.

Furthermore, these equipment may have been avoided by philanthropic organisations, individuals or charities, some of whom may be foreign based. In such situations, it may be difficult to establish the full monetary value of these equipment for accounting purposes.

- (v) Stocks will consist of drugs, dressing, consumable supplies and disposable items, some of which will have expiry dates. Apart from the problem of examining these items individually in order to determine the expiration dates, the auditor may lack the skills to determine the condition of the items, hence he may have to rely on the opinion of experts.
- (vi) Apart from normal creditors for supplies made or services rendered, the liabilities of a hospital may include contingent liabilities for pending litigation or claims for negligence arising out of faulty medical treatment or application of wrong drugs. In addition to identifying the existence of such claims, there is also the difficulty of estimating the value of the claims. The auditor should therefore make enquiry of officials and examine available correspondence to establish the existence of such claims and the possible value.
- (vii) In addition to ensuring the truth and fairness of the financial statements, they may also be required to be in a particular format for presentation to the relevant supervising authority or donor agencies. The report may be addressed to the governing board with a copy to the supervising Ministry of Health.

(d) **Hotels**

The revenue of a hotel establishment will include accommodation for rooms, meals served in restaurants, bar sales for beverages and tobacco, sale of snacks, laundry services, hire of conference halls, telephone, fax and internet services, room service, car hire service. The sources of revenue for hotels are diverse and of non-

standard value. For instance, hotel rooms are of different classes and restaurant meals are based on the specific orders by guests which are required to be “costed” by attendants and waiters who may not have any accounting knowledge.

In order to carry out the audit of a large hotel establishment, the auditor should first identify all sources of revenue to the hotel and evaluate each in terms of control over the revenue generated. One major difficulty relating to the internal control of a hotel establishment is the unlimited hours of business.

Just as in the case of a hospital, guests may arrive at odd hours of the night. Furthermore, guests who have made deposits may fail to utilise the services paid for or may only utilise such services in part. This gives rise to complex computations of refunds which may be open to abuse.

The audit approach to be adopted for a hotel establishment will include the following procedure:

- (i) In respect of guests for accommodation, the auditor should assess the check-in procedure in order to ensure adequate control over:
 - ◆ Initial deposits required;
 - ◆ Billings for the rooms; and
 - ◆ Refunds for deposits not utilised.

He should check the daily cash summaries and agree with the daily chart to confirm that guests have been billed as is appropriate. He should agree the daily collections with the relevant bank paying-in-slips to ensure that the day’s collections have been paid intact into the bank account. He should agree the refunds made to the relevant bills and deposits and check the payments to the imprest cash books. For credit customers, he should identify the individual charges to the monthly bills.

- (ii) In respect of restaurant services, he should ascertain the costing method for meals served and check the bills on a sample basis to the cash receipts book. He should agree individual bills to the menu and confirm calculations for additional charges such as service charge and VAT. He should ensure that the service charge includes, where applicable the room service, ensuring that that this has been billed at the appropriate rate.
- (iii) The telephone and fax bills should be checked to the telephone log and traced therefrom to the individual guest bills.

- (iv) The hire of conference halls should be vouched by reference to the related correspondence in order to ensure adequate billing and effective collection.
- (v) The bar account should be verified by carrying out a physical stock check and overall test of the bar purchases and daily sales. The verification should follow the normal procedure for verifying purchases and sales.
- (vi) The assets and liabilities of the hotel are verified in the normal way. The assets will comprise mainly of vehicles, furniture and equipment.
- (vii) The debtors for bills not yet paid are verified like any trade debtors, focusing particularly on the procedure for granting credit, the status of such debtor and the paying habit. Wherever necessary, the auditor should ensure that appropriate provision is made for debts that are doubtful of recovery.

The revenue of a hotel establishment will include accommodation for rooms, meals served in restaurants, bar sales for beverages and tobacco, sale of snacks, laundry services, hire of conference halls, telephone, fax and internet services, room service, car hire service etc. The sources of revenue to a hotel are diverse and of non-standard value. For instance, hotel rooms are of different classes and restaurant meals are based on the specific orders of guests which are required to be “costed” by attendants and waiters who may not have any accounting knowledge.

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Furthermore, guests who have made deposits may fail to utilise the services paid for or may only utilise such services in part. This gives rise to complex computations of refunds which may be open to abuse.

(e) **A University**

For the audit of a University, the auditor should consider the enabling legislation, the nature of its activities, the funding, the system of internal control, the accounting format and the reporting requirements. Universities in Nigeria are established by special Acts of the National or State Assemblies with approval for the various programmes by the National Universities

Commission (NUC), a body also charged with the responsibility of funding and regulating activities of the universities. It will therefore be appropriate for the auditor to obtain copies of the Act setting up the university and the NUC accreditation of its programmes. On the first visit, the auditor should obtain a schedule of NUC subventions for comparison with the infrastructural developments.

Governmental organisations such as universities, health Institutions and similar organisations are not subject to very stringent legal rules as the Government itself. The financial statements of such governmental organisations are required to provide information useful for making resource allocation or funding decisions, information useful for assessing services provided and the ability to provide such services, information for assessing management stewardship, performance and economic resources, obligations, net resources and changes thereto.

(i) **Review of the System of Internal Control**

In the evaluation of the system of internal control as is applicable to a university, the auditor will consider the following factors:

- ◆ Methods of Keeping Records;
- ◆ Organisation Structure;
- ◆ Segregation of Duties; and
- ◆ Custodial Controls.

The Method of Keeping Records

Books and records which are kept for a University are: the record of fixed assets, the cash and bank books, the record of staff employment, students enrollment record, students academic records, payroll record and other expenditure. Proper internal control requires that these records are kept in a permanent form.

This means that all records that are of continuing importance should be either typed or written in ball point pen. In this age of computers, most records are stored electronically and similarly duplicated for safety and prevented from access to unauthorised persons.

Hence, proper internal control for auditing purposes precludes any records being kept in pencil. It is also necessary to ensure that these records are updated regularly and not allowed to fall into arrears. Proper reconciliation should be carried out between these records and any other relevant independent reports.

For instance;

- ◆ The cash book should be reconciled with the bank statements.
- ◆ The fixed assets register should be reconciled with the physical assets held by the Transport or Works Department.
- ◆ The Library records should be reconciled with the physical stock of books. If such reconciliation is not done promptly and regularly, cases of malpractice or errors may remain undetected for a very long time. It should be noted that a usual method to conceal malpractices is to create chaos in the records by allowing them fall into arrears or setting them ablaze in extreme cases.

Organisation Structure

In order to eliminate friction and promote efficiency, there should be a well defined organisation structure. Not only that the positions and authority levels are well defined, competent staff should be assigned to specific positions of responsibility in respect of which they have the relevant skill.

Professors should be assigned to the academic and research departments, a doctor to the medical centre, an accountant to the bursary and an engineer to the Works Department. A well defined organisation structure helps management to run the business in an orderly manner. This enhances operational efficiency, which is an important feature of internal control. It also eliminates unnecessary costs, which may be incurred as a result of internal role-conflict.

Since internal control does not relate to only financial accounting matters, the auditor of a University should look out for the following in evaluating the system of internal control as it relates to the entity:

- ◆ the catering department for the procurement and distribution of meals in the cafeteria;
- ◆ the student affairs for the control, administration and allocation of students accommodation;
- ◆ the works department for the general administration, the allocation of staff quarters, vehicles and maintenance facilities;
- ◆ the library for the procurement custody and lending of books to students, staff and the general public;

- ◆ the registry for student admissions and general academic regulations;
- ◆ the academic affairs department for graduate academic records, and a lot more as the above is by no means exhaustive.

Segregation of Duties

An important aspect of internal control is the segregation of duties. This does not relate to the division of duties as applicable in Economics. That would have been taken care of by the organisation structure already discussed above. The segregation of duties as it relates to the University requires that no one person or department shall be responsible for the whole three aspects of any transaction (procedure) in the institution. These three aspects are: Authorisation, Custodial and Recording.

For instance, for acquisition of a motor vehicle for the University, the office of the Vice-Chancellor authorises the purchase of the vehicle, the works department does the actual purchase and takes delivery, while the Bursar's office effects payment and keeps record of the vehicle. For students' fees, a bank may be designated to collect cash, the Bursary issues the official receipts and the Registry, student affairs or the faculties carry out different aspects of students' clearance.

The simple objective of the segregation of duties is to ensure that no one person is in a position to both perpetrate a malpractice and at the same time conceal his action by manipulating the records. Hence, if collusion occurs between a student and a dishonest bank staff, and the former is able to obtain an invalid teller for fees paid this will be detected by the Bursary at the time the official receipt is issued or at the time bank reconciliation is carried out. This principle of segregation of duties is extended to other aspects of the operations of a University like:

- ◆ Government grants and other sources of generating funds to the university;
- ◆ Staff salaries, capital expenditure and other payments which the university undertakes;
- ◆ Students admissions, hostel accommodation and cafeteria;
- ◆ Examinations and academic records; and
- ◆ Staff offices and housing allocation.

Custodial Controls

In addition to the general rules (basic controls) which are in place to help ensure efficiency, the University should also establish additional rules (disciplines over basic controls), to ensure that the general rules it had established are indeed being complied with. These custodial controls are designed to physically prevent the loss of assets by ensuring that the general rules of internal control are indeed operating.

The following are policy actions designed to enforce discipline in any institution or public place:

- ◆ The wire fencing or walling of the premises with only one entrance into the University,
- ◆ All vehicles and individuals entering or leaving the University premises pass through the gate and are subject to security checks,
- ◆ Readers are required to drop hand bags and briefcases at the entrance before being admitted into the library,
- ◆ The cash office is a cage whereby the cashier operates from behind an iron barrier with people paying and being paid cash through a slot,
- ◆ Entry into the store is prohibited to “unauthorised persons”,
- ◆ Cheque books, LPOs and other sensitive documents are locked up in a safe or fire proof cabinets in the custody of responsible officials.
- ◆ Stocks of unissued certificates should be locked in vaults preferable with a bank or the Nigerian Security and Minting Company.

(ii) **Analytical Review of the Financial Statements**

The second stage of the audit of a University is the analytical review of the financial statements. This review is designed to ensure that the financial statements are properly drawn-up and show a true and fair view. This is the statutory responsibility on which the auditor’s report is based.

Having carried out a review of the system of internal control in the University, the auditor has a good idea of the strengths and weaknesses in the control.

The strengths relate to those areas in respect of which the controls are operating and which may therefore be relied upon. The weaknesses relate to those areas in respect of which the controls are non-existent or where they exist but fail to operate.

These are the areas which the auditor identifies as potential germinating soil for malpractices or errors. At the end of the review of the system of internal control, the auditor sends a management letter, otherwise called 'letter of weakness.'

In it, the auditor points out to the authorities:

- ◆ The specific areas of weaknesses;
- ◆ Their possible effects on the financial statements or likely losses which they may occasion; and
- ◆ The remedial action needed to put these matters right.

In relation to a University, the letter should be addressed to the Chief Executive (the Vice-Chancellor), after being discussed in detail with the Bursar. The likely points on such a letter are:

- ◆ Improper or incomplete recording of students' fees;
- ◆ Staff salaries prepared in a manner likely to lead to duplications or introduction of non-existent workers;
- ◆ Improper accounting for fixed assets for instance if a fixed assets register is not maintained;
- ◆ Improper physical control of fixed assets which may lead to misuse or even loss of those assets;
- ◆ Non-reconciliation of bank statements; and
- ◆ Payments made on the basis of improperly authorised vouchers, and cheques issued not being restrictively crossed, etc.

Based on the strengths and weaknesses identified and communicated to the Chief Executive of the institution, the auditor is in a position to determine the nature, extent and timing of the analytical reviews to be carried out in respect of each area of the operations of the institution. For instance, he may decide to carry out limited review in respect of students' fees if he is of the opinion that the controls in this area are effective. In respect of cheque payments or payments generally, he may decide to carry out detailed reviews if, in his opinion, the related controls are weak.

(iii) **Detailed Examination of the Financial Statements**

The detailed examination of the financial statements of a University will involve; comparisons, reviews, investigations, confirmations, and verifications.

- ◆ **Comparisons:** The auditor examines the financial statements of the institution for two successive periods with a view to comparing specific items in one period with corresponding balances in the previous period, the objective being to obtain satisfactory explanations for any variations.

For instance, the difference between the staff salary of one year with that of the previous year should be justified by either higher figures as a result of promotions or increases in the number of staff, arising from more recruitment.

- ◆ **Reviews:** The auditor reviews the figures appearing in the financial statements for consistency with available non-financial data. For instance vehicle running cost must be justified by the number of vehicles being operated and the kilometer log of individual vehicles. Cost of meals at the cafeteria must be justified by the number of students that were served meals during the period.
- ◆ **Investigations:** Wherever the auditor is put upon enquiry, i.e. he has reason to be suspicious as a result of the review and comparisons he had carried out, he should investigate the matter to the roots. This will involve vouching, which is an exhaustive examination of a transaction with a view to ascertaining its true meaning and origin.

For instance, if the auditor suspects malpractice in the purchase of a motor vehicle for the University, he may wish to obtain copies of the relevant vouchers relating to the purchase, the minutes of any resolution to buy, review the various tenders obtained for the supply of the vehicle, and the deliberations of the tenders board where applicable. He may also wish to compare with the price list displayed by major distributors or compare the price with that of similar vehicles purchased earlier by the University or similar organisations.

- ◆ **Confirmations:** In order to lend weight to the information, which the auditor has obtained from the officials of the University, he may wish to confirm by contacting external sources. For instance, in respect of insurance claims or premium payments, the auditor may contact the insurance company. In respect of bank balances or cheque payments, the auditor may contact the banker. In respect of subventions, he may wish to confirm direct from the National Universities Commission.
- ◆ **Verifications:** Generally, the auditor carries out a verification of the items appearing in the financial statements. The verification procedure is designed to ascertain the existence, ownership and valuation of these items.

By so doing, he is reasonably assured of the completeness, validity and accuracy of these items and hence that the financial statements show a true and fair view. For instance, in respect of students fees, the verification work which the auditor carries out helps him to satisfy himself that the amount stated as fees:

- ◆ Are indeed in respect of fees and not the proceeds of sale of books or cafeteria meal coupons,
- ◆ Are indeed in respect of fees for the year under review and not in respect of fees for a prior year or fees paid in advance, and
- ◆ That the amount is correct, without any duplications or omissions.

In respect of subventions, the auditor is able to obtain credible and sufficient evidence that it is not an income from the investment of an endowment established by a philanthropic organisation or individual, or the proceeds of a professorial chair established by a professional body or individual.

In respect of cost of furniture purchased, the auditor should be able to confirm that this is not reported as expenditure on repairs and maintenance. In respect of staff salary, he should be able to obtain relevant evidence that no ghost workers were included on the payroll and that the amount paid to each worker is in agreement with his approved rate of pay.

On the same basis, the auditor carries out a verification of all other items in the financial statements and is therefore, in a position to either criticise them or confirm their truth and fairness.

4.3.2 Specific Audit Difficulties Relating to Financial Institutions

The financial services industry, comprising various types of financial institutions, play a significant role in the economic development of the nation. The industry is a sub-sector of the Nigerian Financial System, which includes other players. The Central Bank of Nigeria (CBN) is the apex regulatory authority of the country's financial system while the Nigeria Deposit Insurance Corporation (NDIC) serves as another regulatory institution operating alongside the CBN.

The CBN was established in 1959 under the CBN Act of 1958 and now operates under the CBN Act No. 24 of 1991 (as amended in 1997). It regulates the operations of banks and non-bank (or other) financial institutions.

While the banking sector consists of the commercial banks, the development banks and micro-finance banks; the non-bank financial

institutions consist of the finance companies, insurance companies, bureau de change, pension fund administrators, primary mortgage institutions, the Nigerian Stock Exchange, the stock brokerage firms, registrars and discount houses.

The promulgation of the CBN Act and the Banks and Other Financial Institutions Act (BOFIA), both in 1991, gave the CBN more authority in regulating and supervising the banks and other financial institutions in the sector.

In fact, development banks and other financial institutions were placed under the CBN's supervision by virtue of the amendment to the CBN Act in 1997.

4.3.2.1 **Banks:**

CBN is charged with the responsibility of administering the BOFIA, as amended, which aims at ensuring high standards of banking practice and sustaining financial stability.

There are various provisions in both the CBN Act (as amended) and BOFIA (as amended) which govern the operations of banking business in Nigeria. The provisions cover such issues as:

- (a) Minimum paid-up share capital requirements;
- (b) Minimum capital ratio;
- (c) Minimum holding of cash reserves, specified liquid assets, special deposits and stabilization securities;
- (d) Returns to be submitted to the CBN by banks, on regular basis (for example, mid-month returns, monthly returns, quarterly returns and semi-annual returns);
- (e) Power of the CBN to conduct routine and special examinations;
- (f) Management of ailing banks; and
- (g) Power of the CBN to revoke or vary a bank's license.

In the course of executing its core mandate, the CBN regularly (usually on an annual basis) review the developments in the economy in the preceding years and sets objectives, and targets for the current year. Objectives of monetary policy are contained in the CBN's *Monetary Policy Circular*. The major objectives of monetary policy are as follows:

- (a) Maintenance of price and exchange rate stability;
- (b) Ensuring banking soundness and financial sector stability; and
- (c) Ensuring effective enforcement of the market rules.

The *Prudential Guidelines for Licensed Banks*, which were issued by the CBN in November 1990 and updated in May 1991 and July 2001 is still operational and continuously reproduced as Appendix I to each edition of the Monetary Policy Circular.

The issuance of the Prudential Guidelines is intended to sanitise the financial reporting system in the banking industry; as its provisions deal primarily with early recognition of losses and adequate provision for bad and doubtful debts in respect of bank lending. The Prudential Guidelines, coupled with the SAS No 10 on “Accounting by Banks and Non-Banks Financial Institutions (Part I)” issued by the Nigerian Accounting Standards Board (NASB) in October 1990, have made banks to desist from their previous “window dressing” or “creative accounting” tendencies. This has been achieved through the four main areas of concern relating to accounting practices and accounting methods that are to be followed by banks and these areas are:

- (a) Income Recognition;
- (b) Loss Recognition;
- (c) Balance Sheet Classifications; and
- (d) Disclosure Requirements.

Income Recognition

As regards **income recognition**, the standard recognises the various sources from which banks earn their revenue and provides a guide for recognising income from each of the sources. These sources include: Interest Income on loans, overdrafts and other risk assets; credit-related fee income; non-credit-related income; lease rental income; and profits arising on sale of loans or discounts with recourse to the seller.

Loss Recognition

In the case of **loss recognition**, the standard sets out rules to follow in order to achieve a uniform approach towards the recognition of various types of losses. Each bank is required to classify its loan portfolio into “performing” and “non-performing” loans. A loan is classified as “non-performing” if interest or principal is due and unpaid for 90 days or more. Non-performing loans are further classified into sub-standard, doubtful or lost. A non-performing credit facility is classified thus:

S/N	No. of days principal and/or interests are unpaid	Classification
1	More than 90 days but less than 180 days	Sub-standard
2	At least 180 days but less than 360 days	Doubtful
3	360 days or more	Lost

The specific provisions for loss on the non-performing loans vary according to the classification of such facility as shown below:

- (a) Sub-standard Credit Facilities - 10% of the outstanding balance
- (b) Doubtful Credit Facilities - 50% of the outstanding balance
- (c) Lost Credit Facilities - 100% of the outstanding balance

In addition to the specific provisions stated above, banks are required to make general loan loss provisions of at least 1% of risk assets not specifically provided for. This is to ensure that provision is made against the as-yet-unidentified losses which are known to exist in any portfolio.

The section of the Standard on **balance sheet classifications** is aimed at ensuring that certain methods of presenting the balance sheets of banks (which could be described as “window dressing”) are no longer used. These methods usually result in reducing the banks’ reported credit, or reducing their reported deposit, or improving their reported liquidity; thus giving them a bloated financial position. For instance, the net investments in finance leases granted to customers should not be shown as fixed assets on the balance sheet; rather banks should record them as “advances under finance leases”. In the same vein, all transactions should be reported as having been completed unless the expense and delay associated with the analysis and proper classification of such items are out of proportion to the materiality of the reported balance.

Disclosure Requirements

The Standard sets out a number of items which banks should **disclose** in their financial statements. These include items in the Statement of Accounting Policies, Income Statement, Balance Sheet, and Notes to the Accounts. These are highlighted below:

- (a) The Statement of Accounting Policies should include a brief description of the systematic method by which non-performing loans are identified and the method by which the provisions for loan losses are determined. Also to be included is the nature of off-balance sheet engagements and the methods used to recognise income thereon.
- (b) In the Income Statement, each principal revenue item should be stated separately in a bank’s financial statements to enable the users assess the contribution of that particular source. A bank should not offset one item of revenue or expense by deducting from it another item of revenue or expense. The Standard states the minimum disclosure requirements for the Income Statement indicating that the following should be specifically disclosed.
 - (i) Interest income split between bank and non-bank sources;
 - (ii) Interest expense split between bank and non-bank sources; and
 - (iii) Credit-related fee income and expenses where such fees were recognised at once, as against being deferred and amortised.
- (c) As regards the balance sheet, each bank should group its assets and liabilities in the balance sheet according to their nature and

list them in the order of their liquidity and maturity. The amount of provision for loan losses, shown separately between principal and interest, should be disclosed and deducted from the relevant asset category. Furthermore one item of asset or liability should not be off-set by deducting another asset or liability unless a legal right of set-off exists, while the nature and amount of contingencies and commitments arising from the bank's off-balance sheet engagements should also be disclosed.

- (d) In the Notes on the Accounts, the bank should disclose the major items that make up its "Other Assets" and "Other Liabilities". If there is any other disclosure requirement of the Income Statement and Balance Sheet that is not stated on each of these two components of the financial statements, they should be disclosed in the Notes on the Accounts.

For instance, a maturity profile of a bank's risk assets and deposit liabilities should be provided under the following categories:

	N
Under 1 month	x
1 - 3 months	x
3 - 6 months	x
6 - 12 months	x
Over 12 months	x

SAS No.10 requirements also accord substantially with the requirements of International Accounting Standard (IAS) No. 30, which is "Disclosures in the Financial Statements of Banks and Similar Financial Institutions", issued by the International Accounting Standards Board (IASB) in August 1990. IAS No. 30 became operational for the financial statements of banks covering periods beginning on or after 1st January, 1991.

The recent wave of banking reform by the CBN, which started in June 2004 had centred on a thirteen point agenda. Two essential aspects of the reform are:

- (a) Raising of the minimum capital base to 25.0 billion by the end of 2005; and
- (b) Movement of the deposits of key government parastatals (for example, NNPC, NITEL, PHCN) and overhead of core ministries from commercial banks to the CBN, depending on the liquidity conditions of the organisation.

The emergence of universal banking with effect from year 2000 is also worthy of reference here. All these developments have really led to a lot of expansion in the responsibilities bestowed on the CBN over time. There is now a separate department in the CBN for other financial institutions referred to as Other Financial Institutions Department (OFID).

Establishment of Nigeria Deposit Insurance Corporation (NDIC)

The NDIC was also established under the NDIC Act No. 22 of 1988 and became operational in January 1989. It was established against the backdrop of bank failures and the attendant suffering by depositors in the early 1950's as well as the expected deregulation of the banking system in the late 1980's, following the implementation of the Structural Adjustment Programme (SAP).

The establishment of the Corporation was also informed by the approach which was adopted by some other countries to ensure banking stability; for example, the experience of (the then) Czechoslovakia and the United States of America being particularly relevant, the former being the first country to establish a nation-wide deposit insurance scheme in 1924 as a measure to revitalise the country's banking system after the ravages of the first world war, while the latter having established the Federal Deposit Insurance Corporation (FDIC) in 1933 in response to a banking collapse and panic.

All existing licensed banks are required to insure their total deposit liabilities with the NDIC and to contribute a premium, which is equal to $\frac{15}{16}$ of 1% per annum of their total assessable deposit liabilities standing in their books as at 31 December of the preceding year. This is with a view to being in a position to provide financial guarantee to depositors in case of bank failure. The NDIC also ensures that banks comply with regulations and practices which foster safety and soundness in the financial market. This is achieved by the constant on-site examination of insured banks and off-site surveillance over all insured banks.

In addition to the above, there are various Sections of BOFIA covering the books of accounts and appointment of auditors. These are:

- (a) Section 24 provides that every bank shall keep proper books of accounts in respect of all the bank's transactions. Where the CBN is not satisfied with the books of accounts kept by any bank, the CBN may appoint a firm of chartered accountants to prepare proper books of accounts or render accurate returns for that bank at the bank's expense.
- (b) Section 25 provides for various returns which every bank should render to the CBN on regular basis. This is constantly reviewed through the Monetary Policy Circular.
- (c) Section 26 provides for CBN to regard all statements and returns by banks as confidential but that CBN could publish consolidated statements submitted to it by the various banks (such as contained in CBN Annual Reports).
- (d) Section 27 provides that subject to the approval in writing of the CBN, a bank shall not later than 4 months after the end of its financial year publish, exhibit in a conspicuous position in each

of its offices and branches in Nigeria, and forward to the CBN copies of the bank's balance sheet and profit and loss account duly signed and containing the full and correct names of the directors of the bank. Every such published account shall disclose, in detail, penalties paid as a result of contravention of the provisions of BOFIA and the auditor's report shall reflect such contravention.

- (e) Section 28 provides that every balance sheet and every profit and loss account of a bank shall give a true and fair view of the state of affairs of the bank as at the end of the reporting period; and those forwarded to the CBN shall comply with the requirements of any circular which has been issued by CBN.
- (f) Section 29 provides for the appointment of a qualified person as "the approved auditor" of a bank, such appointment being approved by the CBN. Whenever the approved auditor in the course of his duties as an auditor of a bank, is satisfied that:
 - (i) There has been a contravention of BOFIA, or that an offence under any other law has been committed by the bank or any other person; or
 - (ii) Losses have been incurred by the bank which substantially reduce its capital funds; or
 - (iii) Any irregularity which jeopardises the interest of depositors or creditors of the bank, or any other irregularity has occurred; or
 - (iv) He is unable to confirm that the claims of depositors or creditors are covered by the assets of the bank, he shall immediately report the matter to the CBN.

The approved auditor shall forward to the CBN two copies of the domestic reports on the bank's activities not later than 3 months after the end of the bank's financial year.

The above issues are not exhaustive about the special characteristics of auditing of banks. There are usually changes to or reviews of both the statutory and regulatory matters concerning banks. Consequently, auditing of a bank calls for a clear understanding of all the above issues and more importantly there is a need for the audit files (both permanent and current) to be updated from time to time in order to be ahead of developments, not only in respect of the particular bank being audited but also in respect of the entire industry.

Some Guidelines on the Audit of Banks

- (a) The auditor should review carefully all the loans and advances of the bank during the period of the audit with a view to

- ascertaining the correct application of the provisions of the Prudential Guidelines as well as SAS No. 10 with regard to the gross interest earnings. This review will also confirm the correctness of the provision for bad and doubtful accounts;
- (b) The other sources of revenue should also be carefully investigated so as to obtain evidence for their inclusion in the accounts. Some of these revenue items are: fees and commissions, lease income, dividend from investments, and foreign exchange earnings;
 - (c) Interest expenses should be verified for both correctness and completeness;
 - (d) Apart from loans and advances, the auditor should pay particular attention to each of the other peculiar items of a bank's balance sheet.

Examples of these are: short-term funds, bills discounted, equipment on lease, other assets (including inter-branch balances and a myriad of items), deposit and current accounts, other liabilities (including provision for frauds and losses), statutory reserve, reserve for small and medium scale industries, contingent liabilities and other obligations on behalf of customers and customers' liability thereof;

- (e) The auditor should comply with all the provisions of the Prudential Guidelines and SAS No.10 with regard to income recognition, loss recognition, classification of balance sheet items, and the disclosure requirements; and
- (f) The auditor should comply with all the provisions of BOFIA regarding the audit of a bank, including the submission of two copies of the domestic report on the bank's activities to the Central Bank of Nigeria within the stipulated time.

Challenges of Information Technology on the Audit of Banks

The auditor should pay particular attention to the challenges that Information Technology has brought into the audit of banks and therefore appreciate the need for an effective and efficient internal control system. These challenges include the following:

- (a) Probable incidence of computer fraud;
- (b) Possible problems that may be associated with real time on line operations;
- (c) Possibility of input errors (Garbage in garbage out – GIGO);
- (d) Possibility of system errors; and
- (e) Problems that may be associated with the application of computer based audit procedures.

4.3.2.2 Insurance Companies

Insurance Companies being limited liability companies are concurrently governed by CAMA and the Insurance Act of 2003. The National Insurance Commission is the supervisory body for the industry.

There are two classes of insurance business: Life Insurance business called Life Assurance Companies and General Insurance business. Life Assurance business is an insurance business under which, in consideration for premiums paid, the company undertakes to pay an agreed benefit, primarily on the survival of the policy holder to a specified age or on death which ever occurs first.

Life assurance business includes whole life, endowment, annuity, pensions, permanent disability, and capital redemption or pension fund management business. Life assurance business is generally referred to as Long Term business. This is classified into personal or group life assurance. Personal relates to a policy that covers only one person, while group will cover a group of people like the employees of a company.

(a) **Special Requirements for Insurance Business**

Except for mutual assurance or insurance set up under a cooperative society arrangement, only companies registered under the Companies and Allied Matters Act may carry on insurance business in Nigeria. Hence all insurance companies are limited liability companies.

The share capital requirements with effect from March 2007 are as follows:

◆ Life Assurance companies	₦150 million
◆ General Insurance business	₦200 million
◆ Composite Insurance	₦350 million
◆ Reinsurance business	₦350 million.

The statutory deposit requirement is as follows:

- ◆ 50% of paid-up capital for intending companies, and
- ◆ 10% of paid capital for existing companies.

This is to be deposited with the CBN and attracts interest at the minimum lending rate. It can only be withdrawn in line with provisions set out in section 10 of the Act.

(b) **Accounting and Auditing Requirements**

Insurance companies (including life assurance companies) are required to prepare separate revenue accounts for each class of business undertaken in addition to a profit and loss account. Insurance business is a specialised type of business requiring that the auditor's working papers should be compiled such that all aspects of the business will be covered in order to ensure a thorough audit work.

The peculiar aspects of the accounts, and hence the audit of an insurance company, are in respect of the following:

(c) Unexpired Risks

At any balance sheet date, some of the premium already received will normally include that for the periods subsequent to the balance sheet date. There is therefore the tendencies of the covered risk attracting full liability on a future date. The insurance company, in addition to carrying forward the premium which relate to periods beyond the balance sheet date as “unearned premium,” makes provision for amounts required to meet the full claims and expenses on businesses still in force after the accounting period.

The assessment of an unexpired risk and the provision thereon is a highly specialised exercise. Unexpired risk is like an uncompleted contract whose outcome cannot be determined with any certainty. It is not the duty of the auditor to determine for a company the method of assessing or making provision for unexpired risks. This is the duty of management and it is usually based on experience and the special circumstances of each case. It is for the auditor to assess the adequacy and reasonableness of the particular method adopted. He should ensure that this appears reasonable and in line with the method generally adopted in similar businesses. It is also important to ensure that the method is consistently applied from year to year. Where there is a change in the method, this must be disclosed together with the effects on the financial statements of such a change.

Unexpired risks are like post balance sheet events. It is however necessary to point out the difference in the method of treatment in the accounts. Where the covered event occurs subsequent to the balance sheet date, it does not necessitate any adjustment in the financial statements as it does not relate to the current year but to a subsequent year. Where however the effect of such an event is material, it may be necessary only to disclose the occurrence.

(d) Claims

Unexpired risks are associated with non-life business and claims may occur both in respect of life and non-life business. Claim is the amount payable under a contract of insurance on the occurrence of the insured event. Claims handling expenses are costs incurred in the process of investigating or settling claims. Where such expenses are attributable to a particular claim, they are regarded as

direct expenses. Where these expenses cannot be attributable to a particular claim, they are regarded as indirect expenses.

It is essential for the auditor to ensure that in determining the amount of claims that all claims handling expenses have been included. This is to ensure that each revenue account gets the charge for all expenses related to the claims incurred. There should also be a good basis of apportioning indirect claims handling expenses. Alternatively this may be a charge in the profit and loss where a reasonable basis cannot be determined. Proper cut-off should also be observed in dealing with claims handling expenses in order to ensure that these are charged in the same period with the related claims.

(e) **Investment Expenses**

Investment expenses are those expenses arising from the buying, holding or selling of investments, excluding such costs relating to stamp duty and brokerage on the acquisition and disposal of investments. Investment expenses are associated more with life assurance business as income from investment constitutes the most important revenue of a life business. Investment expenses are principally those costs incurred as a result of holding and managing investments such as the salaries of the investment manager or investment analyst or the cost of safe custody for investment certificates.

The cost of buying or selling investments will include the cost of obtaining information, printing and stationery or the cost of courier and postage to the extent that they are not incurred and billed by the stockbroker. As with claims, it is the duty of the auditor to ensure that investment expenses are matched with the related income from investment and in the correct period.

(f) **Underwriting Expenses**

These are costs incurred in assessing insurance contracts and other related expenses incurred in servicing existing contracts after the acquisition, renewal or amending existing contracts. The treatment given to underwriting expenses will depend on the basis of accounting adopted by the insurance company. Where the annual basis of accounting is adopted, the underwriting results and hence the underwriting expenses are recognised during the accounting year. The result will therefore include

adjustments made to estimates used to determine the underwriting result of the preceding year. Where the deferred annual basis of accounting is adopted, the result of the underwriting business cannot be determined in the current year and is hence carried forward to a future period together with the related underwriting expenses.

(g) **Statutory Deposits**

Statutory deposits are deposits which an insurance company is required to maintain with the Central Bank at all times. This deposit is an asset to the insurance company as it earns interests to the insurance company at the minimum lending rate stipulated by the Central Bank. This deposit is not available for use by the insurance company except in limited circumstances as may be approved by the National Insurance Commission.

(h) **Reserve Requirements**

An insurance company is required to maintain the following reserves:

In respect of its general business:

- (i) provision for unexpired risks, calculated on a time apportionment basis of the risks accepted during the year;
- (ii) provision for outstanding claims which shall be equal to the total amount of such outstanding claims and a further sum equal to 10% of outstanding claims to cover claims not yet reported at the end of the year; and
- (iii) provision for outstanding claims.

Note that (b) above represents those claims that have been reported but not yet accepted while (c) represents those claims that have been reported and accepted.

Contingency reserve required of a general business is an amount not less than 3% of total premium or 20% of net profit whichever is greater. This is accumulated until it attains an amount equal to 50% of net premium or the minimum paid-up share capital whichever is greater.

For life business, there shall be maintained:

- (i) a general reserve which shall be equal to the net liabilities on policies in force at the time of actuarial valuation and an additional amount equal to 25% of net premium for every year between actuarial valuation dates; and

- (ii) a contingency reserve equal to 1% of gross premium or 10% of profit whichever is greater and which is accumulated until it attains the amount of the minimum paid-up capital.

In addition, an insurer in respect of its general business shall maintain a margin of solvency which shall not be less than 15% of the gross premium received less reinsurance premium paid or 15% of the paid-up capital which ever is higher.

(i) **Insurance Funds**

All receipts relating to each class of business are credited to a separate account and built into a separate fund.

For a life business, there should be a further separation of the fund into:

- ◆ Individual life fund;
- ◆ Group life fund; and
- ◆ Health insurance fund.

Funds for each class shall at all times represent the liabilities in respect of that class of insurance and shall consist of:

- ◆ In the case of life insurance, the fund shall be an amount not less than the mathematical reserve, and
- ◆ In the case of a general business, the fund shall be the total of the provisions for unexpired risks, outstanding claims and expenses of settlement of such claims.

(j) **Outstanding Claims**

As at the balance sheet date, there may be in respect of policies in force, risks covered which have occurred but which have not yet been settled by the insurance company. These are prescribed as outstanding claims in the financial statements of the insurance company. The provision made for outstanding claims will depend on the circumstances. There may be:

- ◆ Claims notified and agreed;
- ◆ Claims notified but not agreed; and
- ◆ Claims incurred but not notified.

The provision made for claims notified and agreed is the amount of the claims plus the estimated amount of the claims handling expenses. For claims notified but not agreed the provision shall be the best estimate by the

management plus an estimated amount of claims handling expenses. The estimate of the claims shall not however be in excess of the amount claimed by the insured.

In respect of claims incurred but not reported, the provision shall be based on the experience of the management relating to such business. It shall however not be lower than 3% of total premiums in that class of business or 20% of net profit whichever is greater. It is the duty of the auditor to search minutes, correspondence and records of periods subsequent to the balance sheet date in order to ensure that those claims that relate to the period under review have been taken up. For all claims generally, it will be the duty of the auditor to satisfy himself that a consistent and apparently reasonable and acceptable method has been adopted in making provisions for outstanding claims.

Where there has been a change in the method, it will be necessary to disclose this fact together with any material effects on the financial statements.

(k) **Determination of Life Insurance Profit**

The profit of a life business is determined only by actuarial valuation of the liabilities and comparing this with the available assets.

The valuation should be made whenever it is decided to distribute bonuses (dividends) but at least once in every three years.

The method of actuarial valuation is as follows:

- (i) Determine the present value of the company's total liabilities on all the current policies in force in respect of:
 - ◆ sums assured, and
 - ◆ bonuses already declared.
- (ii) Determine the present value of the total premiums receivable by the company under the existing policies less expenses.
- (iii) Deduct (ii) from (i) above to determine the company's net liability on all policies.
- (iv) Deduct (iii) above (net liability) from the total life fund as per the last balance sheet. The difference if positive is the surplus on the life fund to be transferred (credited) to the profit and loss account. If negative, it is a deficiency to be transferred (debited) to the profit and loss account.

(1) **Verification of the Assets and Liabilities of Insurance Companies**

The steps an auditor should take in the verification of the assets and liabilities of an insurance company are as follows:

- (i) The internal control and check system should be examined in depth in order to assess its adequacy in accounting for the revenue, expenditure, assets and liabilities; and
- (ii) Premium income should be checked with new policy books, renewal register and lapsed policies. For non-life business, premium income is part of revenue, but there must be proper cut-off to ensure that only premiums relating to the period are taken up on an actuarial basis.

Hence the auditor should ensure that:

- (i) Unpaid premium is included both as premium income and debtors;
- (ii) Premium received in advance is excluded from revenue and included as creditors;
- (iii) Commissions paid should be checked with agents' returns, note books and accounts. Such commissions must be in line with the company policy;
- (iv) Surrendered policies are checked with endorsed policies to ensure their removal from the policy register;
- (v) Claims paid are checked to the claims register and related correspondence;
- (vi) Re-insurance premiums and claims on reinsurance are checked with contracts entered into;
- (vii) Where separate funds are maintained, the funds should be seen to have been applied for the specific purpose for which they were set aside; and
- (viii) The actuarial valuation of life policies currently in force should be checked by the auditor in order to ensure the appropriateness and consistency of the valuation.

This is the basis for determining the surplus (or deficit) on the life fund to be transferred to or from the profit and loss account at the end of the year. The auditor should enquire into the qualification and reputation of the valuer.

The valuation is carried out at least once in three years. The auditor should report any inconsistency and the effects on the financial statements.

4.3.2.3 Primary Mortgage Institutions (PMIs)

These are organisations engaged in originating, marketing and serving real estate mortgage loans either as principals or agents. They are classified along with other organisations (such as finance houses, discount houses, Bureau De change) as other financial institutions and therefore covered by the provisions of Sections 56-59 of BOFIA.

Section 59 of BOFIA states clearly that the CBN shall have power to supervise and regulate the activities of other financial institutions, so these institutions are also subject to the supervision and examination by the CBN.

Primary Mortgage Institutions usually engage in four main activities, namely:

- (a) Mobilisation of savings;
- (b) Lending of funds for the acquisition of real estate;
- (c) Servicing of mortgage loans; and
- (d) Purchase and sale of mortgage loans, together with Secondary Mortgage Institutions (SMIs). SMIs are operators dealing in mortgage instruments arising from transactions in the primary mortgage market. Both PMIs and SMIs deal in commercial papers, treasury bills, bankers acceptance, e.t.c.

SAS No.15 provides guidelines for accounting for Non Bank Financial Institutions (NBFIs), among which are PMIs.

The standard focuses on the following three main areas:

- (a) Income Recognition;
- (b) Loss Recognition; and
- (c) Classification and Disclosure in Financial statements.

Income Recognition

In respect of income recognition, SAS No. 15 specifies that PMIs should report each significant item of revenue separately to enable the user of its financial statements to assess the contribution of that particular source of revenue. These significant items of revenue include: income from loans, lease rentals, factoring, and other transactions; interest on loans; credit-related fee income; non-credit related fee income; all of which should be recognised as and when earned.

In the case of any transaction where success is doubtful and income contingent on completion, PMIs should not recognise the income associated with such a transaction until it is reasonably certain that the transaction will be completed.

Loss Recognition

Concerning loss recognition, SAS No.15 takes into consideration the various types of transactions which PMIs could be legitimately involved in and states how losses related to such transactions can be accounted for. Some of them are as stated below:

- (a) In the first place just as in the case of banks, PMIs that have loan portfolios should analyse and classify them between performing and non-performing facilities.
- (b) Secondly, after making a thorough and systematic review of all its credit risks, including loans, leases and off-balance sheet engagements, each PMI should estimate and make **general** and **specific** provisions against loan losses. The provisions should take due account of the long-term nature of the loans and the security available. If a repayment becomes overdue for three months, no further income should be recognised until regular payments resume. Provision against principal should be considered if repayment becomes overdue for more than six months. Where principal repayment is overdue by more than one year, the outstanding unprovided portion should not exceed 50% of the estimated net realisable value of the security. Where principal repayment is overdue by more than two years, there should be no outstanding unprovided portion of the credit facility, irrespective of the estimated net realisable value of security held.
- (c) Thirdly, short-term investments should be carried at the lower of cost and net realisable value, with disclosure of market or directors' valuation.

The exception is the case of a net cumulative loss having been incurred when the said net loss should be charged to the income statement in the period it first arises and any subsequent net gains are credited to the income statement to the extent that the losses have been previously charged.

- (d) Fourthly, long-term investments should be carried at cost, with disclosure of market or directors' valuation, unless a permanent diminution in value occurs, when the carrying amount of the asset in the books of the PMI should be reduced to recognise the loss. (SAS No.13 - Accounting for Investments provides for how to determine such a permanent diminution).

- (e) Other areas of loss recognition covered include sale of loans or securities with or without recourse, foreign exchange transactions (which should be treated in accordance with SAS No.7) and forward contracts.

Classification and Disclosure Requirements

In addition to the disclosure requirements of SAS No.2 (*Information to be Disclosed in Financial Statements*), SAS No.15 states that PMIs should also disclose the following:

- (a) The methods and bases by which provisions for loan or securities losses are made;
- (b) The nature of off-balance sheet engagements and the methods used to recognise income or loss thereon;
- (c) Total liabilities to National Housing Fund;
- (d) Total value of Mortgage Assets and movements thereon, showing assets brought forward, additions during the year, disposal and realisation during the year, and balance carried forward;
- (e) Other sources of funds apart from share capital and National Housing Fund;
- (f) Classification of mortgage loans receivable and mortgage backed securities into those held for sale and those held for long term investment; and
- (g) Detailed breakdown of servicing rights acquired during the year stating the amount capitalised, the method of amortisation, and the amount amortised.

All the above in addition to all the relevant provisions of CAMA and BOFIA as they relate to primary mortgage institutions are the areas which an auditor will need to consider in approaching the audit of PMIs.

Note

The auditor of any bank or other financial institution has several duties. Apart from conducting the audit and reporting to management, audit committee, board of directors and the shareholders at the annual general meeting, he has to submit various types of reports to different types of regulators in accordance with the provisions of different statutes as appropriate.

4.4 AUDIT OF NOT-FOR-PROFIT ORGANISATIONS

Not-for-profit organisations are those entities that possess the following characteristics which distinguish them from business enterprises:

- (a) Contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary returns;
- (b) Operating purposes other than to provide goods or services at a profit; and
- (c) Absence of ownership interests like those of business enterprises.

These not-for-profit organisations include educational, social, scientific, literary, cultural, religious, sporting, charitable, voluntary, health and welfare entities set up in different forms and sizes. They receive significant amounts of resources from members of the public, government and organisations that identify with their mission. For instance, large corporations in the private sector willingly donate to some of these not-for-profit organisations from year to year, as shown in the annual reports and accounts under corporate social responsibility.

The two examples of charities and NGOs given in the syllabus are merely to indicate the types of not-for-profit organisations. Some of them are so big and complex because of their setup while others are very small in their scale of operations.

It is noteworthy that Section 673 of CAMA provides for incorporation of trustees of certain bodies and associations (under Part C of CAMA). It is, however, optional for the trustees of any association of persons established for any religious, educational, literary, scientific, social, cultural, sporting or charitable purpose to apply for registration under CAMA. It is based on whether the association opts for registration or not. Once the association has opted for the registration of its trustees, such trustees shall become a corporate body in accordance with the provisions of Section 679 of CAMA. The procedure for and effect of registration are stated in Sections 674-679 of CAMA. Some not-for-profit organisations have their own enabling act while some others are incorporated as companies limited by guarantee.

The audit approach to be adopted for not-for-profit organisations requires some duty of care from the auditors. Each organisation should be considered properly in order to identify first and foremost the structure of the organisation. For example, is it a company, an incorporated trustee or an association with only a constitution or rules and regulations?

Whatever the structure or form, the auditor is required to understand it in detail with particular reference to any applicable accounting and auditing standards, principles and guidelines.

Other matters which the auditor should consider carefully are:

- (a) The letter of engagement setting out the terms of the engagement who the auditor should report to;
- (b) All the sources of fund should be carefully investigated so as to obtain evidence for their inclusion in the accounts. Some of the funds may be in the form of grants, some of which are meant for specific events which when they do not take place will translate to a refund of the amount to the donor(s). The auditor should take note of this and consider making a provision for it or at least disclosing it by way of a note;
- (c) Cash collections can be verified for completeness with some commitment on the part of the auditor. An internal control system of recording cash collections can be instituted to aid verifications in future;
- (d) Expenditure can be verified by reference to written evidence and process of authorisation;

- (e) Fixed assets should be verified in the usual way, though the donated portions thereof should be valued in some appropriate way in order to recognise and account for the asset;
- (f) Some of the funds come through direct donations, endowments or legacies. The instruments setting up each of these should be checked and the movement in the accounts of each of these items should be checked annually; and
- (g) Finally, the auditor should always prepare a report to be submitted to the person(s) indicated in the letter of engagement.

4.4.1 Charities

Charities are not for profit organisations usually set up by philanthropic individuals or organisations to engage in welfare activities. Usually, there are no strict legal rules governing charities except to the extent that they may not engage in any illegal, anti-social or subversive activities. For convenience and in order to assume a definite legal structure, some charities may be incorporated as companies limited by guarantee.

Some problems are usually associated with charities as a result of the nature of the activities, sources of income or the staff engaged. These are:

- (a) The staff engaged in charities are usually not trained in accounting, business or finance. Little emphasis is placed on the system of internal control as greater emphasis is placed on the integrity of the staff (volunteers);
- (b) The sources of revenue to a charity are diverse and indefinite, hence there is the problem of determining the completeness of receipts;
- (c) The expenses of a charity are of non-business nature and usually involve third parties who may not undertake any form of documentation. For instance, refugees may not issue any receipts for resettlement cash paid to them;
- (d) Benefits-in-kind received from donors may not be appropriately valued as a basis for proper accounting measurement; and
- (e) The activities of charities may be so diverse and unrelated such that there can be no consistent method of recognising income or accruing for expenses;

Most Charities have overseas affiliates, hence it may be required that their accounts will be delivered to the overseas sponsors for incorporation into the accounts of the affiliates. It is therefore essential for the auditor to ensure that the financial statements of the local charity meet the requirements of the overseas sponsors.

The Audit Approach

The following approach may be adopted by the auditor with respect to most charities:

- (a) Obtain a copy of the constitution of the charity for his understanding and the permanent file. He should ascertain the requirements for accounting and audit;
- (b) Send a letter of engagement in order to specify the objects of the engagement and the nature of his report;
- (c) Verify the funding of the charity in order to ensure that all funds have been received. If funds are repayable, it should not be treated as revenue but a liability which should be appropriately disclosed in the account;
- (d) Most charities receive legacies arising from wills. Copies of relevant wills should be obtained and studied by the auditor in order to ensure that all legacies have been received in full as devised by the deceased especially in cases of reversions;
- (e) Donations should be verified by ensuring that so far as possible, cheques are drawn crossed restrictively in the name of the charity and by sending acknowledgements;
- (f) Cash collections should be counted as soon as possible in the presence of two persons. Such cash should be recorded and acknowledged by the volunteer responsible for the custody. Where collections are made in collecting boxes or tins, these can only be opened and counted in the presence of two persons;
- (g) Expenditure can be verified by reference to the appropriate vouchers which must be duly authorised;
- (h) Outstanding expenditure should be verified at the end of the year to ensure that all liabilities have been included;
- (i) Fixed assets should be verified as to existence, ownership, and valuation. Appropriate values should be attached to all gifts in kind;
- (j) The auditor should assess the liquidity of the charity with a view to determining whether the going concern concept applies as is appropriate. Where the liquidity problem is so acute, it will be necessary for the auditor to express an opinion as to the uncertainty of the charity continuing as a going concern;
- (k) Where donations are received in kind, the auditor should state the appropriate monetary measurement; and
- (l) The nature of the report the auditor will issue depends on whether the charity is:
 - ◆ A company limited by guarantee;
 - ◆ A trustee established by law; or
 - ◆ An unincorporated entity

The underlying objective of the audit of a unit trust may not include an expression of opinion that the financial statements show a true and fair view. Most of these financial statements may comprise of a receipts and payments account, the object of the audit being to obtain an assurance as to the honesty, integrity and competence of the handlers of the affairs of the charity.

4.4.2 Pension Funds

Pensions are amounts paid to a worker at retirement or on the attainment of a specified age. This may be paid as lump sum or as an annuity. It is therefore, a recurring liability on the part of any company to pay such pension. For this reason, therefore, companies like to build up funds so as to ensure that such recurring liabilities are met when due without, in any way, affecting the smooth operations of the company.

The Pensions Reform Act of 2004 has relieved employers of the burden of managing pensions and transferred this responsibility to designated Pension Fund Administrators (PFAs). Under this arrangement, employers have the responsibility of making appropriate monthly contributions, which together with the mandatory amount deducted from the employees remuneration, are remitted to the employee's nominated PFA. Such remittances are credited to employee's account and accumulated until maturity. The management and remittances from the fund at maturity is based on the agreement between the employee and the PFA.

Under the Pension Reforms Act 2004, it is now mandatory that employers contribute at least $7\frac{1}{2}\%$ of employees' emolument to the pension fund monthly, while the employee contributes an additional $7\frac{1}{2}\%$. The employer may increase ratio of contribution, provided that total contribution is not less than 15% in any case.

Gross emolument of an employee is calculated to be the total of basic, transport and housing allowances due to an employee in any particular month.

The Auditor's Duties

Whichever form the pension takes, the auditor's duties are as follows:

- (a) Examine the agreement existing between employee and employer and ensure that the provisions have been fully carried out.
- (b) Verify that proper control is exercised over the transactions of the fund, such as:
 - (i) deductions from contributors' wages; and
 - (ii) the total contributions remitted to the PFA on monthly basis.
- (c) Verify that the pension deductions agree with the provisions of the Pensions Reform Act, 2004.

- (d) It is vital for the auditor to ensure that the realisable assets available to the old pension fund are paid to the employees or transferred to the new PFA on agreement with the employees; and
- (e) It is important on grounds of public interest, for the auditor to determine and state in his management letter if the pension fund is being managed in the best interest of the employees.

4.5 JOINT AUDIT

A joint audit is an audit assignment that is carried out by more than one audit firm at the same time and for the same financial statements. It is at times necessary or advisable to have joint audits where management or shareholders would like to have more than one assurance on the audit of their financial statements. It is also applicable where the operations of the company are somehow very large or complex that it might require the combination of the efforts of more than one firm to have an effective and timely audit. Joint Audit is more pronounced in the banking industry where many branches spread all over the country and the auditor has to visit a number of the branches annually.

Also where shareholders perceive that their interests are better served, they might opt for joint audit. An example is where a multinational company operating in Nigeria has an international firm of auditor, the local shareholders or investors might argue for a joint auditor who will be able to take adequate care of their interest, although this is just a perceived rather than a real problem as any auditor should be able to take care of the interest of all parties.

As provided in the Rules of Professional Conduct for members of ICAN, a member whose firm is nominated as a joint auditor should communicate with all existing auditors and be guided by similar principles, to those set out in relation to nomination as an auditor. Where it is proposed that a joint audit appointment becomes a sole appointment, the surviving auditor should communicate formally with the other joint auditor as though it is for a new appointment.

As regards the principles set out for a new appointment, the following are some of the steps that should be taken:

- (a) When a member is first approached by a prospective client, he should explain that he has a professional duty to communicate with the existing auditor or adviser;
- (b) When nominated or asked to act, the member should ask the client to inform the existing auditor of the proposed change and also give the latter written authority to discuss the client's affair with the member;
- (c) The member should then write to the existing auditor seeking information, which could influence his decision as to whether or not to accept the appointment;
- (d) If the client fails or refuses to grant the existing auditor permission to discuss the client's affairs with the proposed auditor, the existing auditor should report that fact to the proposed auditor who should not accept nomination/appointment; and

- (e) The existing auditor should answer without delay the communication from the prospective auditor.

The joint auditors are both jointly liable for the assignment they undertake as only a single set of financial statements is signed by both of them at the end of the audit. It does not matter who audits what aspect during the audit.

The responsibilities/liabilities of the joint auditors are:

- (a) Ensure that the term of the assignment is clear as being that of joint audit and not that one firm is doing accounting work and the other an audit;
- (b) There should be meeting(s) with the client by the joint auditors where agreements are reached on the approach to the work and the responsibility of the auditors;
- (c) The joint auditors should also meet to share and agree responsibilities for the work at a particular time;
- (d) Ensure that all agreements as to work division are in writing and are not ambiguous;
- (e) There should be periodic review of progress of work by partners of the two firms;
- (f) There should be exchange of working papers by the joint auditors so that each firm has a full set of working papers for the year's audit;
- (g) If possible the joint auditors should use the same audit programme to ensure that all aspects of the work are covered;
- (h) In some situations there should be a joint work in respect of certain areas of the client's operations. For example, both joint auditors should review the loans and advances of a bank every year and have a common position on issues like provisions to be made; and
- (i) Financial statements should be jointly reviewed and agreed by the joint auditors before being presented to management.

All the above steps are necessary in order to ensure that clients do not decide to change their auditors simply because of conflict of viewpoints. The clients have the right to choose or change their auditors if they so desire, but this should be carried out in an appropriate manner as specified in CAMA under the appointment of auditors.

4.6 INVESTIGATIONS

This section deals with "Specialised Audit and Investigation". It is aimed at discussing those aspects of the functions of an accountant, which are strictly outside the realms of auditing. These functions are referred to as investigations. When accountants, as auditors are requested to carry out investigations, they do so in addition to their statutory duties to the shareholders of the company.

4.6.1 Distinction between Auditing and Investigations

As presented in the *Preface to Auditing Standards and guidelines* issued by the Institute of Chartered Accountants of Nigeria (ICAN), "an audit is

the independent examination of, and expression of opinion on, the financial statements of an enterprise by an appointed auditor in pursuance of that appointment and in compliance with any relevant law and regulation.” While it is the responsibility of management of the enterprise (in the case of a company, the directors) to prepare the financial statements of the enterprise and present same to the auditors, it is the responsibility of the auditors to report on the financial statements as presented to them.

The relevant law in the case of the audit of a company is the Companies and Allied Matters Act (CAMA), Cap. C20, LFN 2004 and any other enabling Act as appropriate to the organisation involved. For example, Banks and Other Financial Institutions Act (BOFIA), 1991, Central Bank Act, 1991 and Nigeria Deposit Insurance Corporation Act, 1988, as amended for banks and other financial institutions and the Insurance Act, 2003 for insurance companies.

The external auditor of a company is responsible to the shareholders of the company and his scope of work arises from the responsibilities placed on him by the provisions of CAMA. His function, which is required statutorily, is to lend credibility to the financial statements of the company to which he serves as auditor.

In addition to legal requirements, there may also be regulations to comply with, for example, CBN monetary and fiscal policy circulars, National Insurance Commission (NAICOM) guidelines.

The responsibility for the prevention and detection of fraud and irregularities is that of the management of the enterprise who may obtain reasonable assurance that this responsibility has been discharged by establishing an adequate system of internal control. It is not part of an auditor’s duties to search for fraud unless he is required to do so by a specific term of his engagement. However, if properly carried out, the work of an auditor should expose fraud and irregularities where they exist.

Investigations consist of various non-auditing tasks carried out by accountants, who usually have served as auditors to the organisation. Oremade (1988) has defined investigation as “an act of examining, searching and inquiring into a matter with adequate care and accuracy; usually undertaken to obtain information of particular or special nature”. It is not statutorily required of an auditor. In order to avoid being held liable for not performing the assignment well, an auditor conducting an investigation should have his instructions clearly stated and should continuously bear in mind throughout the duration of the assignment, the objectives and purposes set out in the instructions.

An auditor conducting an investigation is seen as an expert and should therefore exercise great skill and care. He should see the assignment as it is, that is, involving an inquiry into the financial affairs of a business with definite purposes and defined objectives, as laid down in the client's instructions. It is also necessary to note that the exact scope of the assignment and the type of report required at the end of the assignment should be agreed by all parties prior to the commencement of the assignment. The work required for a particular type of investigation may be wider or narrower than the function of auditing, depending on what type of investigation that is being conducted.

4.6.2 Nature, Classes and Methods of Investigation

Nature

Auditors usually have a special type of relationship with the companies to which they serve as auditors. The relationship is that of familiarity with the affairs of the company, which emanates from the experience which their audit function has afforded them the opportunity to have. Consequently, auditors are usually in a very good position to conduct investigations. Again, it is necessary to emphasise that auditors conduct investigations purely as experts or specialists and not as part of their statutory audit function.

Classes

The various classes of investigations can be derived from the various reasons for which such assignments are carried out. The following are some of the different classes of investigations:

- (a) Investigation for the proposed purchase of a business or for investment purpose;
- (b) Investigation for a lending banker or financial institution for audit appraisal purpose;
- (c) Investigations under Companies and Allied Matters Act (CAMA), 1990 as amended (Section 589 in respect of investigation of a Unit Trust Scheme);
- (d) Investigation to ascertain the extent of suspected financial crime or fraud, burglary or damage caused by fire;
- (e) Investigation for a prospective partner;
- (f) Investigation preceding the issue of a prospectus; and
- (g) Investigation for the purpose of business re-organisation and reconstruction or for a merger and acquisition scheme.

Methods

The methods of carrying out investigation assignment can be divided into three major stages with each stage having its separate sections as shown below:

Stage 1: Preparation

- (a) The preliminary review;
- (b) Obtaining written instructions from clients; and
- (c) Planning.

Stage 2: Field work

- (a) Ascertaining the facts and obtaining information from relevant people; and
- (b) Examination and verification of data obtained.

Stage 3: Reporting

- (a) Interpretation and evaluation of evidence; and
- (b) Writing the report of the assignment.

The above is a general approach that can be adopted for carrying out any investigation assignment while specific variations to the general approach will depend on the purpose for which the assignment is conducted.

The investigating auditor should appreciate the need to be familiar with the business concerned and understand the client's instructions. Thereafter, he would need to plan his programme in accordance with the client's instructions, which should have been obtained in writing.

Usually, the clients will like the investigating auditor to put in writing his own understanding of the assignment, state the time plan or time schedule that he thinks will fit into the assignment, as required by the client.

The second stage involving field work can take a relatively long time or a short period depending on the extent to which the investigating team may have to go. In some cases, information and data may need to be obtained by visiting some of the branches of the organisation or even with the assistance of other experts. The data obtained most usually will have to be subjected to analysis in order to make them more relevant to the third and final stage, which is that of reporting.

The report of the investigating auditor should include sections on the following matters:

- (a) Executive Summary;
- (b) Detailed report;
- (c) Nature of the assignment;
- (d) Date on which the client gave his written instructions for the assignment;
- (e) Scope of the investigation;
- (f) The approach used in carrying out the assignment;
- (g) Findings and observations; and
- (h) Conclusions and recommendations.

The value of the report could be enhanced by the inclusion of schedules, tables, graphics and charts to properly support and explain the findings.

4.6.3 Auditor's Involvement with Prospectuses and Other Offer Documents

There is an auditing guideline entitled "Prospectus and the Reporting Accountants" issued by ICAN and this guideline has clearly set out the various aspects of what a member of the Institute should do if he is required to act as Reporting Accountant under the provisions of CAMA and/or the Listing Requirements of the Nigerian Stock Exchange (NSE). The content of the guideline is covered extensively in this section of the chapter.

A Reporting Accountant is a Chartered Accountant in public practice, who is reporting under the relevant provisions of CAMA and/or the Listing Requirements of the NSE. He may be the statutory auditor of the company on which he is reporting or some other chartered accountants.

A Prospectus means any notice, circular, advertisement, or other invitation, offering any shares or debentures of a company/enterprise for sale or subscription.

Section 650 of CAMA defines the term prospectus as:

"any prospectus, notice, circular, and advertisement, or other invitation, offering to the public for subscription or purchase any shares or debentures of a company and includes any document which save to the extent that it offers securities for a consideration other than cash, is prospectus".

Issue (or offer) document means the totality of the instrument, circular, e.t.c. by which the share and other securities of a company are offered to the public for sale or subscription.

4.6.3.1 Legal Requirement

The legal requirement relating to the issue of a prospectus, as contained in the appropriate sections and schedules of CAMA are follows:

- (a) By virtue of Section 550(1) of CAMA, every prospectus issued by or on behalf of a company shall set out the reports specified in Part II of Schedule 15 to the Act;
- (b) Part II of Schedule 15 deals with the reports to be issued by the auditors of the company and is generally known as the "Accountants' Report";
- (c) Although the Act requires the Reports to be issued by the Auditors of the company, sometimes a firm of chartered accountants other than the auditors is appointed to issue

the reports either as the sole reporting accountant or jointly with the auditors;

- (d) By virtue of Section 554(1), the report of the Reporting Accountant is not valid unless:
 - (i) “he has given and has not, before delivery of a copy of the prospectus for registration, withdrawn his written consent to the issue thereof with the reports included in the form and context in which it is included; and
 - (ii) a statement that he has given and has not withdrawn his consent appears in the prospectus”.
- (e) Section 562 of the Act provides for civil liability for misstatements in a prospectus. The Reporting Accountant is by virtue of this section liable to pay compensation to all persons for any untrue statement made by him as an expert.

4.6.3.2 Professionalism and Excellence

The Reporting Accountant should not rush to accept an appointment. Rather, he should carefully consider whether there are any matters which *prima facie*, might make it difficult or impossible for him to report on the forecasts, for example:

- (a) insufficient time allowed for obtaining and assessing information required;
- (b) the nature of the business activities;
- (c) unreliable costing and accounting methods;
- (d) unreliable methods of forecasting; and
- (e) the reputation of the promoters.

It is in the interest of the auditors not to associate themselves directly or indirectly with an Issue Document unless:

- (a) Their name is mentioned in the issue document;
- (b) They have been given adequate time to read the Issue document and check all material facts and figures, particularly the five years financial statement (balance sheet and profit and loss accounts); and
- (c) Their consent to mention their names in the Issue document has been obtained and it is so stated therein.

4.6.3.3 Cautious Approach

There is need for auditors to be very cautious in their approach to the assignment of Reporting Accountants. Consequently, members of the Institute, when acting as reporting accountants, must exercise great care in carrying out the investigation and analytical work that would lead to the Report required by Part II of Schedule 15 of the Act.

Furthermore, where the company is his audit client, the Reporting Accountant should ensure that, as far as possible and practicable, the staff engaged on the prospectus work are not those who audit the company. This arrangement will ensure the quality and independence of the Accountants' Report.

4.6.3.4 Procedure

As in the case of any investigation assignment, the assignment of a Reporting Accountant must be carefully and methodically planned. A typical outline of the work programme of a Reporting Accountant is shown below:

- (a) **General Information to be Obtained**
 - (i) History and nature of business;
 - (ii) Share capital and borrowed money (or debt capital);
 - (iii) Management;
 - (iv) Employees;
 - (v) Premises, plant and machinery (or property, plant and equipment);
 - (vi) Raw materials and supplies;
 - (vii) Sales; and
 - (viii) Other matters.

- (b) **Work to be Done**
 - (i) Preliminary Enquiries;
 - (ii) Profits;
 - (iii) Net Assets; and
 - (iv) Taxation.

- (c) **Profit Forecast and Cash Flow Statement**
 - (i) Preliminary enquiries;
 - (ii) Accounting principles;
 - (iii) Forecasting procedures;
 - (iv) Assumptions;
 - (v) Detailed examination of profits forecast; and
 - (vi) Detailed examination of cash flow statement.

- (d) **Miscellaneous**
 - (i) Prospectus check list;
 - (ii) Verification check list;
 - (iii) Completion Board Meeting;
 - (iv) Letter of consent;
 - (v) Comfort letter; and
 - (vi) Use of firm's name.

The ICAN Auditing Guidelines provide as appendices the following:

- (a) Contents of a prospectus for companies applying for full listing on the Nigerian Stock Exchange;
- (b) Contents of Accountant's Report;
- (c) Specimen Accountant's Report;
- (d) Specimen Profit Forecast Letter;
- (e) Specimen Letter of Comfort; and
- (f) Specimen Letter of Consent.

It is advisable for readers to familiarise themselves with all the above as shown in the Appendices VI - VII (f). In that way, the various types of contents of a prospectus will become very clear and simple to understand.

4.6.3.5 Detailed Programme

In complying with the outline of the procedure given above, some of the matters which should feature in the detailed programme for carrying out the Reporting Accountant's investigation assignment are:

- (a) Where the Reporting Accountant is not the auditor, he should ensure that the auditors are notified in writing and their full co-operation with him is solicited.
- (b) Before starting work, the following documents should be read:
 - (i) CAMA Sections 50, 550, 554, 557, 567, and Schedule 15;
 - (ii) Nigerian Stock Exchange Listing Requirements; and
 - (iii) Investments and Securities Act of 1999.
- (c) Obtain the client's (or Issuing House's) written instructions and ensure that they include: time-table, scope of work, and any special instructions on confidentiality.
- (d) From copies of the audited and supporting detailed management accounts, prepare summaries of detailed trading and profit and loss accounts and balance sheets for the immediately preceding five years.

The audit working papers for the relevant years should be reviewed to assess the reliability of the audited accounts. The accounting policies should also be reviewed for appropriateness and consistency.

Qualifications (if any) in the auditor's reports and any significant notes on the accounts should be recorded for special consideration.

- (e) The Reporting Accountant is obliged to make such adjustments to the profit and loss accounts and balance sheets as he considers necessary. It is however, advisable to discuss any proposed adjustments not only with the client but also with its auditors. Adjustments do not necessarily mean that the audited accounts are wrong.

Adjustments would normally be necessitated by:

- (i) Changes in accounting policies; and
- (ii) Fundamental errors.

Changes in accounting estimates, which were properly made at the time the relevant accounts were finalised, would not normally require adjustment but may require disclosure as exceptional items.

- (f) The Reporting Accountant should arrange to have access to:
- (i) Statutory books including Memorandum and Articles of Association and minutes of meetings of the board of directors;
 - (ii) Tax computations and correspondence with the Federal Inland Revenue Service; and
 - (iii) Copies of any relevant reports (Valuation and Feasibility Reports) prepared by outside consultants or internally, by the company.
- (g) The Reporting Accountant should arrange tour of factory, works, etc.
- (h) The Reporting Accountant should arrange attendance at all parties' meetings. The role of the reporting accountant at these meetings is to see that reasonable steps are taken to check the accuracy of figures, words and all relevant information and material facts.

4.7 EXAMINATION OF FINANCIAL FORECASTS AND PROJECTIONS

The statement of profits forecast and working capital adequacy (the financial forecasts) are undoubtedly the most important part of a prospectus. Though, the directors are solely responsible for the profit forecast and for the assumptions on which it is based, the Reporting Accountant must take special care in regard to this section of his work.

The main features of the work programme on financial forecast and projections include the following:

- (a) Review of underlying assumptions and outline of the company's forecasting technique and methods, for example, the existence of a budget corporate plan and its regular revision.

Assumptions should be stated in clear and unambiguous terms to assist the reader in assessing the reasonableness of the forecast and its inherent uncertainties.

- (b) Review the accounting policies adopted in preparing the forecast and ensure they are consistent with those normally adopted by the company for preparing its annual accounts.
- (c) Compare the detailed results of the company for, the preceding three years with a view to ascertaining the trend and assessing the extent to which the company's past experience in forecasting indicates that its forecasts can be relied upon.
- (d) Compare the forecast under review with any earlier forecast made in respect of the same or over-lapping period and obtain explanations for any material changes.
- (e) When reviewing the cash forecast, the following factors must be carefully considered:
 - (i) the assumptions used are the same as those used for the profit forecast;
 - (ii) the changes in level of stock and work-in-progress, debtors and creditors, appear reasonable having regard to the budgeted level of trading or operation;
 - (iii) items such as capital expenditure, investment, taxation and dividends, are included in the correct period;
 - (iv) recently announced fiscal legislations and regulations have been taken into account; and
 - (v) the proforma balance sheet at the end of the profit forecast period reconciles with both profits and cash forecasts.
- (f) Obtain written confirmation from bankers and other loan creditors in respect of the overdraft and loan facilities assumed to be available during the period of the forecast.

Note

In his report, the Reporting Accountant should avoid giving any impression that the forecast is accurate since profit forecasts, by their nature, are based on subjective judgements. The Reporting Accountant should, however, review the underlying assumptions to ensure that there are no material omissions or unrealistic assumptions.

4.8 FORENSIC INVESTIGATION AND AUDIT

“Forensic”, according to the Webster’s Dictionary means, “belonging to, used in or suitable for courts of judicature or to public discussion and debate”. Flowing from this, forensic accounting is seen as providing an accounting analysis that is suitable for the court and which will form the basis for discussion, debate and ultimately dispute resolution. It is actually the integration of accounting, auditing and investigative skills that has yielded the speciality known as forensic accounting.

Forensic accounting encompasses both Litigation Support and Investigative Accounting, explained thus:

- (a) Litigation support provides assistance of an accounting nature in a matter involving existing or pending litigation. It deals primarily with issues which relate to the quantification of economic damages. An example of a litigation support assignment would be the calculation of the economic loss resulting from a breach of contract.
- (b) Investigative Accounting is often associated with investigations of criminal matters. Examples of investigative accounting assignments would be an investigation of employees’ theft, insurance fraud, securities fraud, kickbacks and proceeds of crime investigation.

According to Alan Zysman, “forensic investigation is the utilisation of specialised investigative skills in carrying out an inquiry conducted in such a manner that the outcome will have application to a court of law”. Thus, a forensic investigation may be based on various fields such as accounting, engineering, medicine, or some other discipline.

On the other hand, “forensic audit is an examination of evidence regarding an assertion to determine its correspondence to established criteria carried out in a manner suitable to the court”. An example would be a forensic audit of income records to determine the quantum of rent owing under a lease agreement, which is the subject of litigation.

As the definition clearly shows, a forensic audit is quite distinct from either internal audit or external audit.

A typical approach to a forensic accounting assignment, as suggested by Alan Zysman will include the following steps:

- (a) Meet with the client;
- (b) Perform a conflict check;
- (c) Perform an initial investigation;
- (d) Develop an Action Plan;
- (e) Obtain the relevant evidence;
- (f) Perform the analysis, which in turn will be dependent on the nature of the assignment and may involve:
 - (i) Calculating economic damages;

- (ii) Summarising a large number of transactions;
 - (iii) Performing a tracing of assets;
 - (iv) Performing present value calculations utilising appropriate discount rates;
 - (v) Performing a regression or sensitivity analysis;
 - (vi) Utilising a computerized application such as a spread sheet, data base or computer model; and
 - (vii) Utilising charts and graphics to explain the analysis.
- (g) Prepare the report which will include:
- (i) Nature of the assignment;
 - (ii) Scope of the investigation;
 - (iii) Approach used;
 - (iv) Limitations of scope; and
 - (v) Findings and/or opinion:

Prepare schedules and graphics necessary to properly support and explain the findings.

4.9 THE REPORT APPROPRIATE TO EACH TYPE OF INVESTIGATION

Each investigation assignment is unique, though some of them fall into typical cases. For example, the inclusion of the accountant's report in a prospectus and for a merger scheme. The report appropriate to each type of investigation should follow the general approach to any investigation but be specifically addressed to the nature of the assignment carried out.

By way of illustration, we consider these two reports:

- (a) The Reporting Accountant's Report for the prospectus issued by Guaranty Trust Bank Plc on 11 June, 2004 for the offer for subscription of one billion ordinary shares; and
- (b) The Reporting Accountant's Report on Unipetrol Nigeria Plc for the Scheme of Merger between Agip Nigeria Plc and Unipetrol Nigeria Plc issued on 7 November, 2002.

**(a) REPORTING ACCOUNTANT'S REPORT on Guaranty Trust Bank Plc (Copy of the letter from the Reporting Accountants)
3 May 2004**

The Directors
Guaranty Trust Bank Plc
Plural House
Plot 1669, Oyin Jolayemi Street
Victoria Island
Lagos

And

The Directors
FCMB Capital Markets
(A division of First City Monument Bank Limited)
Primrose Tower
17A, Tinubu Street
Lagos

And

The Directors
Asset & Resource Management Company Limited
1, Mekunwen Street
Ikoyi
Lagos

Gentlemen,

We report on the financial information set out in paragraphs 6.3 to 6.6. This financial information has been prepared for inclusion in the prospectus issued in connection with the offer for subscription of 1 billion Ordinary shares in Guaranty Trust Bank Plc (“the Bank”)

Basis of preparation

The financial information is based on the audited consolidated financial statements of the Bank for the five years ended 29th February, 2004 and has been prepared in accordance with the accounting policies set out in paragraph 6.2.

Responsibility

The financial statements on which our report is based are the responsibility of the Directors of the Bank who approved the issue. The Directors of the Bank and the Directors of both First City Monument Bank Limited and Asset & Resource Management Company Limited are responsible for the contents of the prospectus in which this report is included.

It is our responsibility to compile the financial information, to form an opinion on the financial information and to report our opinion to you.

Basis of opinion

We conducted our work in accordance with generally accepted auditing standards. Our work included an assessment of evidence relevant to the amounts and disclosures in the financial information. The evidence included that recorded by the auditors who audited the financial statements underlying the financial information. It also included an assessment of significant estimates and judgements made by those responsible for the preparation of the financial statements underlying the financial information and whether the accounting policies are appropriate to the Bank’s circumstances, consistently applied and adequately disclosed.

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial information is free from material misstatement whether caused by fraud or other irregularity or error.

Opinion

In our opinion, the financial information gives, for the purpose of the prospectus issued in connection with the Offer for subscription of 1 billion Ordinary shares of the Bank, a true and fair view of the state of affairs of the Bank as the dates stated and of its profits and cash flows for the periods then ended.

Yours faithfully,
(Signed by the)
(Reporting Accountants)

(b) REPORTING ACCOUNTANTS' REPORT ON UNIPETROL NIGERIA PLC.

The following is a copy of the Report of the Reporting Accountants to the Scheme:

30 September, 2002

The Directors
Unipetrol Nigeria Plc
STALLION HOUSE
(8th –10th Floor)
2 Ajose Adeogun Street
Victoria Island-Lagos

and

The Directors
FCMB CAPITAL MARKETS
(A division of First City Monument Bank Limited)
Primrose Tower
17A Tinubu Street
Lagos

Gentlemen,

PROPOSED MERGER OF AGIP NIGERIA PLC (“AGIP”) WITH UNIPETROL NIGERIA PLC (“UNIPETROL”) - ACCOUNTANTS' REPORT ON THE FINANCIAL STATEMENTS OF UNIPETROL NIGERIA PLC FOR 5 YEARS AND 6 MONTHS ENDED 30 JUNE, 2002.

We have reviewed the audited financial statements of Unipetrol Nigeria Plc (“the Company”) for 5 years and 6 months ended 30th June, 2002. The financial statements were prepared under the historical cost convention. Messrs XYZ (Chartered Accountants) were the auditors of the Company for all the periods of the accounts reviewed.

The summarised balance sheets, profit and loss accounts and statement of cash flows set out below are based on the audited financial statements of Unipetrol Nigeria Plc after making such adjustments, as we considered necessary.

In our opinion, the financial statements together with the notes thereon set out below, give a true and fair view of the affairs of Unipetrol Nigeria Plc and of the profit and cash flows for each of the years ended 31st December, 1997, 1998, 1999, 2000, 2001 and six months ended 30th June, 2002 and the state of affairs of the Company as at these dates and have been prepared on the same accounting basis normally adopted by the Company.

Yours faithfully,
Signed by the)
Reporting Accountants)

4.10 INSOLVENCY

This section of the chapter covers the various aspects of insolvency. In very simple terms, insolvency is the inability of a particular person (either corporate or not) to pay debts when due. An insolvent corporate body is a company that cannot meet its debts and other financial obligations as and when due. In the same vein, an insolvent debtor is a person or trader who is unable to pay his creditors as and when due.

An insolvent company will need to identify what the actual problems are in order to know the appropriate solution that can be embarked upon. The solutions may vary from contracting the company's management out to experts in a particular field, or carrying out a scheme of refinancing or capital restructuring, or the company facing either receivership or liquidation. On the other hand, an insolvent debtor may be declared bankrupt after he/she must have committed an "Act of Bankruptcy".

4.10.1 Corporate Distress

In order to be tagged as successful, a company must meet its financial objectives and non-financial objectives such as its marketing objectives and its social responsibility objectives. The company's financial objectives normally take care of its profitability, which leads to its growth and survival, while its marketing objectives will focus on what the company proposes to offer to the society (be it product or service), ensuring that it is special, unique, or in high demand. Its social responsibility objectives will focus on what the company can do in terms of improving the welfare of the environment in which it operates.

By a combination of all these objectives, a company should be able to continue to render services or make products acceptable to the customers,

provide continuous employment to its employees and earn a reasonable level of return for its shareholders.

However, when a company cannot perform as planned or as expected, such a company is said to have failed to meet its objectives. Consequently, such a company is deemed to be experiencing corporate distress, or corporate failure or corporate insolvency.

Causes of Corporate Distress

Corporate distress can be caused by either internal factors, such as bad management, inadequate working capital at commencement, poor financial management, high gearing, over trading/expansion, and lack of co-ordination at board level or external factors such as effect of government policies, effect of national and international economic climate, and lack of co-operation by foreign technical partners.

Whatever factors might have led to the condition, corporate distress always shows itself clearly in the persistence of “liquidity problem” that the company experiences. This is really the climax of the various warning signals, which ought to have been observed and taken care of.

Corporate Distress Signals

Some of the warning signals are usually felt by the company’s employees. For example, delay in payment of workers’ salaries and allowances, withdrawal of some of the fringe benefits, production at low capacity, and retrenchment of workers or a policy of no recruitment, no replacement and no retrenchment. In some cases, the company is unable to pay interest on loans and thereby unable to raise capital of the desired type. Such company will start reporting low profit or no profit at all, and may not be able to meet any of its social responsibility objectives. Worse still, such company may not be able to remit Pay As You Earn (PAYE) and staff pension deductions to the appropriate authorities.

Corporate Distress Process

The processes involved in corporate distress vary according to the causes and symptoms displayed by any particular company. The first step is to conduct a detailed review of the situation with a view to identifying what the actual problems are. Once the problem is identified, then an appropriate solution can be embarked upon. For instance, if the problem is mainly that of poor management, the company’s management may be contracted out to experts in that field; whereas if the problem is mainly that of inadequate funds, a scheme of refinancing or capital restructuring may be the solution. In extreme cases where the situation has become complicated by virtue of the complexity of problems involved, the company may have to face either receivership or liquidation.

There are ample provisions in the Companies and Allied Matters Act (CAMA), 1990 as amended guiding the appointment of receivers, receiver/managers and liquidators. As regards bankruptcy, corporate entities are excluded. Only individuals can be declared or adjudged bankrupt and the laws of bankruptcy are quite distinct from those of receivership and liquidation of companies.

4.10.2 Receiverships

Receivership is the process by which someone (referred to as a receiver or receiver/manager) is appointed in whom is vested the legal right to “receive” property belonging to a company which cannot meet its obligations on a debenture trust deed.

In addition to the right to receive, the receiver may be given power to manage the assets coming under his control; in such cases, he is then known as a receiver/manager. The conditions for the appointment of a receiver and manager and how they should operate are all set out in Sections 387 - 400 of CAMA.

Receiverships are usually encountered as a result of an agreement, willingly entered into by a company (which wishes to borrow money for business purposes) and the lender. The company, as security for the loan, agrees that the lender be given the right, in the event of its failing to adhere to the terms of the loan agreement, of appointing a receiver to take over the assets of the company with the main purpose of securing to the lender the repayment of the outstanding loan. By so doing, the company is said to “charge” its assets; the agreement itself is known as a charge or debenture, and charges may be either “fixed” or “floating”. The lender is referred to as the debenture holder.

In other words, a receiver is an individual appointed to recover sums owing to the holder of a charge (usually referred to as a debenture) over assets. The receiver may be appointed by the debenture holder under the terms of the debenture deed giving a fixed and/or floating charge over the assets or by the court.

(a) **Fixed Charge**

A fixed charge is a charge on one or more specific assets of the company, which should be clearly identifiable, such as leasehold or freehold property. When any property is subjected to fixed charge, the company cannot deal freely with it and it must not have created any prior charge on the assets affected, nor dispose any of them without the consent of the debenture holders.

A fixed charge on any property shall have priority over a floating charge affecting that company, unless the terms on which the floating charge was granted prohibited the company from granting any later charge having priority over the floating charge

and the person in whose favour such later charge was granted had actual notice of that prohibition at the time when the charge was granted to him (Section 179 of CAMA).

(b) **Floating Charge**

A floating charge is an equitable charge over the whole or a specified part of the company's undertakings and assets, including cash and uncalled capital of the company both present and future (Section 178 of CAMA). Unlike a fixed charge, a floating charge does not create a charge on any specific assets of the company, unless an event occurs on the happening of which the charge is deemed to crystallise, that is, become a fixed equitable charge on such company's assets as are subject to the charge. Floating charges are most frequently encountered and are usually combined with a fixed charge to give a fixed and floating charge.

Examples of events that may occur and cause a floating charge to crystallise are:

- (i) appointment of a receiver; and
- (ii) commencement of a liquidation.

Section 190 of CAMA requires every company to cause a copy of every instrument creating a charge requiring registration to be kept at the registered office of the company. However, in the case of a series of uniform debentures, a copy of one debenture of the series shall be sufficient.

(c) **Appointment by a Debenture Holder under a Fixed Charge**

A debenture deed conferring rights under a fixed charge stipulates certain assets, which are pledged as security. The deed also states certain events, which will give the debenture holder the right to sell those assets and recover monies due to him. These events will be deemed to be breaches of the terms of the contractual arrangement. Once any breach of the debenture terms arises, a receiver may be appointed by the debenture holder. If a company has given a fixed charge only, the charge will probably not confer on a receiver a power of management of the business as opposed to management of the properties specifically charged.

A receiver appointed under a fixed charge becomes the agent of the company although a receiver appointed under the terms of the debentures or trust deed would naturally be expected to be the agent of the debenture holders. However, in the event that the company goes into liquidation, the receiver ceases to be the agent of the company and becomes an independent principal.

A receiver appointed under a fixed charge is responsible only for the payment of the amounts owed to his debenture holder, which are covered by the debenture, together with his own costs. Therefore apart from a general duty of care he does not have any responsibility towards other classes of creditors (either preferential or not) of the company, other than to realise the best possible price at the time when he chooses to sell the assets.

(d) **Appointment by a Debenture Holder under a Floating Charge**

The type of debenture that creates a floating charge is the most common type entered into by a company and it is usually linked with a fixed charge. This arrangement permits the company to continue its business upon normal terms without constant referral back to the debenture holder.

Once the debenture holder exercises his right to appoint a receiver or a receiver/manager, over the company's assets, the floating charge crystallises. No application to the court is necessary for such an action unless the debenture deed does not specify the circumstances in which a receiver can be appointed.

The receiver's powers of management will be set out in the debenture deed and care must be exercised to ensure that he does not act outside the powers thus conferred on him. His power to act as agent of the company ceases upon the company being placed in liquidation.

(e) **Appointment by the Court**

The court may, on the application of a person interested, appoint a receiver or a receiver/manager of the property or undertaking of a company if:

- (i) the principal money borrowed by the company or the interest is in arrears; or
- (ii) the security or property of the company is in jeopardy.

A receiver or manager of any property or undertaking of a company appointed by the court shall be deemed to be an officer of the court and not an agent of the company. He shall therefore act in accordance with the directions and instructions of the court. He shall also be personally liable for all contracts that he enters into except in so far as the contract otherwise expressly provides.

(f) **Disqualification for Appointment as Receiver or Manager**

Section 387(1) of CAMA states that the following categories of persons shall not be eligible for appointment as a receiver or manager of any property or undertaking of any company:

- (i) An infant;
 - (ii) Any person found by a competent court to be of unsound mind;
 - (iii) A body corporate;
 - (iv) An un-discharged bankrupt, unless he shall have been given leave to act as a receiver or manager of the property or undertaking of the company by the court by which he was adjudged bankrupt;
 - (v) A director or auditor of the company; and
 - (vi) Any person convicted of any offence involving fraud, dishonesty, official corruption or moral turpitude and who is disqualified under Section 254 of CAMA.
- (g) **Actions Prior to and Upon Appointment**
In order not to render a receivership ineffective from its inception, a receiver or manager should take steps to ensure that the lender, that is, the debenture holder has complied with all relevant legal requirements. These requirements include:
- (i) Registration of the instrument of charge within 90 days as required by Section 197 of CAMA;
 - (ii) Adequate proper final Demand Notice to the debtor company. Generally, a 21 days final notice is required after which the appointment of the receiver or manager is justified;
 - (iii) Possession of title documents to the assets charged or obtaining such documents from the debtor company; and
 - (iv) Avoidance of hasty appointments – under a fixed charge, the appointment shall not be effected within 6 months of the creation of the charge, while in the case of a floating charge, the period is 12 months.

All the above-stated issues can be cleared at a pre-appointment meeting with the lender in order to put the receivership in the right direction.

Upon appointment, the receiver or manager shall ensure that notice is given to the Corporate Affairs Commission within 14 days, indicating the terms of and remuneration for the appointment, and every invoice, order for goods or business letter issued by or on behalf of the company, or the receiver or manager or the liquidator of the company being a document on or in which the company's name appears, shall contain a statement that a receiver or manager has been appointed (Section 392 of CAMA).

4.10.3 Bankruptcy

Bankruptcy can be defined as a legal proceeding by which an insolvent debtor is declared bankrupt. An insolvent debtor is a person or trader who is unable to meet his liabilities, that is, unable to pay his creditors.

An insolvent debtor does not automatically become a bankrupt. Before such a person can be declared bankrupt, he/she must have committed an “Act of Bankruptcy”, that is, an act or default on the part of such a debtor which is deemed to be evidence of his insolvency.

Legally, bankruptcy can be voluntary or involuntary. Voluntary bankruptcy is when the debtor brings the petition, while involuntary bankruptcy is when one or more creditors petition to have a debtor adjudged insolvent by a court.

In both cases, the purpose is to have an orderly and equitable settlement of the debtors’ obligations.

(a) **Acts of Bankruptcy**

The various acts of bankruptcy arise if a debtor does any of the following:

- (i) Makes a conveyance or assignment of his property to a trustee for the benefit of his creditors generally;
- (ii) Makes a fraudulent conveyance, gift, delivery, or transfer of his property or any part thereof;
- (iii) Makes any conveyance or transfer of his property or any part thereof, or creates any charge thereon which would be void as a fraudulent preference if he were adjudged bankrupt;
- (iv) Departs out of or makes himself absent from Nigeria, or departs from his dwelling house or place of business, or begins to keep house with intent to defeat or delay his creditors;
- (v) Permits execution to be levied against him, and allows the goods to be sold or held by the court bailiff for more than 21 days;
- (vi) Files a declaration of his inability to pay his debts, or files a bankruptcy petition against himself;
- (vii) Fails to comply with a bankruptcy notice served upon him; and
- (viii) Gives notice to any of his creditors that he has suspended, or is about to suspend payment of his debts.

(b) **Bankruptcy Laws and Their Objects**

In Nigeria, there is currently the Bankruptcy Act, 1979. Before then, there was reliance on the Bankruptcy Act, 1914 and the Bankruptcy (Amendment) Act, 1926, both of the United Kingdom. The objects of these bankruptcy laws are as follows:

- (i) to set free a debtor who has become hopelessly involved in financial difficulties;
- (ii) to distribute his estate equitably among his creditors; and
- (iii) to release him from all further liabilities in respect of his past debts.

(c) **Persons who may be Declared Bankrupt**

The following categories of debtors may be declared bankrupt:

- (i) A debtor owing a liquidated sum of at least ₦2,000.00 (Two thousand Naira only);
- (ii) A debtor who has committed an act of bankruptcy within 3 months before presentation of bankruptcy petition; and
- (iii) Any debtor domiciled in Nigeria or who has carried on business in Nigeria by means of an agent or a manager.

Note

The implication of the above is that companies incorporated under CAMA cannot be declared bankrupt, rather companies are wound up if they commit acts deserving such a treatment.

(d) **Persons who may petition a debtor**

The following categories of persons may petition a court praying that the debtor be adjudged bankrupt:

- (i) An unsecured creditor may petition a debtor provided that he satisfies the following conditions:
 - ◆ he is owed a liquidated sum of at least 2,000.00 (two thousand Naira only);
 - ◆ the debtor has committed an act of bankruptcy within three months before the presentation of the bankruptcy petition; and
 - ◆ at the date of the presentation of the petition, the debtor must be domiciled in Nigeria or must have carried on business in Nigeria by means of an agent or manager,
- (ii) A secured creditor may also petition if he has surrendered his securities or given an estimate of its value.
- (iii) The debtor himself may petition for a Receiving Order in respect of his estate, that he should be adjudged bankrupt. The petition must allege inability to pay his debts.
- (iv) A court may also petition if the debtor resides or carries on business for the greater part of six months preceding the petition, or he is not resident in Nigeria, or a creditor cannot ascertain his residence. In this case, action can be brought against the debtor in the High Court of Justice.

(e) **Bankruptcy of Partners**

As regards a partnership, the bankruptcy of a partner dissolves the partnership but does not necessarily make the firm bankrupt. The firm will not be made bankrupt if any one partner is able to pay the firm's debts. Consequently the bankruptcy of the firm will involve the bankruptcy of all the general partners.

The joint estate of the firm shall be applicable in the first instance in the payment of the partners' joint debt, and the separate estate of each partner shall be applicable in the first instance in the payment of his separate debt.

In the case of a surplus arising on any partner's estate, such a surplus must be transferred to the joint estate, while a surplus on the joint estate shall be shared to the partners in their profit sharing ratio.

4.11 LIQUIDATION

Liquidation can simply be referred to as the process of dismantling a business, paying off its debts in order of priority, and distributing the remaining assets in cash to the owners. As it relates to a company, this process is referred to as a winding up and Sections 401-536 of CAMA contain the various provisions on the winding up of companies.

The winding-up of a company involves the realisation of its assets and distribution with a view to terminating (or liquidating) the affairs of the company, in cooperation with its creditors, and bringing its existence to an end.

(a) **Modes of Winding Up**

The winding up of a company under Section 401 of CAMA may be effected:

- (i) By the court;
- (ii) Voluntarily; or
- (iii) Subject to the supervision of the court.

Winding up by the court is usually referred to as a "compulsory winding up". Voluntary winding up, on the other hand, may take the form of either a "members' voluntary winding up" or a "creditors voluntary winding up",

(b) **Winding up by the Court**

A company may be wound up by the court under section 408 of CAMA if:

- (i) The company has by special resolution resolved that the company be wound up by the court;
- (ii) Default is made in delivering the statutory report to the Corporate Affairs Commission;
- (iii) The number of members is reduced below two;
- (iv) The company is unable to pay its debts;
- (v) The court is of the opinion that it is just and equitable that the company should be wound up.

Section 410 of CAMA provides that an application to the court for the winding up of a company shall be by the presentation of a petition by any of the following:

- (i) The company;
- (ii) A creditor, including a contingent or prospective creditor of the company;
- (iii) The official receiver;
- (iv) A contributory;
- (v) A trustee in bankruptcy to, or a personal representative of, a creditor or contributory;
- (vi) The Corporate Affairs Commission under Section 323 of the Act;
- (vii) A receiver, if authorised by the instrument under which he was appointed; or
- (viii) All or any of these parties, together or separately.

The commencement of winding up by the court is provided for in Section 415 as follows:

- (i) Where, before the presentation of a petition for the winding up of a company by the court, a resolution for voluntary winding up has been passed by the company, the winding up of the company shall be deemed to have commenced at the time of the passing of the resolution, unless the court, on proof of fraud or mistake, thinks fit to direct otherwise (Section 415[1]).
- (ii) In any other case, the winding up of a company by the court shall be deemed to commence at the time of the presentation of the petition for the winding up (Section 415[2]).

The consequences of a winding up by the court, which normally date back to the commencement of the winding up, are:

- (i) Any disposition of the property of the company, including things in action and any transfer of shares, or alteration in the status of the members of the company, made after the commencement of the winding up shall be void, unless the court orders otherwise (Section 413).
- (ii) Any attachment, sequestration, distress or execution put in force against the estate or effects of the company after the commencement of the winding up by the court shall be void. (Section 414).
- (iii) A copy of the winding up order shall be sent at once to the Corporate Affairs Commission (Section 416).
- (iv) Once a winding up order is made, all pending actions against the company are suspended; and no fresh proceeding shall be commenced, except with the leave of the court (Section 417).
- (v) The Official Receiver automatically takes charge of the affairs of the company as provisional liquidator if no liquidator is appointed (Section 422[3]).
- (vi) If a liquidator is appointed under Section 422, all the powers of the directors shall cease immediately, except so far as the court may by order sanction the continuance thereof (Section 422[9]).

(c) Voluntary Winding Up

A company may be wound up voluntarily under Section 457 of CAMA:

- (i) When the period, if any, fixed for the duration of the company by the articles of association expires, or the event, if any, occurs, on occurrence of which the articles provided that the company is to be dissolved and the company in general meeting has passed a resolution requiring the company to be wound up voluntarily;
- (ii) If the company resolves by special resolution that the company be wound up voluntarily.

A voluntary winding up shall be deemed to commence at the time of the passing of the resolution for voluntary winding up. The consequences of voluntary winding up are:

- (i) With effect from the date of commencement of the winding up, the company must cease to carry on business, except so far as may be required for the beneficial winding up (Section 460).
- (ii) Any transfer of shares, not being a transfer made to or with the sanction of the liquidator, and any alteration in the status of the members of the company, made after the commencement of a voluntary winding up, shall be void (Section 461).
- (iii) On the appointment of a liquidator by the company in general meeting in the course of a members' voluntary winding up, all the powers of the directors shall cease except in so far as the company in general meeting or the liquidator sanctions its continuance (Section 464).
- (iv) In the case of a creditors' voluntary winding up, the creditors and the company at their respective meetings mentioned in Section 472 of the Act, may nominate a person to be liquidator for the purpose of winding up the affairs and distributing the assets of the company, and if the creditors and the company nominate different persons, the person nominated by the creditors shall be liquidator, and if no person is nominated by the creditors the person, if any, nominated by the company shall be liquidator (Section 473).

“Member’s voluntary winding up” can be adopted whenever the company’s directors have made a statutory declaration that the company’s liabilities can be paid in full within such a period not exceeding 12 months from the date of commencement of winding up. In any case where such a statutory declaration has been made, “creditors’ voluntary winding up” shall be adopted.

(d) Winding up Subject to the Supervision of the Court

If a company has passed a resolution for voluntary winding up, the court may on petition order that the voluntary winding up shall continue but subject to the supervision of the court (Section 486). A winding up subject

to the supervision of the court shall, for the purposes of Sections 413 and 414 of CAMA, be deemed to be winding up by the court (Section 488).

Where an order is made for winding up subject to supervision, the court may, by the same or any subsequent order, appoint an additional liquidator. This liquidator shall have the same powers, be subject to the same obligations, and in all respects stand in the same position, as if he had been duly appointed in accordance with the provisions of CAMA with respect to the appointment of liquidators in a voluntary winding up. The court may remove any liquidator so appointed by the court or any liquidator continued under the supervision order, and may fill any vacancy occasioned by the removal, or by death or resignation (Section 489).

Note

In all cases of winding up of a company, the liquidator shall, within 14 days after his appointment publish in the Gazette and in two (2) daily newspapers and deliver to the Corporate Affairs Commission for registration, a notice of his appointment in such form as the Commission may from time to time approve (Section 491).

4.12 IMPLICATIONS OF INSOLVENCY FOR CORPORATE GOVERNANCE AND GOING CONCERN THREATS

- (a) **Corporate Governance:** This refers to the action, manner and system of governing a corporate entity. So many definitions of corporate governance have been given but the one set out in the Principles of *Corporate Governance* developed by the Organisation for Economic Co-operation and Development (OECD) in 1999 is considered appropriate and given below:

“Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation....., and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it provides the structure through which the company objectives are set and the means of attaining those objectives and monitoring performance” (OECD, 1999)

Many countries have specific rules, regulations and guidelines on corporate governance; Nigeria is not an exception. Though, Chapter 23 is devoted to Corporate Governance, the reference to the topic here is merely as it concerns how insolvency may affect it. There is no doubt that the implications of insolvency for corporate governance can be enormous. Once there is corporate insolvency, the position of those

charged with corporate governance becomes threatened. How much of the effectiveness and accountability of boards of directors can be discussed when the company itself is on the verge of collapse?

In essence, therefore, insolvency should not occur when corporate governance rules, regulations and guidelines are carefully and religiously implemented.

On the other hand, once insolvency has set in and it is persistent, there will be little or nothing that the corporate governance rules, regulations and guidelines can do to bring the company back to business.

In a few cases where restructuring of the company is still possible, there may be a strong need for the management and the entire board of directors to be changed.

- (b) **Going Concern:** This is one of the fundamental accounting concepts referred to in the Statement of Accounting Standard (SAS) No. 1. It is defined as:

“an assumption that the business unit will operate in perpetuity: that is, the business is not expected to be liquidated in the foreseeable future”.

This concept implies that the directors of a company shall consider the company as a going concern if the company is capable of earning a reasonable net income and there is no threat from any source or intention by any person(s) to curtail significantly its line of business in the foreseeable future. If there is any reason for the directors to doubt the appropriateness of the going concern, then in preparing the financial statements they should give such information. The auditors of the company should also form their opinion on the appropriateness or otherwise of the going concern status of the company.

If a company is persistently insolvent, then both the directors and auditors should not take things for granted. Immediate remedial actions should be taken and if the situation is beyond redemption, the option of winding up should be considered and this means the company is no longer a going concern.

4.13 SUMMARY AND CONCLUSIONS

This chapter dwelt on audits of different types of organisations; general approach to audit; specific approach to each organisation's audit; audit of specific industries, such as farmers, professionals, hospitals and hotels; Specific audit difficulties relating to financial institutions; audit of not-for-profit organisations and Joint audits.

It also touched on the distinction between auditing and investigations; nature, classes and methods of investigations; auditors' involvement with prospectuses and other offer documents; examination of financial forecasts and projections; forensic investigation and audit; and the report appropriate to each type of investigation.

Lastly various legal processes involved in corporate distress; Receivership and receiver/manager; bankruptcy; liquidation; insolvency and corporate governance with attendant going concern threats, were thoroughly discussed.

Refer to Comprehensive Questions and Suggested Solutions in Appendix II, page 303.

4.14 REVISION QUESTIONS

1. Whenever the approved auditor of a licensed bank is satisfied that there has been a contravention of any section of the Banks and Other Financial Institutions Act,
 - (A) He shall note that contravention in the permanent audit file.
 - (B) He shall report to the Engagement Partner.
 - (C) He shall immediately report the matter to the Central Bank of Nigeria.
 - (D) He shall alert all the members of the engagement team.
 - (E) He shall consult with the Quality Control Partner.

2. In preparing the auditor's report for a special type of organisation, the following section is not required:
 - (A) Addressee.
 - (B) Date of the report.
 - (C) The audit opinion.
 - (D) The date of the engagement letter.
 - (E) Auditing standards followed.

3. The specific approach to the audit of any peculiar organisation will not include the consideration of the following:
 - (A) Internal control.
 - (B) Statutory requirements.
 - (C) Assets and liabilities.
 - (D) Accounting policies.
 - (E) Profit forecast and cash flow statement.

4. In conducting the audit of an insurance company, the auditor needs to pay attention to the following:
 - (A) Provision for outstanding claims.
 - (B) Provision for Recurrent Reserve.
 - (C) Reserve for Small Scale Industries.
 - (D) Provision for loan losses.
 - (E) Provision for Unearned Interest.

5. The statutory requirements that are relevant to an auditor of financial institutions do not include the following:
 - (A) Banks and Other Financial Institutions Act.
 - (B) Nigeria Deposit Insurance Corporation Act.
 - (C) Companies and Allied Matters Act.
 - (D) Central Bank of Nigeria Act.
 - (E) Federal Deposit-taking Banks Act.

6. In conducting the audit of a not-for-profit organisation, an auditor must consider all relevant matters except the following:
- (A) Legal form of the organisation.
 - (B) Relationship with the Federal Government.
 - (C) Letter of Engagement.
 - (D) Sources of fund.
 - (E) Fixed Assets.
7. An good example of an investigation assignment is
- (A) Investigation for a proposed business purchase.
 - (B) Investigation for the purpose of ascertaining the balance of sales account.
 - (C) Investigation for the completion board meeting.
 - (D) Investigation for preparation of audit evidence.
 - (E) Investigation for a proposed audit assignment.
8. The report of the investigating auditor should include sections on relevant matters except the following:
- (A) Nature of the assignment.
 - (B) Scope of the investigation.
 - (C) Findings and observations.
 - (D) Names of those from whom information is obtained.
 - (E) Conclusions and recommendations.
9. The following matter may make it difficult or impossible for a reporting accountant to report on the forecasts
- (A) Sufficient time allowed for obtaining and assessing required information.
 - (B) Reliable costing and accounting records.
 - (C) The nature of the business activities.
 - (D) Reliable methods of forecasting.
 - (E) Good reputation of the promoters.
10. The general information to be obtained by a reporting accountant in performing his duties includes the following:
- (A) Competitor's names and zones represented.
 - (B) Registered offices of the suppliers.
 - (C) Shareholders' names and addresses.
 - (D) Share capital and debt capital.
 - (E) Customers' names and addresses.
11. An event that may occur and cause a floating charge to crystallise is
- (A) Commencement of a debenture stock
 - (B) Appointment of a receiver
 - (C) Appointment of a director
 - (D) Appointment of an external auditor
 - (E) Issuing of ordinary shares.
12. The court may, on the application of a person interested, appoint a receiver or a receiver/manager of the property of a company if
- (A) The security or property of the company is in jeopardy
 - (B) The principal money borrowed by the company has reduced
 - (C) The interest on the principal money borrowed by the company has been paid
 - (D) The company has acquired more of the property of the company
 - (E) The company is refurbishing a major part of the company

13. The following category of persons shall be eligible for appointment as a receiver or manager of any property or undertaking of any company
 - (A) A body corporate.
 - (B) An infant.
 - (C) A director of the company.
 - (D) A qualified accountant who is not an auditor.
 - (E) An auditor of the company.

14. The following categories of debtors may not be declared bankrupt
 - (A) A debtor who has committed an act of bankruptcy within 3 months before presentation of bankruptcy petition.
 - (B) A debtor domiciled in Nigeria.
 - (C) A debtor who transacts business in Nigeria and is able to meet his obligations as and when they fall due.
 - (D) A debtor who has carried on business in Nigeria by means of an agent or a manager.
 - (E) A debtor owing a liquidated sum of at least ₦2,000 (Two thousand Naira).

15. An application to the court for the winding up of a company shall be by the presentation of a petition by any of the following except
 - (A) The company.
 - (B) The external auditor.
 - (C) The Corporate Affairs Commission.
 - (D) A contributory.
 - (E) The official receiver.

16. A company may be wound up voluntarily under Section 457 of CAMA if the company resolves by special resolution that
 - (A) The directors resign their appointment
 - (B) The debentures be redeemed
 - (C) The forfeited shares be re-issued
 - (D) The chairman of the board be removed
 - (E) The company be wound up.

17. In auditing, a _____ contains records relating to the client organisation and which do not change from time to time.

18. _____ is an act of examining, searching and inquiring into a matter with adequate care and accuracy; usually undertaken to obtain information of particular or special nature.

19. What are the three major stages into which the methods of carrying out an investigation assignment fall?

20. A _____ is a chartered accountant in public practice who is reporting under the relevant provisions of CAMA and/or the Listing Requirements of the NSE.

21. Forensic accounting encompasses both _____ and Investigative Accounting.

22. _____ is the process by which there is appointed someone in whom is vested the legal right to receive property belonging to a company.

23. The receiver's powers of management are usually set out in the _____ deed.

24. What is a joint audit?

25. There are three main ways by which the winding up of a company can be accomplished. What are they?

Refer to Suggested Solutions in Appendix I, page 297.

PRINCIPLES AND APPLICATION OF PROFESSIONAL ETHICS

5.0 LEARNING OBJECTIVES

After studying this chapter, readers should be able to understand the:

- ◆ Nature of ethics.
- ◆ Concepts of Integrity, Obligation, Independence and Public expectations.
- ◆ Importance of ethics in the practice of different professions.
- ◆ Relevance of ethical standards in some of the statutory provisions affecting the accountants' job.
- ◆ Consequences of unethical behaviour.
- ◆ Ethical standards required of accountants and the related professional responsibilities; as they affect the professional Accountants.
- ◆ Type of relationship that professional accountants could have with fellow members.
- ◆ Concept and the need for corporate governance.
- ◆ Role of board of directors, shareholders, and audit committee in corporate governance.

5.1 THE NATURE OF ETHICS

The Oxford Advanced Learner's Dictionary defines ethics as "the moral principles that control or influence a person's behaviour". It goes on to affirm that ethics is the branch of philosophy that deals with moral principles.

There could be business ethics, and professional ethics. Ethics can be related to each particular profession such as accounting, medicine, engineering, etc. Other words which have been used to describe ethics are moral values, morality, rules of conduct, standards, conscience, moral code, and moral philosophy.

Ethics, as a branch of philosophy, is concerned with the study of what is either good or bad and right or wrong for human beings. The essence of ethics is to ascertain and continuously review how human beings should behave in order to lead a fulfilling life. Leading a fulfilling life will require considering others as well as oneself. It is not sufficient to think of what one considers as right or good, but the interests of others who may be affected by one's behaviour must be taken into consideration. The development of these moral values is philosophically seen as dependent on the uniqueness of man that makes it

possible for him to look for solutions to the problems in his environment. In his quest for solutions, some standards of morality are developed, consistently adhered to and they become acceptable to the whole group.

Thus what is ethically acceptable in one culture may not be ethically acceptable in another culture.

Based on this postulation, the philosophical approach to ethics is usually discussed from various viewpoints. These are sometimes referred to as different schools of thought and for each school of thought, ethical theorists will be pointing to different bases for the formulation of ethics. Different terminologies are used to describe these different bases as well. For instance, ethics could be formed on the basis of deontology or teleology. Sometimes such terms as utilitarianism and dilemma could be used. These terms are explained below:

- (a) Deontology is the theory of duty or obligation. Where ethical theories are formulated on deontological basis, an ethical requirement is justified because it is a “good theory in itself”. The ethical requirement is based on the “act” and whether it is “right” or not. An example of the application of this basis is the ethical requirement for professional integrity as this connotes a sense of duty or moral obligation to act truthfully or honestly.
- (b) Teleology is concerned not with the act in itself but rather with the consequences of the particular act. Hence, it is sometimes referred to as “ends-based ethics” or “consequentialism”. Where ethical theories are formulated on teleological basis, the ethical requirement on its own may neither be good nor bad in itself but the intended result of applying it is considered good. An example of the application of teleological basis to ethical requirement is when one considers the end as justifying the means.
- (c) Utilitarianism is a special version of teleology. It is involved with maximising “welfare” and sometimes loosely described as creating the greatest good for the greatest number. It is the end justifying the means to some extent too.
- (d) Dilemma is a situation in which all the available courses of action appear to include morally undesirable as well as morally desirable aspects.

In view of the fact that ethics is on its own a branch of philosophy, it is most likely and in all cases going to be true that a professional approach to viewing ethics will revert to a philosophical approach. This is because a professional approach here is seen to refer to an expert or competent approach. Therefore, the clause in the syllabus under “The Nature of Ethics” that refers to the differentiation between philosophical and professional approach may really be intended to discuss “ethics” from a professional’s viewpoint, that is, to do less of theoretical expositions and apply more of practical applications, then one can refer to such authors who have written on business ethics (Elegido),

ethics in organisations (Murray), accounting ethics (Maurice) and ethics in professional practices (Adewunmi, Unegbu, Omoregie, etc). What all these authors have in common is the application of ethics to their different focal points.

A professional's approach to ethical issues concentrates on how each professional body or organisational unit tackles the problem of ethical requirements. Each professional body or organisational unit is seen as willingly embracing the idea of providing either a Code of Ethics/Professional Conduct or a Code of Practice/Conduct for its members or employees to follow respectively.

Ethics, as relates to professions shall form the basis of discussion in this Section. As regards organisational units, these could be subdivided into profit-making organisations (usually referred to as business entities) and not-for-profit organisations. For the purpose of our discussion, the former type shall be used for further illustration.

Ethics, as relates to business, is essentially, concerned with how an enterprise carries out its operations in a morally acceptable manner, ensuring that the decisions taken at all times are fair to all the parties involved. These parties usually referred to as stakeholders include the shareholders, customers, suppliers, employees, creditors, government, local community and the society as a whole. The various professionals usually occupy one position or the other from time-to-time, but more usually they are seen as performing their professional roles in or outside the various organisations.

A manager on his own, needs to be experienced and knowledgeable enough to be able to maintain high moral standards at all times; in fact he needs strength of character for this. However, when the organisation within or with which he operates has imbibed a set of moral standards for itself, it makes it much easier for each manager (or indeed each employee) to maintain high moral standards. Furthermore, if the organisation's Code of Practice or Code of Conduct has been properly developed and is being properly implemented, the Code would have included some measure of ethical standards and defined the corporate culture of the organisation.

Organisations that act ethically will not only provide the environment for its employees to act ethically but will also succeed in earning for themselves a good reputation. The multiplier effect of such a situation will also spill over to the society at large. In fact such organisations can become more productive and socially responsible in the long run.

5.2 CONCEPTS OF INTEGRITY, OBJECTIVITY, INDEPENDENCE AND PUBLIC EXPECTATIONS

Elegido (1996) refers to independent and ultimate principles of business ethics as consisting of principles of solidarity, rationality, fairness or impartiality, efficiency, refraining from willing harm to a human being, and role-responsibility.

In one of the Auditing Standards for professional accountants, the ethical principles which govern auditors' responsibilities are stated to include integrity, objectivity, independence, professional competence and due care, professional behaviour, and confidentiality.

The syllabus of the Institute has, however, identified four concepts under the topic of ethics for further explanation. These four are not necessarily fundamental, neither are they in the same group of consideration for any particular aspect of ethics or ethical standards. What is clear is that an understanding of these four concepts will help in appreciating the role of ethics within the context of training a chartered accountant. They are all regarded as essential in relation to ethical requirements.

5.2.1 Integrity

This is an important concept that runs through the Code of Ethics or Code of Conduct of many professional bodies, for example, accountancy, banking, quantity surveying, taxation, etc.

The Oxford Advanced Learner's Dictionary defines integrity as "the quality of being honest and having strong moral principles" (personal or professional integrity). Honesty (which is "being honest") on its own means truthfulness, which implies the "whole truth and nothing but the truth", (the truth as it is).

In addition to honesty, other synonyms for integrity include probity, uprightness and incorruptibility. Integrity implies not merely being honest, but fair dealing and truthfulness. It is either one has integrity or does not have it; there is no measure of it that is considered acceptable. Therefore, a professional should aim at simply being a person of integrity, rather than seeking to be operating at any acceptable level of integrity. He/she should deal with any situation with all sincerity of purpose, being transparently honest.

Each professional body expects that its members will at all times conduct themselves in such a way that will not bring discredit to the professional body. Members should not only be honest but must be seen to be honest in all their dealings with others. Examples abound from one profession to another, such as "a chartered tax practitioner must not act for both a taxpayer and Revenue Service simultaneously in respect of tax matter"; a journalist "shall use only fair and honest methods to obtain news, pictures and documents"; a member of the Nigerian Institute of Building "shall at all times act with integrity so as to uphold and enhance the dignity, standing and reputation of the building profession"; and a Chartered Accountant "should behave with integrity in all professional and business relationships".

The integrity of an individual manager or professional has interplay with the organisation in which he operates as well as the society at large. What type of organisation is it? Is it an organisation that has a code of conduct or code of ethics? How does the management of the organisation feel about integrity? Is it a place where there is absolutely no set of ethical standards for the way business is done? The tendency has always been that the society respects a rich or wealthy man without caring to know how he got his riches. The day that each individual or professional starts to take the issue of integrity seriously that day will be the beginning of and indeed a turning point to the right direction for our society in terms of integrity.

5.2.2 Obligation

This means a law or a promise, or an influence that forces one to do something. It also means a duty, for example, fulfilling one's professional obligations. In relation to ethical requirements, obligation can also be seen as a responsibility or a compulsion.

An individual in the process of being ethical may consider his obligation of keeping promises while in the case of an organisation, it may be necessary to ask if we consider that an organisation has an ethical obligation to be socially responsible. The point has been made earlier in this chapter that ethical requirements make it necessary for one not to be thinking of being good to himself alone, but also to others. In view of this it becomes necessary to see organisations as needing to consider how they can be of any use to their immediate environment.

The professional should be able to ascertain from time to time if he is under obligation to do certain things. This becomes more pertinent when he/she is under pressure to do things, which by virtue of the provisions of the Code of Conduct of his professional body, he is precluded from doing.

5.2.3 Independence

This refers to the state of not being controlled by other people or things, such as financial benefits. 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 chartered 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 judgement, allowing an individual to act with integrity, and exercise objectivity and professional scepticism.
- (b) Independence in appearance: The avoidance of facts and circumstances that 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 scepticism had been compromised.”

In other words, a professional should not only be independent, but must be seen to be independent.

5.2.4 Public Expectations

The society at large should be in a position to expect individual professionals and organisations to comply with some form of ethical standards. This is because of the fact that neither the individual professional nor the organisational unit can operate without affecting or being affected by the environment in which either of them operates. That environment may be small or big, may be heterogeneous or homogeneous. The important thing is that the environment has its own expectations.

An individual professional is expected by the public to possess certain attributes, some of which are integrity, objectivity, independence, technical and professional competence. He/she is expected to be able to avoid disclosing confidential information about his/her clients’ business, employers or customers business indiscriminately. Imagine a doctor, a banker, an accountant, etc, not being able to keep information confidential.

The public (in the various forms of stakeholders) also expect that information provided by a professional will be true and accurate. An engineer’s report on a project, a doctor’s report on a patient, an estate valuer’s valuation report on a piece of property, a lawyer’s report on a case, etc are all examples of information provided by professionals which the public expect to be true and accurate. Truthfulness in this

case is expected to be what indeed is true, not what ought to be true. This requires integrity, that is, probity, honesty, incompatibility, or uprightness.

In fact each individual is expected to be morally good, morally fair and to prefer to choose good over evil. For instance the public expects people to say the truth at all times.

5.3 ETHICS AND THE PROFESSIONS

Profession is a paid occupation that requires advanced training and education. A profession has been defined in differing ways by various authors, though each attempt is still revolving round the one quoted above. A clearer understanding of it is however provided when one considers the premises upon which the idea of a profession rests. Millichamp (1990) revealed that a profession has the following characteristics:

- (a) A recognisable discrete body of knowledge;
- (b) An educational process;
- (c) A system of examinations;
- (d) A system for licensing practitioners;
- (e) A professional association;
- (f) A sense of responsibility to society;
- (g) A code of ethics; and
- (h) A set of technical standards.

The members of a profession usually endorse a code of ethics governing their professional behaviour. They define the area of their technical competence, ensuring from time to time that those who possess the required formal educational qualifications and appropriate practical experience are given the right to practice within the stipulated code of ethics.

Another attempt at defining a profession as provided by Okogwu is to see it as an “occupation requiring specialised knowledge that can only be gained after intensive preparation”. Professional occupations tend to possess three features:

- (a) A body of erudite knowledge which is applied to the service of society;
- (b) A standard of success measured by accomplishment in serving the needs of society rather than purely serving personal gain; and
- (c) A system of control over the professional practice which regulates the education of its members and maintain both a code of ethics and appropriate sanctions:

Professional ethics or the ethics of any particular profession regulate the way and manner each member is to relate to other members on the one hand and to the society on the other, both from a moral perspective. Morality is the bedrock of all the issues about ethics. The type of questions that usually arise are in the realm of choosing or deciding to do what is considered to be good, right, fair, and acceptable. The age long biblical golden rule of “doing unto others what

you want others to do to you” or “whatever you want men to do to you, do also to them” seems to be appropriate in discussing ethics.

This is because there is really nobody that would prefer other people not to be fair to them, or not to do good things to them or to do them any wrong. This is why ethical issues do not stop at what one does to have a fulfilled life but also how what one does affects other people.

Any misconduct committed by members of a profession will tend to bring both the affected members and their profession to disrepute or discredit. An individual professional can become more respectable and be counted among those people of integrity by maintaining high ethical standards in a consistent manner.

5.4 ETHICS AND THE LAW

The questions may be asked: Has law got anything to do with ethics? Can matters of ethics constitute areas in which governments might legislate for improved standards of behaviour? The answers to these questions are no doubt in the affirmative.

According to Murray (1997), “a civilised economic system needs a legal framework which while providing for initiative and enterprise, will curb the worst excesses. This, however, must be supplemented by a general acceptance among business people at all levels that many areas outside legislative control should be policed by shared values such as integrity, fairness, honesty, stewardship, respect for human dignity and concern for others”.

Some professions are regulated while others are not. In the case of the regulated professions such as accountancy, banking, law and medicine the distinction between statutory and ethical requirements may not be as clear as in the case of the less regulated professions. In the regulated professions a lot of their ethical requirements have a statutory basis.

There are many examples of the statutory basis of the ethical requirements of some of the professions, spanning through the provisions of CAMA, BOFIA, CBN Act, and the enabling Act of each of the professional bodies (ICAN Act, CIBN Act, etc).

The following are examples of statutory provisions which reflect some ethical rules or standards:

- (a) Sections 331- 369 of CAMA provides extensively for financial statements and audit. One of such provisions is that “an officer of a company commits an offence if he knowingly or recklessly makes to a company’s auditors a statement (whether written or oral) which:
 - (i) Conveys or purports to convey any information or explanation which the auditors require, or are entitled to require, as auditors of the company; and
 - (ii) Is misleading, false or deceptive in a material particular.

- (b) Sections 615 and 616 of CAMA prohibit insider trading and the abuse of privileged information by an insider of any company registered under the Act.
- (c) Various provisions abound in both the CBN Act and BOFIA governing the operations of banking business in Nigeria.
- (d) Provisions of the Insurance Act, 2003 stipulate how insurance business should be carried out.
- (e) The Securities and Exchange Commission (SEC) requires full public disclosure of specified items of accounting information by companies offering their shares for the first time in the Nigerian securities market.
- (f) The Nigerian Stock Exchange (NSE) regulates items that quoted companies must disclose in published accounts in addition to those statutorily specified by CAMA.
- (g) The Audit Committee, has as one of its objectives and functions (as provided for in Section 359(6) of CAMA), the ascertainment of whether the accounting and reporting policies of the company are in accordance with legal requirements and agreed ethical practices.

In addition to self-regulation in a given profession, the professional who, working with a client that operates in a regulated sector also has to exercise due care and diligence that such clients are compliant with both the law and the regulations affecting them. A good example of this situation is when an auditor is working for a bank where BOFIA, CBN Act, NDIC Act and CAMA are not sufficient, but all the circulars from CBN and NDIC have to be reckoned with.

Furthermore, there may be statutory prohibitions on an individual professional or his firm while performing their professional duties. For instance, Section 358 (2) of CAMA prohibits an officer or employee of a company or a partner or employee of such a person, from accepting appointment as auditor of that company.

The state of being law-abiding is not sufficient for the society to accept individuals or organisations who want to operate at any level of society to adopt a behaviour of inhumanity or immorality as they please. Even if they do not break explicit laws, the fact that their actions are either inhuman or immoral shall be sufficient for the society to frown on them.

Note

The duty of creating and sustaining an ethical environment is for us all to share equally and generally. It calls for the dedication of all of us, regardless of our position in the society.

5.5 ETHICS AND THE PROFESSIONAL ACCOUNTANT

In the conduct of any of the professional duties of a Chartered Accountant, for example, financial accounting, auditing, taxation etc., he/she must comply with the ethical guidance issued by his/her professional body.

For instance, the International Standard on Auditing (ISA) No. 200 titled *Objective and General Principles of Audit* provides that “in the conduct of any audit of financial statements auditors should comply with the ethical guidance issued by their relevant professional bodies”.

The ethical principles that govern auditors’ professional responsibilities are provided to serve as guidance to the chartered accountant while providing auditing and related services. However, a chartered accountant performing non-audit functions is also to be guided by the professional code of conduct of the Institute.

The International Federation of Accountants (IFAC), which is the international body comprising about 150 member organisations from all over the world, representing over 1.5 million professionally qualified accountants, has its own Code of Ethics for professional accountants. This Code is binding on all the IFAC member bodies, and the latter are obliged to ensure that either in the form of their own local Code or directly by adopting the IFAC Code, their own members are appropriately guided to comply with the IFAC Code.

In the case of Nigeria, and in view of the fact that ICAN is the only Nigerian accountancy body recognised by IFAC, there is a **Code of Professional Conduct for Members** issued by ICAN. This Code draws mainly from and conforms to the guidelines of IFAC.

Professional accountants are required to observe the ethical standards of their professional body. By extension, chartered accountants in Nigeria are required to observe and comply with the ethical standards of ICAN. Some of these ethical standards (or most of them) are written while some are unwritten. In paragraph 5 of the Introduction to ICAN’s Code, it is stated that the guidance on professional conduct is not exhaustive as members are admonished to “be guided not merely by the terms, but also by the spirit of this Guide and the fact that a particular conduct does not appear among a list of examples does not prevent it from amounting to misconduct”. In fact paragraph 20 of the same section of the Code states by way of *Further Advice* that “a member who is in doubt as to his or her ethical position in any matter may seek advice of the Institute through the Registrar/Chief Executive”.

In spite of the fact that misconduct is difficult to define and the Code has subtly warned that ignorance of misconduct or its omission from the list of examples does not absolve any member from sanction, professional accountants are urged to refrain from misconduct. Misconduct is seen as including any act or default which is likely to bring disrepute to him, his fellow accountant, and the profession of accountancy in general.

Millichamp (1996) has made some general points on ethics and the professional accountant. They are as stated below:

- (a) Integrity is vital;
- (b) Professional independence is very important;

- (c) Accountants must not only be people of integrity and independence; they must also be seen to be so; and
- (d) When a professional accountant has ethical difficulties or is uncertain about the course of action to take, he should either seek advice from his professional body or even take legal advice.

5.6 CONSEQUENCES OF UNETHICAL BEHAVIOUR

The consequences of unethical behaviour are reflected not only on the individual but also on his profession, his professional body and indeed the society at large. The first thing to consider here is, what constitutes an unethical behaviour. An understanding of ethics could be presumed to be a pre-requisite of understanding what can constitute an unethical behaviour.

In a study involving different categories of players in the financial services industry, Adewunmi (1998) was able to identify various types of description of unethical behaviour. Some of them that are of general application are:

- (a) Any act or behaviour which is not in consonance with professional code of conduct;
- (b) Behaving in ways outside the moral principles or ethics which govern a certain profession;
- (c) Any act that does not follow the norms of a profession;
- (d) A behaviour that negates the code of conduct guiding an operation.
- (e) Any attitude that is not in consonance with the accepted norms;
- (f) A conduct that is morally adjudged wrong, unbecoming and below expectation;
- (g) Behaviour that is not based on moral principles;
- (h) Deviation from standard and known norms; and
- (i) An act that is not normally right.

The above list shows clearly that in each case, there has been an attempt to see unethical behaviour as the opposite of ethical behaviour. The major attributes of unethical behaviour refer to failure to comply with the expected normal moral standards of a profession. It is simply a professional misconduct.

The consequences of failure to comply with the ethical standards of a profession can be clearly identified from the Code of Conduct or Code of Ethics of that profession. Using the ICAN Code and chartered accountants as an illustration here, the section on *Enforcement of Ethical Standards* is reproduced below:

“This statement shall apply to all members:

- 1.1 The power of the Institute to enforce ethical standards is by the ICAN Act conferred on the Accountants’ Disciplinary Tribunal which is in respect of this power independent of the Council.
- 1.2 The Investigating Panel considers complaints against the conduct of members, and is empowered to initiate disciplinary action by referring appropriate cases to the Disciplinary Tribunal for adjudication.

- 1.3 Where a complaint is received by the Institute alleging a case of misconduct against a member, such a member shall be requested by the Investigating Panel to furnish his defence or reaction to the complaint within 14 days of the receipt of the request to do so if the member is resident within Lagos State or twenty one days if the member is resident outside Lagos State.
- 1.4 If the member fails to respond within the specified time, a first reminder shall be sent to him requesting him to send his defence/reaction within 7 days from the receipt of the reminder. If the member fails to respond again, a second reminder shall be sent to him requesting him to send his defence/reaction within seven days ultimatum within which to reply and a warning that non-response shall amount to contempt of the Institute and is sanctionable by the Disciplinary Tribunal.
- 1.5 If the member fails to respond after the second reminder, a formal charge of contempt shall be preferred against the member before the Disciplinary Tribunal.
- 1.6 The provisions and/or procedures contained in paragraphs 1.4 and 1.5 above shall apply to any other requirement or directive of the Panel to a member so much so that failure or neglect by the member to abide by the requirement or directive shall also be treated as contempt of the Institute and could be sanctioned by the Disciplinary Tribunal.
- 1.7 If having considered the facts before it, and any representation made by the member, the Panel is of the opinion that in all the circumstances those facts amount to misconduct and is of the further opinion that disciplinary proceedings should be brought, it will prefer a formal complaint to the Disciplinary Tribunal. Alternatively, the Panel, if it considers that the case does not call for the most serious sanctions, may make certain orders against him.

In cases which give rise to or include questions of public concern, the Panel may alternatively refer the matter to the Disciplinary Tribunal.
- 1.8 It is the Disciplinary Tribunal which, alone, can determine, subject to the right of appeal referred to below, whether a complaint of misconduct is proved.
- 1.9 Where a complaint is against the conduct of a firm having more than one partner, the complaint shall be deemed to have been made against each and every member who was a partner in the said firm at the material time, for the purposes of this statement.
- 1.10 From the Accountants' Disciplinary Tribunal, a member has a right of appeal to the Court of Appeal (See Section 12(5) of the ICAN Act).

Any failure to follow the guidance in the Fundamental Principles or in the Statements may also be taken into account by the Committee of the Institute responsible for regulating the work of members and member firms (ICAN, 1999, pp.79-80)".

The Accountants' Disciplinary Tribunal has powers equivalent to those of a High Court and that is why any appeal against its verdict goes to the Court of Appeal, and thereafter to the Supreme Court. Consequently, the normal rules of evidence are applicable; all complaints should be in writing while any accusation against any member should be substantiated with documentary evidence.

Sanctions which are commonly imposed by the Institute for misconduct include the following:

- (a) Reprimand;
- (b) Payment of costs;
- (c) Fine;
- (d) Withdrawal of practising rights;
- (e) Suspension from membership for a period of time; and
- (f) Expulsion from membership.

The above consequences could be seen as affecting the individual chartered accountant alone. However on a deeper reflection, it will be observed that the profession as well as the entire society would have suffered one form of disadvantage or the other if a single professional accountant has been found guilty of professional misconduct.

Some of the disadvantages to the profession and society are:

- (a) Each time a professional accountant (or any other professional for that matter) is found guilty of misconduct, any type of sanction meted out to him has ripple effects on his immediate family, business and the economy. He might have ended up losing his practising licence or getting his name struck off from the register; this is a loss of income for him. If serious enough, his professional misconduct could have affected the going concern status of his firm.
- (b) A misconduct of a professional that affects the going concern status of his firm affects the various stakeholders in that firm. For example, the creditors may not be able to receive all that is due to them, the partners may lose either all or a substantial part of their capital while the employees as a whole may lose their jobs.
- (c) The economy suffers from this type of scenario, the loss of income to government either on the employees' personal income tax or the partners' income tax (if in partnership).
- (d) Any or all of the above situations will have adverse effect on the particular profession of the affected individual.

5.7 ETHICAL STANDARDS AND PROFESSIONAL RESPONSIBILITIES

The ethical standards as contained in the ICAN Code are in two categories, namely:

- (a) Fundamental Principles; and
- (b) Statements.

5.7.1 Fundamental Principles

These are drawn from the duties owed by all members of the profession, whether in practice or not. They are framed in broad and general terms and constitute basic advice on professional behaviour. These principles stipulate that a member of the Institute should:

- (a) Behave with integrity in all professional and business relationships. Integrity implies not only honesty but fair dealing and truthfulness;
- (b) Strive for objectivity in all professional and business judgements. Objectivity is the state of mind which has regard to all considerations relevant to the task in hand but no other;
- (c) Not accept or perform work which he or she is not competent to undertake unless he/she obtains such advice and assistance as will enable him/her to competently carry out the work;
- (d) Carry out his or her professional work with due skill, care, diligence and expedition and with proper regard for the technical and professional standards expected of him as a member; and
- (e) Conduct himself or herself with courtesy and consideration towards all with whom he comes into contact during the course of performing his work.

5.7.2 Statements

These provide more details on what is expected of members in certain circumstances. They are for the most part in the form of principles followed by discussion and illustrations. Most of the Statements are relevant to members engaged in practice and also, where appropriate, to employees of practising firms but not to other members. The various sections of the Statements and their respective subject matters, showing those to whom they are applicable are shown on Illustration 5.8.

The fundamental principles in the Code have already indicated that the following ethical principles are essential for members:

- (a) Integrity;
- (b) Objectivity;
- (c) Technical or professional competence;
- (d) Due skill, care and diligence; and
- (e) Professional behaviour.

Though, the first two are also mentioned under the Statements, there are other ethical standards which are not specified under the fundamental Principles, but mentioned under the Statements only. These are:

- (a) Independence; and
- (b) Confidentiality.

Statement No. 1 is titled *Integrity, Objectivity and Independence*. Under it, the various explanations of integrity and objectivity already given under the Fundamental Principles are re-presented. However, independence is given prominence as it is merged with objectivity and related to the various functions performed by a professional accountant, that is:

- Section A – Objectivity, Independence and the Audit
- Section B – Objectivity and Independence in financial reporting and similar non-audit roles.
- Section C – Objectivity and Independence in professional roles other than those covered in Sections A and B.

The above are further explained in the table below:

Table 5.1: Analysis of the Statements of Ethical Standards

Number	Subject Matter	Those to Whom Applicable
1	Integrity, Objectivity and Independence Preface — Integrity, Objectivity, Framework etc.	All Members
	Introduction – Safeguarding Objectivity Section A – Objectivity & Independence & the Audit	All Members, Practising Members Affiliates and Employees of Practising Firms
	Section B — Objectivity & independence in financial Reporting & similar Non-Audit Roles	Practising, Members Affiliates and Employee of Practicing firms
	Section C— Objectivity & independence in Professional Roles Other than covered in Sections A & B	Practising Members, Affiliates and Employees of Practising Firms
	Section D – Definitions	All Members
2.	Conflicts of Interest	Practising Members, Affiliates and Employees of Practising Firms
3.	Confidentiality	All Members

Number	Subject Matter	Those to Whom Applicable
4.	Changes in a Professional Appointment	Practising Members, Affiliates and Employees of Practising Firms
5.	Consultancy	Practising Members, Affiliates and Employees of Practising Firms
6.	Associations with Non-Members	Practising Members, Affiliates and Employees of Practising Firms
7.	Fees	Practising Members, Affiliates and Employees of Practising Firms
8.	Obtaining Professional Work	Practising Members, Affiliates and Employees of Practising Firms
9.	Names and Letterheads of Practising Firms	Practising Members, Affiliates and Employees of Practising Firms
10.	Second and Other Opinions	All Members
11.	Members in Business	Members in Business
12.	Enforcement of Ethical Standards	All Members

Each of the ethical principles is discussed below:

5.7.3 Objectivity

An auditor's objectivity must be beyond question when conducting an audit. An auditor must always approach his work with integrity and objectivity. Objectivity is essential for any professional person exercising professional judgement. It is equally important for accountants in business as well as those in public practice. It is the state of mind that has regard to all considerations relevant to the task in hand but no other.

It is sometimes described as "independence of mind" (ICAN). There is no doubt that the need for objectivity is particularly evident in the case of an auditor whose work entails giving a professional opinion that is likely to affect rights between various parties and the decisions they take (ICAN, 1999).

It has become clear that there are sometimes instances of threats to objectivity. These threats may arise in relation to the auditor's own person or in relation to a connected person such as a member of his family or a partner or a person who is close to him for reasons of past or present association, obligation or indebtedness. Threats to objectivity, as articulated in ICAN's *Rules of Professional Conduct for Members* include the following:

- (a) Self-interest threat
- (b) Self-review threat
- (c) Advocacy threat

- (d) Familiarity or trust threat
- (e) Intimidation threat
- (a) **The self-interest threat** is a threat to the auditor's objectivity stemming from a self-interest conflict. This could arise from a direct or indirect interest in the shares of a client or from a fear of losing a client because of the significance of its fee as part of the firm's income.
- (b) **The self-review threat** is the apparent difficulty of maintaining objectivity and conducting what is effectively a self-review if any product or judgement of a previous audit assignment or a non-audit assignment needs to be challenged or re-evaluated in reaching audit conclusions.
- (c) **The advocacy threat** occurs when there is an apparent threat to the auditor's objectivity, if he becomes an advocate for (or against) his client's position in any adversarial proceedings or situations. Whenever the auditor takes a strongly proactive stance on the client's behalf, this may appear to be incompatible with the special objectivity that audit requires.
- (d) **The familiarity or trust threat** is a threat that the auditor may become over-influenced by the personality and qualities of the directors and management, and consequently too sympathetic to their interest. On the other hand, the auditor may become too trusting of management representations so as to be inadequately rigorous in his testing of them because he knows the client and/or the issue too well or for some similar reason.
- (e) **The intimidation threat** is the possibility that the auditor may become intimidated by a dominating personality, or by other pressures, actual or feared, by a director or manager of the client or by some other party.

5.7.4 Independence

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 independent of the entity and its directors. However, it has been observed that it is not always an easy task for the auditor to exercise this independence; there are usually some matters, which may threaten or appear to threaten the independence of an auditor. According to Millichamp (1996), these matters include:

- (a) **Undue dependence on an audit client.** Public perception of independence may be put in jeopardy if the fees from any one client or group of connected clients exceed 15% of gross practice income or 10% in the case of listed or other public interest companies. This general observation needs modifying in the cases

of new practices. ICAN has put this percentage at 25% (ICAN 1998).

- (b) **Family or other personal relationships.** It is desirable to avoid professional relationships where personal relationships exist. Examples of personal relationships include mutual business interests with members of the group comprising the client, the audit firm, officers or employees of the client, partners or members of staff of the audit firm.
- (c) **Beneficial interests in shares and other investments.** In general, partners, their spouses, and minor children should not hold shares in or have other investments in client companies. An audit staff member should not be employed on an audit if the staff member or some person connected with him has a beneficial interest in the audit client. Some company articles require the auditor to have a qualifying shareholding. In such cases the minimum only should be held and the holding should be disclosed in the accounts.
- (d) **Loans to and from clients.** An auditing practice or anyone closely connected with it should not make loans to its clients nor receive loans from clients. The same applies to guarantees. Overdue fees may in some circumstances constitute a loan.
- (e) **Acceptance of goods and services.** Goods and services should not be accepted by a practice or by anyone closely connected with it unless the value of any benefit is modest. Acceptance of undue hospitality poses a similar threat. A bottle of Scotch at Christmas is acceptable but a weekend in Cape Town or Obudu Cattle Ranch would probably not be.
- (f) **Actual or threatened litigation.** Litigation or threatened litigation, for example, on auditor's negligence between a client company and an audit firm would mean the parties being placed in an adversarial situation which clearly undermines the auditor's objectivity.
- (g) **Influences outside the practice.** There is a risk of loss of objectivity due to pressure from associated practices, bankers, solicitors, government or those introducing business.
- (h) **Provision of other services.** This is acceptable in principle but care has to be taken.
- (i) **Receipt of reward from a third party other than the client.** Auditors should not allow their judgement to be swayed by the receipt of a commission, fee or other reward from the third party as a result of advising a client to pursue one course rather than another. If a commission is to be received the accountant should

either give it to the client or, with the client's express or implied consent, retain it. If it is to be retained then the fact of a payment of commission, and the amount or how it is to be calculated, should be disclosed to the client, preferably in the letter of engagement. The client should consent to retention.

Audit firms should review on an annual basis every client to determine if it is proper to accept or continue an audit engagement bearing in mind actual or apparent threats to both audit objectivity and independence. The *Rules of Professional Conduct for Members* of ICAN should always be followed.

5.7.5 Safeguards to Independence

There are various safeguards available to offset the different types of threats enumerated above. Auditors should always consider the use of safeguards and procedures, which may negate or reduce threats. They should be prepared to demonstrate that in relation to each identified threat; they have considered the availability and effectiveness of the safeguards and procedures and are satisfied that their objectivity in carrying out the assignment will be properly preserved.

(a) Safeguards and Procedures in individual firms

The safeguards and procedures might include the environment of the practice firm within which the professionals operate so as to offset any threat to objectivity. Though it is not possible to provide an exhaustive list of these factors, but auditors should expect where possible to have developed the following characteristics in their firms.

Where they have been developed, they will provide the necessary safeguards

- (i) Chartered accountants are taught from the onset of their training contracts to behave with integrity in all their professional and business relationships and to strive for objectivity in all professional and business judgement. These factors rank highly in the qualities that the chartered accountants have to demonstrate prior to admission.
- (ii) Engagement partners should have sufficient regard for their own career and reputation to be encouraged towards objectivity and to effective use of safeguards.
- (iii) Within every firm, there, should be strong peer pressure towards integrity. Reliance on one another's integrity should be the essential force, which permits partners to entrust their public reputation and personal liability to each other.

- (iv) Firms should set great store by their reputation for impartiality and objectivity. It is the foundation for their ability to practise and to gain work over the medium and long term, and they should not permit a member of the firm to risk it for short-term benefit or gain.
 - (v) Firms of all sizes should have established strong internal procedures and controls over the work of individual principals, so that difficult and sensitive judgements are reinforced by the collective views of other principals, thereby also reducing the possibility of litigation.
- (b) **Safeguards and Sanctions Built Into the Structure of The Profession Itself**

These might include:

- (i) The longstanding code of ethics of the profession, of which the ***“Rules of Professional Conduct for Members”*** forms part. Where appropriate, these rules impose specific prohibitions where the threat to the auditor’s objectivity is so significant, or generally perceived to be so, that no other appropriate safeguards would be effective.
- (ii) The ethical support provided by the Institute.
- (iii) The reinforcement given to the above safeguards by a policing system which reacts to complaints, whether by members of the public or members of the profession, investigates the background to the complaints, and where necessary commences disciplinary proceedings against an offending member. Together with monitoring, the system ensures that a firm’s past conduct and current procedures are likely to come under close scrutiny if the conduct of practising members gives rise to challenge over their exercise of these guidelines.
- (iv) The active monitoring procedures conducted by the profession for activities such as auditing. On behalf of the Institute, the Professional Practice Monitoring Committee may visit firms which conduct audits and examine firms’ compliance with auditing guidelines and standards.

5.7.6 Confidentiality

Statement No. 3 of the ICAN’s Rules of Professional Conduct for Members is on confidentiality and it is applicable to all members. It gives guidance on how members should handle confidential information. Information that is confidential to a client or employer and acquired in the course of professional work should not be disclosed by a member except where consent has been obtained from the client, employer or other proper

source, or where there is a legal right or duty to disclose. In the latter case, the client or employer should first be notified before disclosure is made.

It is possible for a member to be in doubt as to whether he/she has a right or duty to disclose information. Under such a circumstance, he/she should take legal advice or consult the Institute for advice. A member who has acquired or received confidential information in the course of his/her professional work should neither use nor appear to use that information for his/her personal advantage or for the advantage of a third party.

A member should not deal in the shares of a company with which he has a professional association at such a time or in such a manner as might make it seem that he was turning to his advantage information obtained by him in his professional capacity.

Most importantly, it should be noted that it may be a criminal offence in certain circumstances to use confidential information for an improper purpose.

5.7.7 Consultancy

Statement No. 5 of the ICAN's Rules of Professional Conduct for members is on consultancy, but it is applicable to practicing members, affiliates, and where applicable, employees of practicing firms. It states that if a member in practice, that is, the practitioner obtains the advice of another member (in this case the consultant on a consultancy basis on behalf of a client, the consultant or any practicing firm with which he or his consultancy organisation is associated should not, without the consent of the practitioner, accept from that client within one year of completion of the consultancy assignment any work which was, at the time the consultant was first retained in relation to that client's affairs, being carried out by the practitioner.

The same considerations apply where a practitioner introduces one of his clients to the consultant for the purpose of consultancy.

5.7.8 Other Professional Responsibilities

There are laid down ethical standards covering the following professional responsibilities:

- (a) Obtaining (or securing) professional work is covered in Statement No. 8 of the ICAN Code, which is applicable to practising members, affiliates, and where applicable, employees of practising firms.

A chartered accountant is guided in the way he handles various methods of obtaining professional work such as seeking publicity through advertising his or her services, achievements and

products. Advertisements should be legal, decent, clear, honest, and truthful. Promotional materials should not make disparaging references to or disparaging comparisons with the services of others. There shall be no harassment of a prospective client, no cold calling, that is, unsolicited contact through phone or personal visit) of a non-client with a view to obtaining professional work from him. Any of these would constitute misconduct.

Even when trying to obtain non-audit work, for example, insolvency assignments or appointment as receivers and liquidators, members of the Institute should exercise due care. For instance appointment of a partner of a firm as receiver or liquidator should not be accepted if at any time within the preceding two years, the following situation subsisted:

- (i) A member firm acted as auditor to the insolvent company.
- (ii) A partner or employee of a member firm has been a director of the insolvent company.
- (iii) A partner has been Receiver of any asset or undertaking of the company (in the case of liquidator).

If the liquidation is a members' voluntary winding up, there will normally be no objection to a partner in the firm acting as a liquidator.

- (b) Disciplinary procedures are covered in Statement No. 12 of the ICAN Code entitled *Enforcement of Ethical Standards*.
- (c) Compliance with standards and professional development is covered under Statement No. 11 of the ICAN Code captioned *Members in Business*.

This is to assure chartered accountants in business that they have an obligation to carry out their professional work with proper regard for the technical and professional standards expected of them as chartered accountants.

The standards include SASs issued by NASB, IASs and IFRSs issued by the IASC, and where applicable and appropriate, the rules and regulations of SEC and the requirements of CAMA. Furthermore, where they are dealing with banks, the requirements of BOFIA (1991), CBN Act (1991) and NDIC Act (1988) and for those working with insurance companies, the requirements of the Insurance Act, 2003 shall be relevant.

An employed member may be faced with a conflict of loyalties in seeking to comply with standards if his employers give contrary directives to him. In any case when an employed member is faced with any ethical problem he may consult the Institute for confidential advice.

Whether the member is solely responsible or not for the preparation and approval of accounting information, he/she should ensure that such information complies with the applicable standards and relevant statutes, rules and regulations. However, if the information does not comply, he/she should ensure that the reasons for non-compliance are stated truthfully, unambiguously and fairly.

- (d) Succession arrangement is properly covered in Statement No. 4 of the ICAN Code captioned *Changes in Professional Appointment*. Some of these are already discussed in Chapter 4. But the emphasis here is on the ethical standards involved.

The incoming auditor or adviser should contact his predecessor for information as to his nomination and appointment. Even if the previous auditor has been a sole practitioner and is now dead, the incoming auditor should try to obtain necessary information as he may need from the latter's alternate (where appropriate), the administrators of the estate or other sources.

If the client does not give his consent for the existing auditor or adviser to discuss the client's affairs with the proposed successor, the existing auditor should report that fact to the prospective auditor or adviser who should not accept nomination/appointment.

The existing auditor or adviser should respond promptly to communication from the prospective auditor or adviser.

When the incoming auditor or adviser asks his predecessor for information as to the client's affairs, lack of which might prejudice the client's interests, such information should be promptly given. There should be no charge for providing such information unless there is a good reason to the contrary such as a significant amount of work having been involved.

Note

When there is no existing auditor or adviser the procedures of succession and the laid down ethical considerations apply equally to the previous auditor or adviser.

5.8 RELATIONSHIP WITH FELLOW MEMBERS

There are laid down ethical standards guiding a chartered accountant in the course of performing his professional duties, he has to relate with other members of the Institute. The various situations and circumstances under which a chartered accountant may have to relate to another member of the Institute are as follows:

- (a) Joint engagement either as joint auditors. Joint receivers, etc.

- (b) Fresh nomination/appointment calling for communication with predecessors.
- (c) Special assignment which requires expert or specialist advice on certain issues.
- (d) Need for consultancy services, from other members or member firms.
- (e) Other assurance services, for example, involvement in the audit of a company being in the same group either as associate or subsidiary company to other companies having other auditors.

The following terminologies are used in cases of these relationships and they need to be properly understood:

- (a) **Principal Auditors** — These are the auditors with responsibility for reporting on the audit of financial statements of an entity when those financial statements include financial information of one or more components audited by other auditors.
- (b) **Other Auditors** — These are auditors, other than the principal auditors, with responsibility for reporting on the financial information of a component, which is included in the financial statements audited by the principal auditors. Other auditors include affiliated firms, whether using the same name or not, and correspondent firms, as well as unrelated auditors.
- (c) **Incoming Auditors** — These are the auditors who are auditing and reporting on the current period's financial statements not having audited and reported on those for the preceding period.
- (d) **Predecessor Auditors** — These are the auditors who previously audited and reported on the financial statements of an entity and who have been replaced by the incoming auditors.

5.9 CORPORATE GOVERNANCE

In recent times, the world has witnessed the failure of large corporate organisations which has been attributed to large scale fraud by directors in connivance with auditors. There is the case of Enron in the U.S., Parmalat in Italy and many cases in the U.K. such as Polly Peck, Maxwell Communications and BCCI.

This development brought about once more the debate for corporate governance to be in place which will ensure that companies are well managed by the directors and other management staff to whom shareholders have entrusted this function. Given that in most listed companies, shareholders only have opportunity to find out about the management of the company only at the annual general meetings, which today are often poorly attended. There is, therefore, the need to ensure good corporate governance on the part of the managers of the company as this will not be achieved at annual general meetings.

5.9.1 Definition

Corporate governance is defined as the system by which the affairs of companies are directed and controlled by those charged with the responsibility.

5.9.2 The need for Corporate Governance

The failure of large listed corporate organisations described above brought in its wake the lack of public confidence in audit reports and auditing.

It was believed that directors and other management staff who are entrusted with the day to day running of the business enterprise see accounting standards as a set of rules to be circumvented by putting auditors under increasing commercial pressure such that creative accounting becomes the order of the day. The professional accounting bodies dealt with the financial reporting problems by introducing new standard setting regimes for both financial reporting and auditing. However, the general public expressed concern about the accountability of directors in that:

- (a) No clear framework exists to ensure that directors review internal controls in their companies; and
- (b) Accountability for director's remuneration was perceived to be lacking coupled with its inadequate disclosure.

5.9.3 Corporate Governance Internationally

Internationally, it is organisations such as the UN and the OECD that have been advocating for standards of corporate behaviour. Ministers from all the members of OECD countries, Argentina, Brazil, Chile and Slovakia signed a new international code of conduct dealing with international standards to be followed by multinational companies in combating corruption, safeguarding consumer rights and promoting good labour practices in June 2000 meeting. Responsibility for ensuring that multinational companies operating in or from their home countries abide by the guidelines devolves on each member government.

In the U.K., like Nigeria, corporate governance is dealt with partly in the company's legislation (which specifically requires audit committee) but has generally been developed by independent committees which produced series of reports:

- (a) Cadbury Report
- (b) Greenbury Report
- (c) Hampel Report
- (d) Turnbull Report.

The major reason for setting up the Cadbury Committee was to address the lack of confidence perceived to exist in financial reporting by members of the public and in the ability of auditors to provide the assurances required by users of financial statements.

This stemmed from the relationship between auditors and boards of directors as well as the ability of the board to control their organisations.

The Greenbury committee was set up in the light of continuing public disquiet about the excessive amounts that directors are paying themselves in the face of falling company results and the inadequate disclosure of directors remuneration, among other controversies.

The committee's recommendations which centred more on director's remuneration, were incorporated in the listing requirements of the London Stock Exchange.

It was Hampell committee's report that actually centred on corporate governance and was aimed at restricting the regulatory burden on companies as well as highlighting the positive contribution which corporate governance can make. The London Stock Exchange after considering Hampell Committee's report published the **Combined Code**.

It is generally agreed that in the U.K. and U.S. there is a political will for the improvements in corporate governance backed up with certain amount of statutory authority, but however corporate governance is hinged on self-regulation having been left in the hands of the business world. Shareholders particularly large institutional investors always bring pressure to bear upon companies to improve on corporate governance.

In many European countries there is two-tier board structure consisting of an executive board and a supervisory board, which increases the strength of corporate governance.

5.9.4 Corporate Governance in Nigeria

Good corporate governance has become an acceptable international practice, which every country is embracing.

Realising the need to align with international best practices the Securities and Exchange Commission (SEC) in collaboration with Corporate Affairs Commission (CAC) inaugurated a seventeen (17) member committee in June 2000. It was headed by Mr. Atedo Peterside, OON. The committee was mandated to identify weaknesses in the current corporate governance practises in Nigeria and fashion out necessary changes that would bring about improvements. Membership of the committee was carefully selected to cut across all sectors of the economy including members of professional organisations, the organised private sector and regulatory agencies.

The terms of reference of the committee are to:

- (a) Identify weaknesses in the current corporate governance practices in Nigeria with respect to public companies;

- (b) Examine practices in other jurisdictions with a view to the adoption of international best practices in corporate governance in Nigeria;
- (c) Make recommendations on necessary changes in current practices; and
- (d) Examine any other issue relating to corporate governance in Nigeria.

The committee submitted a draft code of corporate governance on 12th July, 2001 which was published in several newspapers and further reviewed at three locations across the country, namely: Lagos, Abuja and Port Harcourt. Comments and contributions were made from various stakeholders of which a good number of them were accepted and subsequently incorporated in the committee's final report.

The committee's final report which centred on **Code of Best Practice on Corporate Governance in Nigeria** was approved by the Boards of the Securities and Exchange Commission (SEC), being the regulatory authority of the capital market and the Corporate Affairs Commission, being the regulatory authority of companies in Nigeria. The main target of the code is the Board of directors as leaders of corporate organisations as well as the responsibilities of other stakeholders, including shareholders and professional bodies.

5.9.5 Codes Of Best Practices On Corporate Governance

The code is divided into three parts:

- (a) Board of Directors
- (b) Shareholders
- (c) Audit Committee.

(a) **Board of Directors**

This is further divided into the following sub-sections:

Responsibilities of The Board of Directors

- (i) The board of directors should be in control of the affairs of the company in lawful and efficient manner, such that the company continuously improve on its value creation.
- (ii) The board should with due regard to the other stakeholder's interest, ensure that the value created is shared among the shareholders and employees.
- (iii) The functions of the board should include but not limited to the following:
 - ◆ Strategic planning;
 - ◆ Selection, performance appraisal and compensation of senior executives;
 - ◆ Succession planning ;
 - ◆ Communication with shareholders;

- ◆ Ensuring the integrity of financial controls and reports; and
 - ◆ Ensuring that ethical standards are maintained and that the company complies with the laws of Nigeria.
- (b) The chairman's primary responsibility is to ensure effective operation of the board and he should as far as possible maintain a distance from the day to day running of the company which should be the primary responsibility of the chief executive officer and management team.

Composition of The Board of Directors

- (a) The board should be composed in such a way as to ensure diversity of experience without compromising compatibility, integrity, availability and independence.
- (b) Membership of the board should possess the following attributes:
- (i) Upright personal characteristics;
 - (ii) Relevant core competencies;
 - (iii) Knowledge on board matters;
 - (iv) Entrepreneurial bias; and
 - (v) Sense of accountability, integrity, commitment to the task of corporate and institutional building.
- (c) The position of the chairman and chief executive officer should ideally be separated and held by different persons.
- (d) There should be a strong non-executive independent director as vice-chairman of the board where the position of the chairman and chief executive officer are combined in one individual.

Board of Directors

- (a) The board should meet regularly, at least once in a quarter, with sufficient notices and a formal schedule of matters specifically reserved for its decision, in order to maintain effective control over the company and monitor the executive and management;
- (b) An agreed procedure should exist for directors to take independent professional advice which the cost should be borne by the company in the furtherance of their duty, if necessary;
- (c) The advice and services of the company secretary who should be appointed by the board and is responsible for ensuring that the procedures are followed and that applicable rules and regulations are complied with, should be accessible to all directors. His removal should be decided by the board; and

- (d) The advice and services of other professionals in areas where such advice will improve the quality of contribution of the directors to the overall decision making process should also be accessible to all directors.

Non-Executive Directors

- (a) Non-executive directors should bring independent judgement to bear on issues such as integrity, performance, resources including key appointments and standard of conduct;
- (b) Shareholders' approval is required where directors' service contract is to exceed three years;
- (c) Other than their fees and allowances, non-executive directors should not be dependent on the company for their income. They should be independent and not be involved in business relationship with the company that could fetter or encumber their independent judgement;
- (d) They should neither participate in the company's share option scheme nor be pensionable by the company;
- (e) Appointment as non-executive director should be for a specified period and re-appointment should be dependent on performance;
- (f) It should be a matter for the entire board to decide the appointment of non-executive directors, which should be done through a defined formal selection process;
- (g) Skills mix of non-executive directors should reflect the range of the competency needs of the company; and
- (h) Proper company and board orientation should be undertaken by newly appointed directors and where necessary formal training aimed at making them effective in the discharge of their duties should be given at the company's cost.

Executive Directors

- (a) There should be full and clear disclosure of directors' total emolument and those of the chairman and highest paid director including pension contributions, stock options, where the earnings are in excess of 500,000; and
- (b) In the determination of their remuneration, executive directors should not play an active role.

Compensation of Board Members

- (a) The remuneration of executive directors should not be fixed at shareholders' meeting, but by the board;
- (b) The remuneration should be recommended by remuneration committees, wholly or mainly composed of non-executive/independent directors and chaired by non-executive director;

- (c) The following should be disclosed in relation to directors' remuneration:
 - (i) Directors' emolument and that of the chairman and highest paid director;
 - (ii) Relevant information about stock options and any pension contribution; and
 - (iii) Future service contract.

Reporting and Control

- (a) It is the duty of the board to present a balanced, reasonable and transparent assessment of the company's position;
- (b) In financial and non financial reporting, there is an overriding need to promote transparency;
- (c) It is the primary responsibility of the board to ensure good internal controls;
- (d) The board should ensure that an objective and professional relationship is maintained with the external auditors;
- (e) External auditors should not be involved in business relationships with the company;
- (f) An audit committee of at least three non-executive directors with written terms of reference which deal clearly with its authority and duties should be established by the board;
- (g) A report on the effectiveness of the company's system of internal control should be presented by the directors in the annual report; and
- (h) In compliance with the Companies and Allied Matters Act, the directors should report that the business is a going concern, with supporting assumptions or qualifications as necessary, with written terms of reference.

(b) SHAREHOLDERS

Shareholders' Right And Privileges

- (a) The company through the directors, should ensure that shareholders' statutory and general rights are protected at all times;
- (b) It should be the responsibility of shareholders to elect directors and approve the terms and conditions of their directorships;
- (c) The venue of the annual general meeting should be carefully chosen such that the majority of shareholders can attend and vote and not be disenfranchised in terms of distance and cost;
- (d) Before the annual general meeting, notices should be sent at least 21 working days with such details as annual reports,

- audited financial statements and other information that will enable them vote properly on any issue;
- (e) A separate resolution should be proposed by the board at the general meeting on each substantial issue in such a way that they can be voted for in an organised manner;
 - (f) The board should ensure that decisions reached at the general meetings are implemented;
 - (g) There should be at least one director on the board to represent minority shareholders;
 - (h) Unless they are in a competing business or have conflicts of interest that warrant their exclusion, shareholders holding more than 20% of the total issued share capital of the company should have a representative on the board;
 - (i) The board should ensure equal treatment of all shareholders such that none is given preferential treatment or superior access to information or other materials; and
 - (j) The annual general meeting should be used by the board to communicate with the shareholders and encourage their participation.

Institutional Investors

- (a) Shareholders' activism whether by institutional or by organised shareholders' group should not be discouraged by the board.
- (b) Institutional and non-institutional shareholders with larger holdings should act and influence the standard of corporate governance positively, thereby ensuring the optimisation of stakeholders' value.
- (c) Information made available to institutional shareholders should also be made available to other shareholders at the same time in such a manner as to ensure that neither group enjoys preferential treatment.

(c) AUDIT COMMITTEE

Audit Committees

- (a) Audit committees should be established by companies with the key objective of raising standard of corporate governance;
- (b) The committee should not be under the influence of any dominant personality on the main board, neither should they get in the way and obstruct executive management;
- (c) They should not act as a barrier between external auditors and the executive directors or encourage the main board to abdicate its responsibilities in reviewing and approving the financial statements; and

- (d) Audit committees should be made up of strong and independent persons.

Composition of the Audit Committee

- (a) Audit committee should be established in accordance with CAMA Section 359 (3), with not more than one executive director;
- (b) A majority of the non-executives serving on the committee should be independent of the company in terms of management or business or other relationship, which could materially interfere with the exercise of their independent judgement as committee members;
- (c) A non-executive director nominated by members of the audit committee should be the chairman of the committee;
- (d) Membership of the audit committee should be for a fixed tenure; however, any member of the committee should be eligible for re-election after his tenure; and
- (e) The secretary of the audit committee should be the company secretary, auditor or such other person nominated by the committee.

Qualification and Experience of Members of Audit Committee

- (a) Members of the audit committee should be capable of reading and understanding basic financial statements and make valuable contributions to the committee's deliberation;
- (b) Audit committee should review not only external auditor's reports but also most importantly the report of the internal auditor;
- (c) Members of the committee should possess the following qualities:
 - (i) Integrity;
 - (ii) Dedication;
 - (iii) Thorough understanding of the business, its products and services;
 - (iv) Reasonable knowledge of the risks facing the company and the essential controls which the company has in place;
 - (v) Inquisitiveness and dependable judgement; and
 - (vi) Ability to offer new or different perspective and constructive suggestions.

Terms of Reference for Audit Committee

- (a) In line with Section 359 (6) (a-e) of the Companies and Allied Matters Act, 2004, the committee should be given terms of reference;

- (b) The performance of the committee and its members should be evaluated periodically and the form of such assessment should be decided by the company; and
- (c) The committee should maintain a constructive dialogue between the external auditors and the board and enhance the credibility of the financial disclosures and the interest of the shareholders.

Meetings

- (a) The number of members of the audit committee would determine the quorum for the meetings and it should be specified in the terms of reference of the committee.
- (b) The committee should meet at least three (3) times in a year.
- (c) The committee should hold a meeting with the external auditors at least once a year without the presence of any executive member.

Enforcement And Compliance

As can be seen from 5.9.3, enforcement of corporate governance is more of self regulatory effort than statutory backing in the U.K, U.SA and internationally, as large institutional investors bring pressure to bear upon companies to improve on corporate governance. It has generally been argued that in this issue voluntary compliance should be encouraged and where it becomes necessary and applicable, appropriate sanctions should be applied. This is the position adopted by the Securities and Exchange Commission (SEC), and Corporate Affairs Commission (CAC) in the enforcement of compliance with corporate governance code of best practice in Nigeria.

Specifically SEC and CAC will give due consideration to the compliance or otherwise of the provisions of the code in the treatment of issues brought before them.

5.10 SUMMARY AND CONCLUSIONS

The chapter critically examined the nature of ethics; concepts of integrity, obligation, independence and public expectations; ethics and the professions; and ethics and the law. It further reviewed ethics vis-a-vis the professional accountant; consequences of unethical behaviour; ethical standards and professional responsibilities of the chartered accountant as well as his/her relationship with fellow members.

Refer to Comprehensive Questions and Suggested Solutions in Appendix II, page 303.

5.11 REVISION QUESTIONS

1. In order to tackle the problem of ethical requirements, ICAN has issued for its members
 - (A) A Code of Conduct
 - (B) A Code of Practice
 - (C) A Code of Ethics
 - (D) A Code of Principles
 - (E) A Code of Management.

2. The ethical principles which govern auditors' responsibilities do not include the following
 - (A) Integrity
 - (B) Consistency
 - (C) Objectivity
 - (D) Independence
 - (E) Professional Competence.

3. CAMA provides that an officer of a company commits an offence if he knowingly or recklessly makes to a company's auditors a statement (whether written or oral) which is
 - (A) misleading, false or deceptive in a material particular.
 - (B) compliant with the Statements of Accounting Standards.
 - (C) in accordance with the underlying accounting records.
 - (D) an extract of the minutes of the Management Meeting.
 - (E) an extract of the minutes of the Board Meeting.

4. One of the functions of the Investigating Panel of ICAN is to
 - (A) Monitor the various committee meetings.
 - (B) Consider disciplinary actions of the Institute's staff.
 - (C) Consider complaints against the conduct of members.
 - (D) Determine whether a member's complaint of misconduct is proved.
 - (E) Monitor the Institute's Council meetings.

5. The following is one of the sanctions commonly imposed by ICAN for misconduct
 - (A) Suspension from membership for a period of time
 - (B) Prevention from being elevated to fellowship status
 - (C) Suspension from attending the Institute's Annual Conference
 - (D) Suspension from serving as a committee member
 - (E) Prevention from sponsoring graduate members for the Institute's membership.

6. The fundamental principle under the ethical standards contained in the ICAN Code of Conduct stipulates that a member of the Institute should do the following except
 - (A) Strive for objectivity in all professional and business judgements.
 - (B) Accept or perform work which he or she is not competent to undertake.
 - (C) Behave with integrity in all professional and business relationships.
 - (D) Carry out his or her professional work due skill, care, diligence and expedition.
 - (E) Conduct himself with courtesy and consideration towards all he relates to in the course of performing his work.

7. Threats to objectivity do not include the following
 - (A) Advocacy threat
 - (B) Self-interest threat

- (C) Intimidation threat
 - (D) Self-regulatory threat
 - (E) Familiarity threat
8. The need for corporate governance arose because
- (A) There was failure of large listed corporate organisations
 - (B) Audit firms were no more carrying out audit of large corporate organisations
 - (C) Financial Accounting Standards were no more addressing adequately complex financial transactions
 - (D) Directors and management of companies were circumventing accounting standards by putting auditors under increasing commercial pressure
 - (E) None of the above.
- (9) Which of the following is not true for Non-Executive directors according to the code of Best Practice
- (A) The range of the competency needs of the company should reflect the skills mix of non-executive directors
 - (B) The entire board should decide the appointed of non-executive directors
 - (C) Non-executive directors bring independent judgement to bear on issues such as strategy, performance, standard of conducts and key appointments.
 - (D) Non-executive directors should not participate in the company's share option but should be pensionable
 - (E) None of the above.
10. According to the Code of Ethics issued by the International Federation of Accountants (IFAC), independence requires both independence of ————— and independence in ————.
11. Professional ————— regulate the way and manner each member is to relate to other members on the one hand and to the society on the other, both from a moral perspective.
12. The ethical standards as contained in the ICAN Code of Conduct are in two main categories. State the two categories.
13. The auditors with responsibility for reporting on the audit of financial statements of an entity when those financial statements include financial information of one or more components audited by other auditors are known as —————.
14. is the chairman of the Committee on corporate governance.
15. Is corporate governance dealt with under the Companies and Allied Matters Act, 1990? If Yes, what is the relevant Section, if No. justify.
16. What is the major reason why SEC and CAC inaugurated the Corporate Governance Committee?
17. Define Corporate Governance.
18. List any two of the terms of reference of the corporate governance committee.
19. Code of Best Practice issued the committee on corporate governance specified the functions of the board of directors. List any two.

20. Who, according to the code of best practice, should be the chairman of the audit committee.
21. List two functions of the audit committee as stipulated in Section 359 of CAMA.

Refer to Suggested Solutions to Revision Questions in Appendix I, page 297.

LOCAL AND INTERNATIONAL LEGISLATIONS AFFECTING AUDITS

6.0 LEARNING OBJECTIVES

After studying this chapter, readers are expected to have a good understanding of the provisions of the legislations of the following institutions and their functions:

- ◆ Economic and Financial Crimes Commission (EFCC).
- ◆ Independent Corrupt Practices Commission (ICPC).
- ◆ Sarbanes Oxley Act (SOx).
- ◆ Background of SOx.
- ◆ General Provisions of the various Acts.
- ◆ Audit and Internal Control in Relation to SOx.
- ◆ Effects of SOx on Corporate Governance.
- ◆ Duties of the Internal Auditor Under SOx.
- ◆ Composition and Duties of the Audit Committee Under SOx.

6.1 THE INDEPENDENT CORRUPT PRACTICES AND OTHER RELATED OFFENCES COMMISSION (ICPC)

In view of the determination of the Federal Government to fight corruption from all angles and eliminate it from both the private and public sectors, the Corrupt Practices and Other Related Offences Act, 2000 (Anti-Corruption Act) was enacted and the Independent Corrupt Practices and Other Related Offences Commission (ICPC) was established.

The duties of the ICPC, as stipulated in Section 3 of the Anti-Corruption Act are to:

- (a) Receive and investigate any report and prosecute any person where reasonable grounds exist for suspecting that the person has conspired to commit or has attempted to commit or has committed an offence amounting to corruption;
- (b) Examine the practices, systems and procedures of public bodies and where, in the opinion of the Commission, such practices, systems or procedures facilitate fraud or corruption, to direct and supervise a review of such systems;

- (c) Instruct, advise and assist any officer, agency or parastatals on ways by which fraud or corruption may be eliminated or minimised;
- (d) Advise head of public bodies of any change in practice, system and procedures compatible with the effective discharge of their duties as the Commission deems fit to reduce the likelihood or incidence of bribery, corruption and other related offences;
- (e) Educate the public on bribery, corruption and other related offences; and
- (f) Enlist and foster public support in combating corruption.

The Anti-Corruption Act has a comprehensive list of offences, which are punishable by imprisonment, fines, and penalties. The offences are summarised as follows:

- (a) Public officer giving, asking and receiving bribe/gratification;
- (b) Public officer inflating the price of any goods or services above the prevailing market or armslength prices;
- (c) Public officer awarding or signing any contract without budget provision, approval or cash backing;
- (d) Public officer transferring or spending any sum allocated for a particular project or service to another project or service;
- (e) Public officer failing to report bribery transaction (Sections 23, 24);
- (f) Any person who, with the intention of defrauding or concealing a crime or frustrating the Commission in its investigation, destroys, alters, mutilates, falsifies materials from any book, documents, valuable security, account, computer system, diskette, computer printout or other electronic device of his employer (Section 15); and
- (g) Any person, who being an officer charged with the receipt, custody, use or management of any part of the public revenue or property and knowingly furnishes any false statement or return in respect of any money or property received by him (Section 16).

6.2 THE ECONOMIC AND FINANCIAL CRIMES COMMISSION (EFCC)

In 2003, the Federal Government established another anti-corruption agency, the Economic and Financial Crimes Commission (EFCC) followed by the enactment of the EFCC Act in year 2004. The EFCC is charged with the following responsibilities, among others:

- (a) Enforcement and administration of the EFCC Act in the over-all context of preventing, detecting, investigating and prosecuting all cases of economic and financial crimes in Nigeria;
- (b) Enforcement of the provisions of other laws and regulations relating to economic and financial crimes including:
 - (i) Money Laundering Act 1995 (as amended)
 - (ii) Advance Fee Fraud and Other Fraud Related Offences Act 1995
 - (iii) Failed Banks (Recovery of Debts) and Financial Malpractices in Banks Act 1994

- (iv) Banks and Other Financial Institutions Act 1991 (as amended)
- (v) Miscellaneous Offences Act 1985;
- (c) Fighting terrorism and terrorist financing.

Section 46 of the EFCC Act defines economic and financial crimes to mean:

“the non-violent criminal and illicit activity committed with the objective of earning wealth illegally either individually or in a group or organised manner thereby violating existing legislation governing economic activities of Government and its administration and includes any form of fraud, narcotic drug trafficking, money laundering, embezzlement, bribery, looting and any form of corrupt malpractices, illegal arms deal, smuggling, human trafficking and child labour, illegal oil bunkering and illegal mining, tax evasion, foreign exchange malpractice including counterfeiting currency, theft of intellectual property and piracy, open market abuse, dumping of toxic waste and prohibited goods, e.t.c.”.

6.3 SARBANES-OXLEY ACT

6.3.1 Introduction

The Sarbanes-Oxley Act (SOx), the Public Accounting Reform and Investor Protection Act, was passed and became law in August 2002 in the US following the series of accounting and governance scandals involving American public corporations, the most widely published being that of Enron and Worldcom corporations which were audited by Arthur Andersen. It took its short name, Sarbanes-Oxley Act (SOx), from the names of the two principal congressional sponsors. The intention was to regulate corporations that are registered under the Securities and Exchange Commission (SEC). The Public Corporations Accounts Oversight Board (PCAOB), was established to ensure adherence to the provisions of the SOx.

The major provisions of that Act relating to accounting and Audit of these corporations are;

- (a) The establishment of a proper internal control system;
- (b) Management taking responsibility for the truth and fairness of the financial statements;
- (c) At least one member of the audit committee, being a financial expert; and
- (d) Preserving audit working papers for at least seven years.

Other minor provisions of the Act include the requirement for these corporations to establish what is called “whistle blower” programmes. These were to report fraudulent accounting and audit practices anonymously.

Though drafted and approved by the US Congress and designed to apply to corporations registered under the SEC, but by its wording, it has application beyond the US and has now gained world wide recognition. While the SEC established general guidelines for its application, the PCAOB made specific rules for the application of the guidelines.

The PCAOB is a non-profit making corporation in the U.S. which has oversight responsibilities over all corporations that are registered under the SEC regardless of their size and nationality. The PCAOB is not a professional but a regulatory body with responsibility to oversee the external auditing processes of public corporations. It does not have responsibility for the internal audit processes of these corporations. However, because of the requirement for corporate governance to establish a proper system of internal control and to take responsibility for the truth and fairness of the financial statements, the activities of the PCAOB impacts directly on the manner in which the internal auditors coordinate their work with the external auditors as part of the overall corporate governance. The PCAOB makes rules for the application of the provisions of the SOx to specific areas as a basis for compliance with the various Auditing Standards that accompanied the SOx.

6.3.2 Oversight Functions of the PCAOB

The oversight and regulatory functions of the PCAOB include:

- (a) Registering public accounting firms that handle the audit of public corporations: Details required at registration include:
 - ◆ Fees collected from the audit;
 - ◆ Audit programmes and quality standards;
 - ◆ the details of staff who will be performing the audits; and
 - ◆ Any pending criminal, civil or administrative litigations.
- (b) Establishing auditing standards: Most of these standards may not be different from earlier standards issued by the AICPA, but the fact that they are issued by the PCAOB gives a greater weight of law thereby making compliance mandatory;
- (c) Conduct inspections of registered firms: The quality inspections carried out by the PCAOB may not be different from the peer-group review carried out by the big firms, but the fact that it is carried out by an independent body makes it more credible;
- (d) Conduct investigations and disciplinary procedures: These investigations may focus on the firm or on particular individuals within the firm. Unethical behaviour may result in sanctions;
- (e) Performing other standard and quality related functions as the board may decide from time to time: This gives the PCAOB the scope and leverage that it requires in order to ensure that the prescribed audit quality and standards are adhered to; and

- (f) **Enforcing compliance with SOx provisions:** The SOx has various provisions and it is the function of the PCAOB to enforce compliance as it deems fit.

The registration record of firms with the PCAOB is a public document open to inspection by corporations at any time.

6.3.3 Specific Rules Applicable to the Audit of Corporations

Some of the specific rules as contained in the standards set by the PCAOB that are applicable to the audit of corporations are:

- (a) **Audit paper retention:** Audit working papers relating to the audit of corporations must be retained for a period of time not less than seven years. Apparently this derives from the discovery during the Enron hearings that the firm, Arthur Andersen & Co. had destroyed working papers relating to the audit except for the current year.
- (b) **Concurring partner's approval:** This requires that a second partner, either within the same firm or an outside must approve a report before it is issued. Some big firms already have this as part of their hot review procedure, but the difference now is that the concurring partner is also required to sign the report.
- (c) **Scope of internal control testing:** Though it has always been part of normal audit procedure to test the internal control system, but since there is no rule relating to that, the external auditor may adopt the most minimal sample for the test. The scope of such test has now increased since the auditors are required to report on their findings following a complete review of the system of internal control.
- (d) **Evaluation of the internal control structure and procedure:** The PCAOB has established models for the evaluation of the system of internal control which requires that external auditors report on their findings relating to identified weaknesses and all cases of material non-compliance. The COSO (Committee on sponsoring Organisations) model continues to be in use, but the rules-based standards have been replaced by more demanding risk-based standards.
- (e) **Audit quality control standards:** Audit quality standards of the past, were limited to peer-group reviews adopted by big firms. The AICPA is now registered under the ISO 9000 quality standards and firms are required to ensure that they comply with those standards. In practical situations, the external auditors may not meet those standards except with the complementary role of the internal auditor.

The PCAOB has not issued any quality standards of its own but SOx requires that public accounting firms set standards relating to:

- ◆ Monitoring of professional ethics and independence;

- ◆ Procedures for resolving accounting and auditing disputes within the firm;
- ◆ Supervision of audit work;
- ◆ Hiring, professional development, and advancement of personnel;
- ◆ Standards for the acceptance and continuation of engagements;
- ◆ Internal control inspections; and
- ◆ Other quality standards as prescribed by the PCAOB.

6.3.4 Independence of Public Auditors

To ensure the independence of the external auditors, certain provisions have been put in place such as are contained in section 358 of the Companies and Allied Matters Act, in Nigeria. It was assumed that the external auditors were separate and independent resource persons to the corporation. Gradually, corporations started outsourcing the internal audit functions to the external auditors. This was principally on the consideration of lower costs but also because individuals involved in corporate governance preferred to deal with one body in respect of what they considered essentially the same service. With the Enron scandal coming to the open, it was clear that part of the problem was conflict of interest, as Andersen performed both external and internal audit functions to the corporation. SOx, therefore made it illegal for a public accounting firm to provide services both as internal and external auditors. With the separation of functions, other services by public accounting firms to the same corporation as listed below are prohibited:

- (a) Financial information systems design and implementation: Public accounting firms, under SOx rules, are not allowed to design and put in place accounting and financial information system which they are required to evaluate and report upon;
- (b) Bookkeeping and accounting services: It has become illegal for public accounting firms to provide bookkeeping and accounting services to the same corporations where they serve as external auditors;
- (c) Management and human resources functions: Senior audit personnel of the public accounting firms are prohibited from employment in senior accounting positions of the corporations for which they served as external auditors; and
- (d) Other prohibited services: A list of other prohibited services include actuarial, investment advisor, accounting related legal services. This does not include taxation services.

The SOx has a number of other provisions, though they do not have direct impact on the quality of the financial statements nor the auditor's report. Nevertheless, they are part of the requirements designed to bring sanity into the audit processes.

These include the following:

- (a) Audit committee's consent prior to any formal approval of all audit and non-audit services;
- (b) External audit lead partner to be rotated at least every five years; Whereas the firms may have had this as its internal arrangement, SOx now makes it a criminal offence where the rotation does not take place as required;
- (c) External auditors to report to the audit committee: Though this had been a requirement even in Nigeria by the provisions of section 359 of CAMA, the external auditor was required to report to the audit committee all management matters in the auditors' report and their disposal by management. This might not have had a significant impact principally as a result of the composition of the audit committee which may not be technically competent to deal with such matters. In the post Enron era and with the recomposition of the audit committee by the provisions of SOx, the external auditor is required to report to the audit committee all alternative accounting treatments adopted by management and the auditor's preferred treatment;
- (d) To assure the independence of the audit committee, only non-executive directors may be appointed members. To be regarded as truly independent, the non-executive director members of the audit committee must not accept any consulting or advisory fees from the corporation as well as from any affiliated subsidiary or associated company; and
- (e) The SOx requires that at least one member of the audit committee should be a financial expert in order to ensure that the committee has the expertise to understand the financial statements they are being asked to review.

Financial Experts

Financial expert is defined in the act as a person who through education or experience has:

- ◆ Understanding of financial statements and the Generally Accepted Accounting Principles (GAAP);
- ◆ Experience in applying such GAAP in connection with accounting as relates to the financial statements of the enterprise;
- ◆ Experience in preparing or auditing financial statements that present accounting issues;
- ◆ Experience with internal control procedures for financial reporting; and
- ◆ Understanding of audit committee functions.

6.3.5 Corporate Responsibility for Financial Reports

Though directors had always been required to sign the financial reports of the entity, the signatures had been a matter of fact without substance or personal responsibility. With SOx, the principal financial officers are

required to certify the quarterly and annual reports and accounts filed, and accept the responsibility for their truth and fairness. By this, the signatories opine that:

- (a) they had reviewed the report;
- (b) based on their knowledge, the financial statements do not contain any materially untrue or misleading information;
- (c) based on their knowledge, the financial statements fairly represent the financial conditions and results of operations of the enterprise;
- (d) the directors take responsibility for:
 - ◆ Establishing and maintaining internal control;
 - ◆ Having designed the internal control to ensure that material information about the enterprise and its subsidiaries was made known to the directors during the period when the report was prepared;
 - ◆ Having evaluated the enterprise's internal control within 90 days prior to the release of the report;
 - ◆ Having presented in the financial statements, the directors' evaluation of the effectiveness of the system of internal control as of the date of the report;
- (e) The signing officers had presented to the auditors, audit committee and other directors:
 - ◆ all significant deficiencies in the design and operation of internal controls that could affect the reliability of the reported financial data and has, further, disclosed these material control weaknesses to the auditors
 - ◆ any fraud whether or not material, that involves management or other employees who have significant role in the enterprise's internal control; and
- (f) The signing officers have indicated in the report whether there were material controls or other changes that could significantly impact those controls, including corrective actions, subsequent to the date of the internal control evaluation.

6.3.6 Improper Influence Over the Conduct of Audits

It is possible that management may have genuine disagreement with the auditors. In such situations, the auditor is expected to report same to the audit committee, making clear his preferred position. There are other circumstances where the directors may try to influence the auditors unduly; hence making them accept their position. Some CEOs are rather too powerful, such that the auditor may accept some questionable accounting treatment proposed or adopted by the directors. With SOx, it is now unlawful for any officer or director to take any actions calculated to fraudulently influence, coerce, manipulate or in any way mislead the auditor for the purpose of rendering the financial statements materially misleading. Though, this has always been in Section 368 of CAMA, it

has had little force in application. With clear provision in the SOx, the external auditor clearly understands the risk of giving in to management opinion.

6.3.7 Forfeiture and Penalties Aimed at Corporate Governance

SOx prescribes various penalties and fines directed at individuals who are in charge of corporate governance. These are designed to enhance the level of compliance with existing rules or introduce new ones to forestall some outrageous behaviour by corporate entity.

These include:

- (a) If an enterprise is required by SEC to re-state its earnings owing to material violation of the securities laws, the CEO and CFO will be required to reimburse any bonuses or incentives received on the basis of the original earnings.
- (b) Where someone demonstrates by conduct any unfitness to serve as director, the court is empowered to bar such person acting as director or officer of a corporation.
- (c) Where there are indications of distress in a corporation, SOx prescribes a period of fund black out for officers and directors of the corporation. This is based on the fact that officers and directors with inside knowledge may dispose of their stocks in the corporation prior to the final collapse of the entity as was the case in Enron.
- (d) Professional attorneys, who owing to their privileged position have knowledge of material violation of the securities law, are required to take steps to report such violations to the CEOs for such matters to be put right. Failure to take appropriate steps by the CEO will make the attorney take the matter to the audit committee. The attorney is not however required to take this matter any further owing to the privileged attorney-client relationship.
- (e) Where investors have suffered loss as a result of fraud or improper accounting, and recoveries are made from the fraudulent parties either as a result of administrative or legal action, such recoveries should be paid as financial settlement to the parties who suffered the loss. This is what is referred to as “disgorgement” fund for investors who have suffered loss.

6.4 THE AUDITOR AND THE RISK OF FRAUD

Prior to accounting scandals, the role of the auditor in relation to fraud may at best be described as ambiguous. It was possible for the auditor to wriggle out of liability for failure to uncover cases of fraud which exist in published financial statements. That was on the basis that no provisions existed in the law that specifically placed the burden of detection of fraud on the auditor. Furthermore, sections 331 and 334 of CAMA specifically make it the responsibility of directors

to keep proper records and prepare from these records financial statements that show a true and fair view to the members at the AGM.

This position is fast changing as the auditor may not easily get away with the failure to uncover fraud which results in material mis-statements in the financial statements. In the US, apart from the fact that the Statement of Auditing Standards (SAS) 99 requires external auditors to actively perform procedures to detect and correct financial statement fraud, the PCAOB has now issued a new set of rules. Auditing Standards 5 (AS5) specifically directs external auditors to be conscious of the possibility of fraud in the course of their work.

Right from the planning stage through the actual performance of the assignment, the auditor is required to perform entity level fraud risk control assessment. This will include an evaluation whether the enterprise's controls are sufficient to address the identified risks of material mis-statements due to fraud as well as controls intended to address the risks of management override of the controls. Specifically, the evaluation should address the following controls:

- (i) controls over significant, unusual transactions and particularly those that result in late or unusual journal entries;
- (ii) controls over journal entries and adjustments made in the period-end financial reporting process;
- (iii) controls over related party transactions;
- (iv) controls relating to management's significant estimates; and
- (v) controls that mitigate incentives for, and pressures on management to falsify or inappropriately manage financial results.

The Nigerian Standards on Auditing (NSA) 5 urges the auditor to obtain reasonable assurance that the financial statements taken as a whole are free from material mis-statements, whether caused by fraud or error. The statement recognises that it may not be possible for the auditor to obtain absolute assurance that material mis-statements in the financial statements will be detected because of the inherent limitation of internal control and because much of the evidence available to the auditor is persuasive rather than conclusive. It therefore directs the auditor to:

- (i) maintain an attitude of professional skepticism throughout the audit;
- (ii) consider the potential for management override of controls; and
- (iii) recognise the fact that audit procedures designed to detect errors may not be effective in the context of an identified risk of material mis-statement due to fraud.

6.5 SUMMARY AND CONCLUSIONS

We have in this chapter discussed the efforts of the Federal Government to fight corruption in the public and private sectors of the economy. In that crusade, a look has been taken at the two anti-crime agencies of the Government, Economic and Financial Crimes Commission and the Independent Corrupt Practices Commission, exploring the activities of the two bodies to date. Following the

many established cases of accounting scandals, the Sarbanes Oxley Act was passed into law in the United States. Owing to its far-reaching effects, it has been adopted internationally and become operational in many parts of the world, including Nigeria.

The law focuses attention on internal control as a framework for ensuring the reliability of published financial statements. The law makes greater demands on the auditor who in consequence should be conscious of the risk to which he is exposed for failure to detect fraud or errors in financial statements. Company directors now take personal responsibility for the truth and fairness of the financial statements as any acts of impropriety or lack of care may attract heavy sanctions. Internal auditors now have wider recognition and responsibilities under SOx.

Refer to Comprehensive Questions and Suggested Solutions in Appendix II, page 303.

6.6 REVISION QUESTIONS

6.6.1 Multiple Choice Questions

1. ICPC in Nigeria is called
 - (A) International Criminal Prosecution Committee
 - (B) Independent Criminal Prosecution Committee
 - (C) Information Committee Public Control
 - (D) Independent, Corrupt Practices and Other Related Offences Commission
 - (E) Intergovernmental Corrupt Practices Committee

2. One of the function of ICPC is to
 - (A) Receive petition to probe Government Officials
 - (B) Prosecute both Foreign and Nigerian individuals for money embezzled offshore
 - (C) To educate the public on bribery, corruption and other related offences
 - (D) Enlist foreign countries to support war against indiscipline
 - (E) Confiscate properties of erring individuals.

3. One of the Economic and Financial Crimes Commission (EFCC) function is
 - (A) Implement the ICPC Act
 - (B) Investigate members of Public Company's Audit Committee
 - (C) Help the National Assembly in its anti corruption crusade
 - (D) Investigate any matter that may be referred to it by OMPADEC.

4. One of the major provisions of the Public Accounting Reform and Investor Committee Protection Act is
 - (A) Auditors to take responsibilities for the truth and fairness of the financial statements
 - (B) The establishment of proper Internal Control System
 - (C) Preserving audit working papers with clients
 - (D) One of the audit committee member must be a Government official
 - (E) None of the above.

5. When auditing a financial statement, an auditor is required to perform entity level fraud related risk control assessment in one of the following areas
- (A) Controls over audit committee members
 - (B) Controls over Non-Executive Directors
 - (C) Controls over Due Diligence reports
 - (D) Controls over related party transactions
 - (E) Controls over Bank circularisation.

6.6.2 SHORT ANSWER QUESTIONS

6. The Sarbanes-Oxley Act (SOx) was passed in the U.S. following accounting and governance scandals recorded in _____ and _____ cases.
7. The EFCC is chartered with the enforcement of the provisions of other laws relating to economic and financial crimes in Nigeria. Mention any two of the laws.
8. In the discussion on Corporate Responsibility for Financial Reports, when Annual Reports are signed by Principal Financial Officers, the signatories opined that they had _____ the reports.
9. Mention any two specific rules applicable to the audit of corporations?
10. In Corporate Governance, where someone demonstrates by conduct any unfitness to serve as a director, the court is empowered to bar such person from acting as a director or officer of a corporation. True or False?

Refer to Suggestion Solutions to Revision Questions in Appendix I, page 297.

QUALITY CONTROL IN AUDIT AND ASSURANCE REPORTS

7.0 LEARNING OBJECTIVES

After studying this chapter, readers should be able to understand:

- ◆ The effects of Nigerian Standards on Auditing on the quality of Audit Reports.
- ◆ The International Standards on Auditing (ISA).
- ◆ Statutory Audit Reports.
- ◆ Audit Reviews for Quality Control Purposes.
- ◆ Reports to Management.
- ◆ Report on Assurance Engagements.

7.1 REVIEW OF AUDITS

The practice of auditing poses great challenges to the accounting profession. It is a mirror through which the profession is evaluated by the general public. Audit engagements performed to the satisfaction of the client and the public enhance the standing of the firm while shoddy work brings to disrepute not only the firm concerned but the entire accountancy profession. One aspect of audit procedure that will help guarantee high quality of work is the review process. There may be internal or external reviews. A review may be carried out at various stages of the audit process and by different levels of staff. The overall intention is to ensure that audit work performed at all stages and by different levels of staff meet the required standards of the firm or the accountancy profession at large.

7.2 INTERNAL REVIEW

Internal reviews require that the work performed by one member of staff is subject to thorough scrutiny by a superior audit staff. Hence, this type of review is carried out by various categories of staff in the chain of command concerned with the audit, i.e. supervisors, managers and partners. Audit reviews are usually carried out after the completion of the audit work but before the audit report is signed by the partner.

The review procedure will normally aim at one or more of the following objectives:

- (a) **Internal Control Evaluation**
Audit review relating to internal control evaluation aims at determining whether or not the documentation of evaluation was complete. Such documentation will include the flowcharts, the internal control questionnaire (ICQ) and compliance tests. All identified weaknesses should be studied and necessary explanations obtained from client through a management letter.
- (b) **Audit Programme**
The review of audit programmes will confirm whether all aspects of the work have been completed and the result obtained adequately documented. A review of the audit programmes is applicable to both the compliance and substantive tests.
- (c) **Audit Files**
The review of audit files will confirm whether all necessary information have been obtained and all items in the Balance Sheet and Profit and Loss account verified. It will also reveal whether all necessary working papers have been placed in the appropriate sections of the audit files.
- (d) **Accounts**
A review of the accounts will help confirm that they comply with all statutory requirements, the statements of accounting standards, that appropriate and consistent accounting policies have been adopted and disclosed. This review also confirms that the accounts show a true and fair view.

7.2.1 Level of Internal Reviews

Internal reviews are classified according to the personnel carrying them out. There may therefore be the supervisor's review, the manager's review and the partner's review. These are briefly discussed, thus:

7.2.1.1 Supervisor's Review

The supervisor's review is usually carried out on the completed working papers while the audit is still in progress. The supervisor has to take into consideration each step in the audit programme, queries raised and any other additional information obtained.

This level of review will deal more with audit procedures than principles. Typical examples of audit procedures to which the supervisor is likely to focus attention are whether:

- (a) All relevant documents have been obtained and checked for validity and accuracy;
- (b) All procedures in the key control areas have been observed as they are carried out by the client and his staff, such as stock-count and payment of wages;

- (c) The re-computation of significant figures such as provision for doubtful debts or depreciation charge in the financial statements has been carried out to confirm accuracy;
- (d) The cast on schedules obtained from the client has been checked in order to confirm arithmetical accuracy;
- (e) All important procedures which the client had carried out have been re-performed in order to confirm that they were actually carried out and are correct;
- (f) The confirmation of existing evidence provided by the client has been received from third parties such as for debtors and bank balances;
- (g) The design of working papers are in line with the firm's standards;
- (h) The necessary comparisons of current year's balances with prior year's balances have been carried out in order to ascertain the relevant variances; and
- (i) The appropriate indices have been computed and reported for review by a superior officer.

7.2.1.2 **Manager's Review**

The manager's review will usually be done with the use of a checklist to confirm whether:

- (a) The working papers comply with the firm's audit standards;
- (b) The working papers are suitably indexed and cross-referenced;
- (c) All schedules agree with the figures in the accounts;
- (d) All necessary letters of confirmation have been received;
- (e) The letter of representation covers all applicable points;
- (f) The accounts comply with all statutory requirements and the applicable standards of accountancy practice;
- (g) The accounting policies adopted by the client are appropriate, acceptable and consistent with prior years;
- (h) The audit programmes have been duly completed and all audit queries raised during the work have been acknowledged and appropriate responses received;
- (i) The working papers are suitable and adequate or if additional working papers will be required;
- (j) There are any points that put the auditor on enquiry and have to be further dealt with by the appropriate level of authority; whether there are any key points which could lead to a qualified audit report;
- (k) All applicable indices have been ascertained and the effects clearly interpreted on the working papers;

- (l) The various audit evidences obtained are relevant, reliable and sufficient to support the conclusions reached;
- (m) The verification procedures adopted are adequate in the circumstances or if additional procedures will be required for an effective verification work; and
- (n) All indices have been obtained and their implications made known to the partner.

The manager's review as can be appreciated above, is a combination of procedures and principles.

7.2.1.3 Partner's Review

This is the last stage of audit internal reviews and is carried out just before the accounts are finalized and signed by the partner. The partner's review is likely to be limited to principles, to the exclusion of procedures. He is likely to look out for those matters which put the auditor on enquiry and which have been separated for his attention. He will like to confirm that all queries raised during the manager's review have been satisfactorily cleared and all matters brought forward from the preceding year's audit have been cleared. By the use of checklist, he is likely to confirm that all matters of accounting principles, related to the audit, have been properly dealt with.

Such principles are that:

- (a) Acceptable and consistent accounting principles have been applied;
- (b) Any material departures from the SASs have been appropriately disclosed;
- (c) The presentation and layout of the accounts conform with the firm's standards;
- (d) The letter of representation contains all relevant points;
- (e) All points that put the auditor on enquiry have been brought to his attention;
- (f) The financial statements as they are to be laid before the members show a true and fair view;
- (g) That the audit report is properly worded in line with the opinion expressed; and
- (h) That the accounts have been duly signed by two of the directors.

7.3 EXTERNAL REVIEWS

Apart from internal reviews by the supervisor, manager and partner, there may at times be external reviews. This type of review does not take place in respect of only one audit engagement but is designed to ascertain whether the firm's auditing standards conform with those generally acceptable for good audit

practice. External reviews are less frequent and are often associated with firms' international affiliations. This type of review is very important if auditing standards are to be maintained and improved. Parties outside the firm are invited, say, once in three years, to confirm that the firm maintains established standards which are consistent with current international standards and those of its affiliations.

7.4 HOT REVIEWS

A procedure of self-examination is referred to as HOT REVIEW. By this procedure, one manager/partner is specifically designated the quality control reviewer of all audit engagements as soon as the audit is completed and before the report is issued. It is usually carried out soon after the completion of the audit but before the partner's review and issuance of the audit report. It is designed by the firm to ensure that up to the level of the managers, standards set for its audit work are strictly adhered to. Usually the manager/partner engaged in such reviews is one adjudged to be highly skilled, experienced and thorough.

By the use of checklists, the reviewer confirms that:

- (a) Audit files are suitably classified and in line with the firm's practice;
- (b) Working papers are filed in the appropriate sections, suitably indexed and appropriately cross-referenced to the other relevant sections of the audit file;
- (c) The working papers are suitably drawn-up, using standard stationery and format wherever practicable;
- (d) The various lead schedules agree with the related sections of the financial statements;
- (e) Proper procedures have been adopted in the verification work and relevant and sufficient evidence obtained;
- (f) The financial statements show a true and fair view;
- (g) The review points raised at the various levels have been appropriately handled and necessary responses received from the client or the audit staff;
- (h) Appropriate accounting policies have been adopted by the client, that these have been consistently applied and are in agreement with the requirements of the SAS and all departure appropriately disclosed;
- (i) All known or perceived risk areas have been appropriately handled during the audit work;
- (j) All required confirmation have been received;
- (k) The letter of representation has been received and contains all relevant points;
- (l) All points which put the auditor on enquiry have been brought to the attention of the partner and appropriately dealt with;
- (m) All matters brought forward from the previous year's audit have been satisfactorily dealt with in the current year;
- (n) The general procedures adopted are still adequate to meet the firm's standard;

- (o) That resources allocated to the audit are adequate and have been effectively applied;
- (p) The format of the financial statements and the classification of items comply with the statutory requirements; and
- (q) The wording of the audit report is appropriate.

7.5 REPORT TO MANAGEMENT

At the conclusion of the internal control evaluation, usually carried out during an interim audit, the weaknesses identified from the internal control evaluation together with the major departure ascertained from the compliance tests, are summarised in an internal control letter to be sent to management. The auditor should also ensure that he brings to the knowledge of management the major weaknesses in the internal control system which will need to be corrected in order to minimise the incidence of fraud and errors in future.

7.5.1 Letter of Weakness

The evaluation of a system of internal control is a fundamental aspect of any modern audit. It is from this evaluation that the auditor becomes aware of such areas of weakness so as to know whether any errors or fraud have been committed.

The evaluation of the system of internal control and the revelation of errors or fraud is a by-product of a thorough and skillfully conducted audit. It is a way of assisting management by pointing out, the existing weaknesses in the system, their possible effects on the financial statements of the company and a recommendation for improvement. The medium for conveying this important information is the management letter which is also called 'internal control letter' or 'letter of weakness.'

Advantages of Letter of Weakness

The following advantages may derive from a properly drawn-up and timely letter of weakness:

- (a) It helps to draw the attention of the directors to weaknesses in the internal control system which the auditor uncovered in his examination so that the former can put the matters right.
- (b) It is a medium of calling the attention of the directors to the weaknesses in the system which may occasion loss of assets to the company or lead to incorrect final accounts.
- (c) It helps to call the attention of management to matters which, if not rectified, may give the auditor sufficient grounds to qualify his report.
- (d) It serves as good defence for the auditor in the event of litigation that the weaknesses occasioning the loss sustained by the company were brought to the attention of the directors.

7.5.2 Procedure for a Management Letter

The procedure for writing a good management letter is as follows:

- (a) First, the identified weaknesses should be discussed verbally with the client. This is important since the auditor's understanding of the system may have been faulty owing to misinformation by an uncooperative staff. Prejudice on the part of the auditor can also lead to a faulty conclusion. Furthermore, there may be other compensating controls to take care of an apparent weakness;
- (b) A formal letter should be prepared specifying the areas of weakness, their possible effects and most importantly, recommendation for remedial action;
- (c) A request should be included in the letter for the client's comments and actions intended to correct the identified weaknesses;
- (d) Follow up is very important on the auditor's next visit; and
- (e) Timeliness is of essence for an effective management letter. The letter should be forwarded early enough to allow management sufficient time to take remedial action before the commencement of a final audit.

The evaluation of the system of internal control is carried out during an interim audit, whereas the verification of assets and liabilities takes place at the final audit. It is pertinent to note that a management letter is not the auditor's report. It is not part of the statutory responsibilities of the auditor to send a management letter. It is only a piece of advice to the management as an aid for them to run the business of the company in an orderly manner, safeguard the assets of the company and ensure the reliability of the company's records. It is, as it were, a service to the management as an offshoot of the audit.

7.5.3 Contents of a Management Letter

A good management letter should contain the following:

- (a) A note of the purpose of the letter;
- (b) A note of the purpose of internal control investigation;
- (c) Disclaimer to the effect that the auditor's examination cannot be relied upon to disclose all weaknesses or fraud that may exist in the system;
- (d) A list of the weaknesses. The explanation has to be specific as to quality and quantity, if applicable, and the possible consequences spelt out in detail. Distinction should be made between material and minor weaknesses,
- (e) A recommendation for improvement; and
- (f) A request to management to send a written reply to the points raised and proposed actions to rectify the weaknesses.

7.5.4 A Specimen Management Letter

The following is a format for a suitable management letter which the auditor may adopt with the relevant modifications in practice.

A. A. ICAN & Co.
(Chartered Accountants)
3 Aiyedire Street
Surulere, Lagos

October 4, 2007

The Financial Controller
Study Pack Industries Ltd
1000 Ikorudu Road
Lagos

Attention: Mr. J. A. Nyong, FCA

Dear Sir,

**MANAGEMENT LETTER
YEAR ENDING 31ST MARCH 20X8**

Work has now been completed in respect of the interim audit of your company for the year ending 31st March 20X8. During our examination, we reviewed the principal controls that your company has established to enable the management, as far as possible, ensure the accuracy and reliability of the records and safeguard the assets.

In addition to reviewing the controls, we also assessed the accounting records as a basis for preparing the financial statements, which, as required by law, show a true and fair view of the financial position of the company. In the course of our examination, some weaknesses in the system of controls came to our notice which, if not rectified, may give rise to incorrect financial statements and/or loss of the company assets. In line with our discussion of 28th September, 20X7, we are writing in order to draw your attention to these weaknesses as revealed by the examinations we carried out.

We set out below those points (not necessarily in the order of significance) which you need to know and our recommendations for the necessary actions for you to put them right.

It must be appreciated that the points outlined below came to our notice during the course of our normal audit procedures. These were designed primarily to enable us to know which aspects of the internal control system we could rely on in the course of our audit. Hence, it should not be relied upon to reveal all possible weaknesses in the internal control system of your company nor cases of fraud or errors which a more detailed investigation may reveal.

Sales in Excess of Credit Limits:

In the course of review, we noted four cases of customers who have been allowed to buy goods from the company in excess of their credit limit as follows:

NAME	CREDIT LIMIT	BALANCE	EXCESS
	₦		
APZ Cosmetics Ltd.	75,000	96,750	21,750
Glamour Salon	30,000	45,245	15,245
Christy Body Care	35,000	50,216	15,216
Healthgate Supermarket Ltd	125,000	157,475	32,475

Effect

It could also give rise to the incidence of bad debt and hence, losses to the company. Although we were told that these were some of the best customers of the company without any risk of default, if this situation is allowed to persist, it may lead to abuse on the part of sales staff.

Recommendations

We recommend that:

- (a) Credit limits should be strictly enforced
- (b) Follow-up action should be stepped up in order to effect immediate collection of over-due amounts.

Management Response

Suppliers' Accounts not Reconciled:

The system requires that suppliers' statements of account should be reconciled with the balances on the creditors' accounts. We saw two cases where these accounts were not reconciled as at 30th June 20X7.

	STATEMENT	LEDGER	DIFFERENCE
Cramfield Chemical Ltd	578,754	674,250	95,496
Hardware Packages Ltd	802,450	984,026	181,576

Effect

If the reconciliation is not carried out, current liabilities may be wrongly stated hence, giving rise to incorrect financial statements.

Recommendations

We recommend as follows:

- (a) Regular and prompt reconciliation of suppliers' accounts should be carried out;
- (b) This should be reviewed and approved by the chief accountant;
- (c) Disputed amounts should be taken up with the suppliers and necessary corrections effected.

Effect

Bank Reconciliations not Independently Reviewed:

The system is such that the cashier prepares the bank reconciliation statements and sends same to the chief accountant for approval. Since there is no independent check of the reconciliation, the cashier may exploit this lapse to perpetrate fraud and/or errors and conceal same for a very long time.

Recommendation

We recommend that the bank reconciliation statements prepared by the cashier should first be reviewed by the accounts supervisor before sending same to the chief accountant for approval, each signifying his own check by signing.

MANAGEMENT RESPONSE

General

The points listed above have been discussed with the chief accountant. We however, look forward to hearing from you, in writing, of the actions you have taken or intend to take to effect an improvement in the system.

Yours faithfully

Chief Examiner

**for: A. A. ICAN & Co.
Chartered Accountants**

Points to Note in the Above Management Letter

The points to note in the above management letter are as follows:

- (a) The letter is addressed to the highest level of management where action can be taken;
- (b) The auditor's language is simple and straight to the point;
- (c) Without being in hurry, he outlined the meaning and essence of an interim audit, and explain the procedure he had adopted;
- (d) He did not lay any claims to have done what he did not do. More importantly, nowhere in the letter did he confer the mark of excellence and thoroughness on his job. Rather he pointed out the possible shortcomings of the procedures he had adopted. This is essential since these shortcomings, if eventually uncovered by the client himself, will lead to loss of reputation on the part of the auditor;
- (e) The matters considered on the letter are limited to the important points, which in the opinion of the auditor will affect the truth and fairness of the financial statements;
Furthermore, the auditor tried to create the impression that all the points should be considered on equal merit. Hence, they all deserve equal attention on the part of management;
- (f) The auditor has included the details of his findings in terms of dates and specific amounts involved. Hence he has avoided any general statements;

- (g) In respect of each point raised, the auditor has included a recommendation which is the specific action management should take in order to rectify the reported weakness;
- (h) Before including any matters in the management letter, the auditor had discussed all the points with the Chief Accountant of the company. This is clearly stated in the letter in order not to leave any doubts as to that fact; and
- (i) Finally, the auditor has requested for management responses and feedback from the client about matters raised as well as the planned remedial action. Clearly, this is feasible as the letter was written nearly six months to the year end. It is important that a management letter should be sent early enough to allow management sufficient time to take the required remedial action. This is obvious on the above letter.

7.6 REPORTS ON ASSURANCE ASSIGNMENTS

A report by the auditor is the end product of any audit. In its simplest form, the Companies and Allied Matters Act, 2004 requires the auditor to state in his report whether in his opinion, the accounts:

- (a) show a true and fair view, and
- (b) comply with the requirements of relevant Sections of the Act.

Most auditor's reports are short statements expressing opinions. Hence, an auditor's report is an opinion and not a certificate, although one which is based on sound and logical procedures.

Forming an Opinion on the Financial Statements

The auditor should evaluate the conclusions drawn from the evidence obtained as the basis for forming an opinion on the financial statements. When forming an opinion on the financial statements, the auditor evaluates whether, based on the evidence obtained, there is reasonable assurance about whether the financial statements taken as a whole are free from material mis-statements. This involves concluding whether sufficient and appropriate audit evidence has been obtained to reduce, to an acceptably low level, the risks of material mis-statements and evaluating the effects of uncorrected mis-statements identified.

Forming an opinion as to whether the financial statements give a true and fair view or are presented fairly, in all material respects, involves evaluating whether the financial statements have been prepared and presented in accordance with the specific requirements of the applicable legislation for particular classes of transactions, account balances and disclosures.

This evaluation includes considering whether, in the context of the applicable financial reporting framework:

- (a) The accounting policies selected and applied are consistent with the applicable legislation and are appropriate in the circumstances;

- (b) The accounting estimates made by management are reasonable in the circumstances;
- (c) The information presented in the financial statements, including the accounting policies, is relevant, reliable, comparable and understandable; and
- (d) The financial statements provide sufficient disclosures to enable users to understand the effect of material transactions and events on the information conveyed in the financial statements.

Forming an opinion as to whether the financial statements give a true and fair view or are presented fairly, in all material respects, in accordance with the applicable legislation also involves evaluating the fair presentation of the financial statements. The auditor considers whether the financial statements, after any adjustments made by management as a result of the audit process, are consistent with the auditor's understanding of the entity and its environment. The auditor considers the overall presentation, structure and content of the financial statements. He also considers whether the financial statements, including the note disclosures, faithfully represent the underlying transactions and events in a manner that gives a true and fair view of or presents fairly, in all material respects, the information conveyed in the published financial statements in the context of the requirements of Companies and Allied Matters Act, Cap. C 20, LFN 2004.

Analytical procedures performed at or near the end of the audit help to corroborate conclusions formed during the audit and assist in arriving at the overall conclusion as to the fair presentation of the financial statements.

7.6.1 The Basis and Elements of an Auditor's Report

The Companies and Allied Matters Act 2004 does not give any clue as to the format of an auditor's report nor the nature of such report, except that it requires that the report should express the auditor's opinion whether the financial statements show a true and fair view. However, the Act provides extensive details (Schedule 6 of CAMA) as to the contents of the report. On the other hand, the International Standards on Auditing (ISA) and the Nigerian Standards on Auditing (NSA) 28 provide details of the basis and format of an auditor's report.

7.7 ELEMENTS OF THE AUDITORS' REPORT

The International Standards on Auditing and NSAs set out the requirements relating to the following elements of the auditor's report when the audit has been conducted in accordance with the standards:

- (a) Title;
- (b) Addressee;
- (c) Introductory paragraph;
- (d) Management's responsibility for the financial statements;
- (e) Auditor's responsibility;

- (f) Auditor's opinion;
- (g) Other reporting responsibilities;
- (h) Auditor's signature;
- (i) Date of the auditor's report; and
- (j) Auditor's address.

Title

The auditor's report should have a title that clearly indicates that it is the report of an independent auditor. A title indicating that the report is that of an independent auditor, for example, "*Independent Auditor's Report*," affirms that the auditor has met all of the relevant ethical requirements regarding independence and, therefore, distinguishes the independent auditor's report from reports issued by others.

Addressee

The auditor's report should be addressed as required by the circumstances of the engagement. National laws or regulations often specify to whom the auditor's report on general purpose financial statements should be addressed. Ordinarily, the auditor's report on general purpose financial statements is addressed to those for whom the report is prepared, the shareholders or to those charged with governance of the entity whose financial statements are being audited if it relates to a public sector establishment or enterprise.

Introductory Paragraph

The introductory paragraph in the auditor's report should identify the entity whose financial statements have been audited and state that the financial statements have been audited. The introductory paragraph should also:

- (a) Identify the title of each of the financial statements that comprises the complete set of financial statements;
- (b) Refer to the summary of significant accounting policies and other explanatory notes; and
- (c) Specify the date and period covered by the financial statements.

This requirement is ordinarily met by stating that the auditor has worked on the accompanying financial statements of the entity which comprise (state the titles) the complete set of financial statements required by the law, specifying the date and period covered by those financial statements and referring to the summary of significant accounting policies and other explanatory notes. In addition, when the auditor is aware that the financial statements will be included in a document that contains other information, such as an annual report, the auditor may consider, if the form of presentation allows, identifying the page numbers on which the financial statements are presented.

This assists readers to identify the financial statements to which the auditor's report relates. The auditor's opinion covers the complete set of financial statements as defined by the Statements of Accounting Standards. In the case of financial statements prepared in accordance with IFRSs, this includes: a balance sheet, an income statement, a statement of changes in equity, a cash

flow statement and a summary of significant accounting policies and other explanatory notes. In some circumstances, additional information may be considered to be an integral part of the financial statements.

In some circumstances, the entity may be required by law, regulation or standards, or may voluntarily choose, to present together with the financial statements supplementary information that are not required by law. For example, supplementary information might be presented to enhance a user's understanding of the financial statements or to provide further explanation of specific financial statement items. Such information is normally presented in either supplementary schedules or as additional notes. The auditor's opinion may or may not cover the supplementary information and it is therefore important for the auditor to be satisfied that any supplementary information that is not covered by his opinion is clearly differentiated, as discussed below.

In some circumstances, the supplementary information cannot be clearly differentiated from the financial statements because of its nature and how it is presented. Such supplementary information is covered by the auditor's opinion. For example, the auditor's opinion covers notes or supplementary schedules that are cross-referenced from the financial statements.

This would also be the case when the notes to the financial statements include an explanation of the extent to which the financial statements comply with another financial reporting requirements.

Supplementary information that is presented as an integral part of the financial statements does not need to be specifically referred to in the introductory paragraph of the auditor's report when the reference to the notes in the description of the components of the financial statements in the introductory paragraph is sufficient.

Management's Responsibility for the Financial Statements

The auditor's report should state that management is responsible for the preparation and the fair presentation of the financial statements in accordance with the applicable provisions of CAMA and that this responsibility includes:

- (a) Designing, implementing and maintaining the internal control system relevant to the preparation and fair presentation of financial statements that are free from material mis-statement, whether due to fraud or error;
- (b) Selecting and applying appropriate accounting policies; and
- (c) Making accounting estimates that are reasonable in the circumstances.

Management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable provisions of CAMA. For example, in the case of financial statements prepared in accordance with IFRSs, management is responsible for preparing statements that fairly present the financial position, performance and cash flows of the entity. To fulfill this responsibility, management designs and implements internal control measures

to prevent or detect and correct mis-statements, whether due to fraud or error, in order to ensure the reliability of the entity's financial reporting. The preparation of the financial statements requires management to exercise judgment in making accounting estimates that are reasonable in the circumstances, as well as to select and apply appropriate accounting policies. These judgments are made in the context of the applicable Statements of Accounting Standards.

There may be circumstances when it is appropriate for the auditor to add to the description of management's responsibilities as required above to reflect additional responsibilities that are relevant to the preparation and presentation of the financial statements in the context of the particular case or the nature of the entity; for instance, banks or insurance companies.

The term 'management' has been used in the ISA to describe those responsible for preparing and fairly presenting the financial statements, i.e., the directors. Other terms may be appropriate depending on the organisation and the legal requirements.

Auditor's Responsibility

The report should state that the responsibility of the auditor is to express an opinion on the financial statements based on the audit. He should therefore, state that his responsibility is to express an opinion on the financial statements based on the audit in order to contrast it to management's responsibility for the preparation and fair presentation of the financial statements.

The auditor's report should state that the audit was conducted in accordance with the Nigerian and International Standards on Auditing. Also, that those standards require that the auditor complies with ethical standards and that he should plan and perform the audit to obtain reasonable assurance, whether the financial statements are free from material mis-statements.

The reference to the standards used conveys to the reader that the audit has been conducted in accordance with established standards. The auditor's report should describe an audit by stating that:

- (a) An audit involves performing procedures to obtain evidence about the amounts and disclosures in the financial statements;
- (b) The procedures selected depend on the auditor's judgment, including the assessment of the risks of material mis-statement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control; and
- (c) An audit also includes evaluating the appropriateness of the accounting policies used, the reasonableness of accounting estimates made by management as well as the overall presentation of the financial statements.

The report should state that the auditor believes that the audit evidence he has obtained is sufficient and appropriate to provide a basis for his opinion.

Auditor's Opinion

An unqualified opinion should be expressed when the auditor concludes that the financial statements give a true and fair view or are presented fairly, in all material respects, in accordance with the requirements of the law. When expressing an unqualified opinion, the opinion paragraph of the auditor's report should state the auditor's opinion that the financial statements give a true and fair view or present fairly in all material respects in accordance with the requirements of CAMA and the SAS. It is important that the auditor should use the appropriate words in expressing his opinion unless in special circumstances or specialised audits where a different wording should be used.

Other Matters

Standards, laws or generally accepted practice in Nigeria may require or permit the auditor to elaborate on matters that provide further explanation of the auditor's responsibilities in the audit of the financial statements or of the auditor's report thereon. Such matters may be addressed in a separate paragraph following the auditor's opinion; for instance, compliance with the Central Bank's regulations or the requirements of the Insurance Act 2007.

Other Reporting Responsibilities

In Nigeria, the auditor may have additional responsibilities to report on other matters that are supplementary to the auditor's responsibility to express an opinion on the financial statements. For example, the auditor was required to report on a company's adherence to provisions of the Productivity, Prices and Income Board's guidelines when that was relevant. Alternatively, the auditor may be asked to perform and report on additional specified procedures or to express an opinion on specific matters, such as the adequacy of the accounting books and records.

Auditor's Signature

The auditor's report should be signed. The auditor's signature is either in the name of the audit firm, the personal name of the auditor or both. In addition to the auditor's signature, the auditor is required to declare his professional accountancy designation or the fact that the auditor or firm, as appropriate, has been recognized by the law.

Date of the Auditor's Report

The auditor should date the report on the financial statements not earlier than the date on which the auditor has obtained sufficient and appropriate audit evidence on which to base the opinion on the financial statements. Sufficient appropriate audit evidence should include evidence that the entity's complete set of financial statements has been prepared and that those with the recognised authority have asserted that they have taken responsibility for them.

The date of the auditor's report informs the reader that the auditor has considered the effect of events and transactions of which the auditor became aware and that occurred up to that date. Since the auditor's opinion is provided on the financial statements and the financial statements are the responsibility of management, the auditor is not in a position to conclude that sufficient appropriate audit evidence has been obtained until the auditor obtains evidence that a complete set of financial statements has been prepared and management has accepted responsibility for them.

In Nigeria, the law identifies the directors as being responsible for concluding that a complete set of financial statements has been prepared and specifies the necessary approval process. Hence, the auditor obtains evidence of that approval before dating the report on the financial statements.

Auditor's Address

The report should state the location in the country from where the auditor practices.

7.8 THE AUDITOR'S REPORT

The auditor's report should be in writing. A written report encompasses both reports issued in 'hard copy' format and those using an electronic medium. Depending on the conclusions reached on the basis of evidence obtained, the auditor may issue an unqualified or a qualified report.

7.8.1 An Unqualified Report

The following is an illustration of the auditor's report incorporating the elements set forth above for an audit of financial statements prepared in accordance with the IFRSs for an unqualified opinion in line with the Nigerian Standards on Auditing (NSA) 29. The illustration assumes that the auditor has no other reporting responsibilities required under the Nigerian law.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Limited

Report on the Financial Statements for the Year Ended December 31, 20X8

We have audited the accompanying financial statements of ABC Company Plc, which comprise the balance sheet as at December 31, 20X8 and the income statement, statement of changes in equity and cash flow statement for the year ended, a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining

internal control relevant to the preparation and fair presentation of financial statements that are free from material mis-statement, whether due to fraud or error; selecting and applying appropriate accounting policies and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing and NSA. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material mis-statement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material mis-statement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence which we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of (*or "present fairly, in all material respects,"*) the financial position of the company as of December 31, 20X8, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards and SASs.

Date of the auditor's report
Auditor's address

Auditor's Identity
Auditor's Signature

The above is a standard report which has been worded in its simple form. If the financial statements contain any assets which have been revalued, then the report will include the phrase "including the revaluation of certain assets" after the words International Financial Reporting Standards and SASs. The above is the standard wording of an unqualified report. It may however be modified as the auditor thinks fit.

7.9 CONTENTS OF THE AUDITOR'S REPORT

The Act requires the auditor's report to include specific statements to the effect that:

- (a) Proper books of accounts have been kept;
- (b) Proper returns have been received from branches not visited by the auditor.
- (c) The financial statements are in agreement with the books and returns;
- (d) All information and explanations necessary for the audit have been obtained. The financial statements show a true and fair view; and
- (e) The financial statements comply with the relevant statutes and other pronouncements.

If the auditor's report is silent on any other matters not mentioned above, it is assumed that he is satisfied and in agreement to such matters.

7.10 MODIFICATIONS IN THE AUDITOR'S REPORT

The Nigerian Standards on Auditing (NSA) 29 describes certain circumstances when there may be modifications in the auditor's report in matters that do not affect his opinion. In such circumstances, it is possible for the auditor to draw attention to some matters in the financial statements without qualifying his report. This is only a matter of emphasis. For instance, where the financial statements contain exceptional or unusual items of income or expenditure such as premium in special insurance cover for unusual risk or losses on such unusual risk, the auditor may wish to draw attention to this.

Another example where an auditor may wish to draw attention to significant matters in the financial statements without qualifying his report is a situation where a company that has a record of making profit, ends up with a loss in a particular year. It will be necessary for the auditor to draw the attention of readers to the cause of the loss. The intention of the auditor, in this instance, is to call the attention of readers to this unusual occurrence, indicating the item of cost or expenditure occasioning the loss and not to qualify his report.

The need on the part of the auditor to draw attention to an unusual item of cost or expenditure will be compelling if it has had the effect of changing what would have been a profit into a loss or an unusual gain changing what would have been a loss into a profit. In both cases, this does not amount to a qualification.

For instance, where the loss occurred as a result of a catastrophe such as fire which destroys a significant portion of the inventory, thus changing what would have been a profit into a loss, then there is need for the auditor to make reference to this in his report and this will not amount to a qualification.

Where however, the auditor is of the opinion that there has been incomplete or improper disclosure of an item in the financial statements, he may expand the item in his report as is proper. This amounts to a qualification in addition to

drawing the attention of readers to the particular item. For instance, where an item of income or expenditure relating to a prior year has been included in the current year without an indication that it does not relate to the current year, the auditor should make the appropriate disclosure. This amounts to a qualification because without the disclosure the financial statements will not give a true and fair view.

Another example is where surpluses arising from the revaluation of fixed assets are included in the profit and loss account when the related assets have not yet been disposed, hence inflating the profit or changing a loss into a profit. The auditor has the obligation to disclose this in his report. This will amount to a qualification as well as drawing the attention of readers to this departure from generally accepted principle of accounting.

The wording of an unqualified audit report may be changed appropriately to suit the particular circumstances but the basic requirements of the Companies and Allied Matters Act must be satisfied. It is possible that a set of financial statements could be prepared under some principles which amount to a departure from a statement of accounting standard. With this departure, the financial statements can still show a true and fair view. In that case, it is important that the auditor makes a specific reference to the departure. This does not amount to a qualification but is aimed at avoiding the readers being misled and to ensure that their attention is drawn to the departure or any other matters which may require emphasis.

7.11 QUALIFIED AUDITOR'S REPORT

There are other matters which affect the auditor's opinion and in material circumstances where he is unable to express an unqualified opinion and which may lead to a qualified auditor's report. These are situations where:

- (i) There is a limitation on the scope of the auditor's work; or
- (ii) There is a disagreement with management regarding the acceptability of the accounting policies selected, the method of their application or the adequacy of financial statements' disclosures.

These circumstances are discussed in the Nigerian Standards on Auditing (NSA) 29 - Modifications to the Independent Auditor's Report.

It is the duty of the directors to keep proper records of a company's transactions and prepare the financial statements. It is the duty of the auditor to examine these financial statements and report thereon.

If the auditor is not satisfied with any matter related to the financial statements, he has a right to deal with that matter in his report, thereby making his dissatisfaction known to the shareholders. The auditor does not have a right to insist on having the system of book-keeping or the financial statements themselves altered, but if it is so bad that these financial statements fail to give a true and fair view, he must make a report to that effect to the shareholders.

When the auditor has decided to make reservations in his report, the choice of words will be very important to convey his views to the readers. The auditor should never allow pressure to be brought upon him as to the exact words to use in his qualification. This is where his right of independence is of utmost importance.

The Act does not lay any specific requirements as to the manner of qualification of an audit report, but the guiding principle is that the qualifying statement has to be **direct, informative and unambiguous**.

It should be clearly worded as to leave no doubt in the minds of readers as to the meaning and implication of the qualification on the financial statements.

(a) **Points to Note in a Qualification**

In issuing a qualified report the auditor should note the following guidelines:

- (i) The qualification should be concise, to the extent that it does not impair clarity;
- (ii) It should be specific as to the items and facts and as far as possible the amount involved;
- (iii) Based on the available information, it should make clear the effect on the financial statements; and
- (d) It should express the auditor's opinion without being misunderstood.

(b) **Grounds for a Qualification**

Qualifications in the auditor's report can arise on two principal grounds. These are 'uncertainty' and 'disagreement.'

Uncertainty

There may be some matters relating to the financial statements of a company which are uncertain as at the date of the balance sheet and which make it difficult for the auditor to form a valid opinion as to their effects on the financial statements or the amount at which they are stated. Examples of these are:

- (i) Major litigations involving the company;
- (ii) The final outcome of major contracts;
- (iii) The recoverability of debts;
- (iv) The continued existence of the company as a going concern; and
- (v) The recoverable value of damaged or obsolete stocks.

Since matters relating to the above may result in many different possibilities, the auditor is not able to form an opinion as to the final outcome; hence, the amounts at which they are shown on the financial statements. For instance, for a company that is engaged in litigation, the decision of the court may make the company liable or not liable. Even when liable, the liability may be for a higher or lower amount than anticipated. A debtor in respect of whom provision has been made may pay in full or pay less than the amount that was anticipated. Hence

at the point when the auditor issues his report, he is not sure of the final outcome; therefore, the opinion expressed is based on an uncertain situation.

Disagreement:

This arises in situations where the auditor has been able to form an opinion, but this is in conflict with the opinion of the directors. Examples of these are:

- (a) Departures from generally accepted accounting principles;
- (b) Incomplete disclosure of matters in the financial statements,
- (c) Disagreement of amounts in the financial statements;
- (d) Inappropriate classifications and presentation of items in the financial statements; and
- (e) Non-compliance with statutory requirements.

Based on their understanding or perception of a situation and its effects on the financial statements, the directors may depart from a particular accounting principle, make what they consider to be the appropriate disclosure of the departure or make a re-classification of the items in the financial statements. The auditor may have a different opinion of such departure, re-classification or disclosure and hence may qualify his report.

(c) **What Type of Qualification to Issue**

On each of the two grounds, uncertainty and disagreement, the auditor has a number of options as to the kind of qualification to issue depending on whether the matter under consideration is fundamental and if the effect is material or otherwise.

In cases of uncertainty he can give either:

- (i) a “**disclaimer of opinion**” if the matter is fundamental. This shows that the auditor has not been able to form an opinion as to whether the financial statements give a true and fair view.
- (ii) a “**subject to opinion**” qualification if the matter is material but not fundamental. This shows that the financial statements give a true and fair view only if the portion of the financial statements referred to is correct.

In cases of disagreement, the auditor can give:

- (a) an “**adverse opinion**” if the matter under consideration is fundamental. This is to the effect that the financial statements do not give a true and fair view.
- (b) an “**except for opinion**” report if the matter is material but not fundamental. This is to the effect that the financial statements give a true and fair view except for matter referred to.

The circumstances under which an auditor may issue exception reports include:

- (i) If proper accounting records have not been kept;
- (ii) If proper returns have not been received from branches not visited by them;
- (iii) If the financial statements are not in agreement with the records and returns;
- (iv) If they have failed to obtain information and explanations necessary for the audit; and
- (v) If the information given in the directors' report are inconsistent with the financial statements.

It will be necessary to consider each of the above circumstances under which an auditor may issue an exception report and explain how the financial statements can show a true and fair view in spite of an exception pointed out in the report.

- (i) Where proper accounting records have not been kept, as may be the case in many practical situations, the auditor may be able to get the directors to re-submit the financial statements as is appropriate; he will then be able to issue a report to the effect that the financial statements show a true and fair view, except that the records (in whatever respects) have not been properly kept.
- (ii) Where proper returns have not been received from branches, it is possible for the directors to provide explanations such that the financial statements are adjusted to the satisfaction of the auditor. In that case, he is able to issue a report to the effect that the financial statements show a true and fair view, except that proper returns were not received from the affected branches.
- (iii) When the financial statements are not in agreement with the records, the overriding need on the part of the auditor is to ensure that they show a true and fair view. This is fundamental and hence of greater significance than the same financial statements being in agreement with the records. In situations such as this, the auditor will be able to issue a report to the effect that the financial statements show a true and fair view, except that they are not in agreement with the records;
- (iv) There may be certain matters relating to the financial statements which the directors may not be able to explain to the satisfaction of the auditor. In such a situation, the auditor may issue a report to the effect that the financial statements show a true and fair view, except for the matter (specifically mentioned) which has not been properly explained by the directors; and
- (v) Where any information contained in the directors' report is inconsistent with the financial statements, it is possible for the auditor to issue a report to the effect that the financial statements

show a true and fair view, except that the particular matter in the directors' report is not consistent with the financial statements.

7.12 MATERIALITY

Auditors are reluctant to qualify reports and usually will not do so on trivial matters. It is therefore, important to consider in all cases when a qualification is contemplated whether or not the matter under consideration is material or not.

Materiality is a particularly difficult matter in practice and also of great importance. It is always tempting to avoid the need to qualify a report by convincing oneself that the matter is not material. Caution should therefore be exercised before coming to the conclusion on matters of materiality.

The following considerations are helpful in deciding on materiality:

(a) **The Companies and Allied Matters Act**

If the law requires any items to be disclosed, then such a disclosure must be made for the financial statements to comply with the requirements. The amount of such an item ceases to be of any significance. For instance, the law requires that in the balance sheet, current assets should be shown separately from fixed assets. This requirement should be complied with regardless of the amount involved.

(b) **Fundamental Principles of Accounting**

Certain matters touch directly on fundamental principles of accounting. Such fundamental principles may consist of aggregating, classifying and presenting of accounting information. This is purely an area of professional judgement and all matters that are in conflict with fundamental principles of accounting have to be disclosed, e.g., the inclusion of prior year profits/losses in the current revenue. The classification of fixed assets and current assets under one heading or the capitalisation of revenue expenses which ordinarily should have been expensed, as in the widely publicised case of Worldcom, is fundamental to accounting and hence is material at all times.

(c) **Absolute/Relative Amounts**

Generally the materiality of an item is not entirely dependent on the size, but the size of any item in relation to other items in the balance sheet is a much better guide. For instance, a bad debt of 100,000 may not be material where total debts amount to ₦1,000,000, whereas a bad debt of ₦10,000 may become critical where total debts amount to only ₦50,000. In this case, the consideration of materiality will involve a decision as to whether the bad debt should be disclosed as a separate item or as a part of a large expense classification. Where bad debts occur it might be disclosed as a matter of special emphasis by showing its effect on the overall performance.

(d) Timing

The point in time at which an event took place may also help to determine the materiality of an item. For instance, if an event occasioning a loss to a company takes place subsequent to the balance sheet date, it may not be disclosed unless its effects on the published accounts are significant such that the accounts would have otherwise been a profit but for the occurrence of the post balance sheet event.

How to Assess an Item for Materiality

To assess an item for materiality, the following should be considered:

- (a) Compare the magnitude of the item with the overall view presented by the financial statements;
- (b) Compare the magnitude of the item with that of the previous years;
- (c) Compare the size of the item with the magnitude of the total of which it forms a part;
- (d) Consider the context and presentation of the item, whether it affects the true and fair view of the accounts;
- (e) Statutory implications are very important; and
- (f) Some items are always material because of their nature being required by law to be disclosed, e.g., directors' remuneration.

Overall Considerations for Qualifications

Issues to be considered are:

- (a) The degree of approximation of an item will affect the materiality of error. For example, an error in depreciation may be immaterial while errors in directors' fees may be material;
- (b) In the years when the profit is low an error which will change the profit into a loss is material, no matter the size; and
- (c) Some items may have significance that is disproportionate to the size, e.g. income from investment.

When is a Qualification Necessary?

The need to qualify may arise in the following circumstances:

- (a) The auditor is unable to obtain all the information and explanations necessary for the purposes of the audit. Examples are where:
 - (i) He is unable to verify title, value or existence of an assets.
 - (ii) He is unable to verify the amount of a liability.
 - (iii) He is not satisfied that all existing liabilities have been included.
- (b) The auditor is unable to satisfy himself that:
 - (i) Proper books of accounts have been kept.
 - (ii) Proper returns have been received.
 - (iii) The financial statements agree with the books and returns.
- (c) The financial statements do not give a true and fair view.
- (d) They do not comply with the requirements of CAMA.
- (e) The policies adopted are inappropriate or inconsistent.

- (f) There is a departure from a statement of accounting standard, without the appropriate disclosure.

Deciding Finally to Qualify the Report

Before the auditor finally decides to qualify his report, he should resolve the following questions:

- (a) **On what specific matters does he have reservations and what is the monetary amount involved?**

It is essential for the auditor to have perfect understanding of the matter in respect of which he is not satisfied and hence the ground for his qualification. Only then will the auditor be able to appropriately express himself in his report without the risk of being misunderstood.

- (b) **Does he disagree with the presentation or the information made available to him?**

If the auditor disagrees with the presentation of the financial statements or the information made available to him by the directors, he should have alternative presentation format or alternative information.

- (c) **Is the matter involved material?**

The matter in respect of which the auditor is qualifying his report should pass the materiality test as specified above. A qualification should never be in respect of trivial matters.

- (d) **Can he persuade the directors to re-submit the financial statements in order to satisfy him?**

Where the directors can be persuaded to modify the financial statements to satisfy the auditor, the qualification is no longer necessary.

- (e) **If he lacks information, is it possible for him to get more information by carrying out additional examination?**

The auditor should never qualify his report on grounds of uncertainty if it is still possible to obtain additional information even if it is by adopting alternative procedure. The need to qualify his report will not arise if the auditor is unable to provide answers to any of the matters above. For instance, the need for a qualification will not arise if the auditor cannot determine the specific matter in respect of which he is not satisfied, since his qualifying statement ought to clearly state the matter in respect of which he is expressing reservations. Similarly, if he can persuade the directors to modify the financial statements to satisfy him, then there is no point for a qualification.

Furthermore, the auditor will bring himself to disrepute, if he issues a qualified report in respect of a matter where he lacks the information

he could have obtained by carrying out additional or alternative procedure.

7.13 GOING CONCERN ASSUMPTIONS

Perhaps, one factor that may lead to modifications in the auditor's report is in relation to the 'going concern' principle.

If the use of the going concern assumption is appropriate but a material uncertainty exists, the auditor considers whether the financial statements:

- (a) Adequately describe the principal events or conditions that give rise to the significant doubt on the entity's ability to continue in operation and management's plans to deal with these events or conditions; and
- (b) State clearly that there is a material uncertainty related to events or conditions which may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realise its assets and discharge its liabilities in the normal course of business.

If adequate disclosure is made in the financial statements, the auditor should express an unqualified opinion but modify his report by adding an emphasis on the matter that highlights the existence of a material uncertainty relating to the event or condition which may cast significant doubt on the entity's ability to continue as a going concern, and draws attention to the note in the financial statements that discloses the relevant matters.

In evaluating the adequacy of the financial statement disclosure, the auditor considers whether the information explicitly draws the reader's attention to the possibility that the entity may be unable to continue, realising its assets and discharging its liabilities in the normal course of business.

The following is an example of the relevant paragraphs when a qualified opinion is to be expressed:

"The company's financing arrangements expired and amounts outstanding are payable on March 19, 20X8. The company has been unable to re-negotiate or obtain replacement financing. This situation indicates the existence of a material uncertainty which may cast significant doubt on the company's ability to continue as a going concern and therefore it may be unable to realise its assets and discharge its liabilities in the normal course of business. The financial statements (and notes thereto) do not disclose this fact. In our opinion, except for the omission of the information included in the paragraph above, the financial statements give a true and fair view of (or present fairly, in all material respects) the financial position of the company at December 31, 20X7 and its operating performance and its cash flows for the year then ended in accordance with the Companies and Allied Matters Act".

The following is an example of the relevant paragraph when an adverse opinion is to be expressed:

“The company’s financing arrangements expired and the amount outstanding was payable on December 31, 20X8. The company has been unable to re-negotiate or obtain replacement financing and is considering filing for bankruptcy. These events indicate a material uncertainty which may cast significant doubt on the company’s ability to continue as a going concern, and therefore it may be unable to realise its assets and discharge its liabilities in the normal course of business. The financial statements (and notes thereto) do not disclose this fact. In our opinion, because of the omission of the information mentioned above, the financial statements do not give a true and fair view of (or do not present fairly) the financial position of the company as at December 31, 20X8, and its operating performance and its cash flows for the year then ended in accordance with (or do not comply with) the Companies and Allied Matters Act”.

7.14 SUMMARY AND CONCLUSIONS

The quality of audit work is paramount in all audit and assurance engagements. The Nigerian Standards on Auditing (NSA) 28 and 29 and the International Standards on Auditing (ISA) expressly state the quality of work expected from a professional audit assignment by the calibre of accountants in public practice.

The International Financial Reporting Standards (IFRSs) and SAS also state clearly the requirements relating to published financial statements produced by directors for presentation to members. Professional firms have to put in place programmes to ensure that the quality of audit works performed are of the highest standards.

These may include some internal and external reviews carried out at various stages of the audit and by different levels of staff to ensure strict adherence. There are the supervisor’s review, manager’s review and the partner’s review. In addition to these, big firms have external reviews as part of quality assurance process which are the peer group reviews and ‘hot’ reviews.

The auditor may report to management those matters relating to weaknesses in internal control which come to his notice in the course of his evaluation of the system. This is part of his effort to help management to ensure the accuracy and reliability of the records, run the business in an orderly manner and safeguard the assets. The statutory responsibility of the auditor, however, is to report to the members. This is the report under the assurance engagement. The auditor may issue an unqualified report where he is satisfied that there are no matters relating to his examination of the financial statements which he needs to bring to the notice of the members. NSA 29 requires, if need be, to modify his report, and as is appropriate, for emphasis of matter in order to draw attention to specific items in the financial statements. Where, however, the auditor is

unable to issue an unqualified report because there are matters that affect his opinion, he is required to issue a qualified report.

Refer to Comprehensive Questions and Suggested Solutions in Appendix II, page 303.

7.15 REVISION QUESTIONS

1. In audit, reviews are designed to ensure:
 - (A) That frauds and errors do not occur in an audit engagement.
 - (B) That the audit is completed early for the report to be issued.
 - (C) That appropriate bill is sent to the client.
 - (D) That the audit is performed with the highest standards of quality.
 - (E) That no dispute arises between the firm and the client.

2. One of the following is not part of the internal review processes
 - (A) Manager's review.
 - (B) Supervisor's review.
 - (C) Peer group review.
 - (D) Hot reviews.
 - (E) Partner's review.

3. There is a great need for high quality of audit work on the part of accountants in the public practice because
 - (A) Auditor's now compete with one another for clients.
 - (B) Accountants want to collect higher fees.
 - (C) Most clients are failing to pay the auditor's fees.
 - (D) Audit engagements are becoming very complicated.
 - (E) Auditors are desirous of restoring confidence in their reports.

4. A supervisor's review will not include one of the following:
 - (A) That the working paper is properly drawn-up.
 - (B) That all points raised by the manager during his/her peer review have been satisfactorily disposed of.
 - (C) That all items in the audit programme have been covered.
 - (D) That the procedure adopted in the verification work is in line with the firm's standards.
 - (E) That all matters brought forward from prior year's audit have been properly disposed of.

5. The peer group review is carried out by:
 - (A) Another firm of comparable size and standards.
 - (B) The most senior partner of the firm.
 - (C) The most experienced partner in the firm.
 - (D) A representative of the client company.
 - (E) The affiliated firm overseas.

6. In issuing qualified report, the auditor should observe the following guidelines except one:
 - (A) The qualification must be concise to the extent that it does not impair clarity.
 - (B) The qualification should discuss the auditor's personal relationship with the directors.
 - (C) The qualification should be specific as to the items and facts and as far as possible the amount involved.

- (D) Based on the available information, the qualification should make clear the effect on the financial statements.
7. A qualification in the auditor's report will not be necessary if:
- (A) The financial statements do not give a true and fair view.
 - (B) If the auditor does not understand the explanation made by the directors
 - (C) They do not comply with the requirements of CAMA.
 - (D) The policies adopted are inappropriate or inconsistent.
 - (E) There is a departure from a statement of accounting standard without the appropriate disclosure.
8. In order to assess an item for materiality, it will not be necessary to:
- (A) Disclose such item in the report by the auditor.
 - (B) Compare the magnitude of the item with the overall view presented by the financial statements.
 - (C) Compare the magnitude of the item with that of the previous years.
 - (D) Compare the size of the item with the magnitude of the total of which it forms a part.
 - (E) Consider the context and presentation of the item whether it
9. The letter sent by the external auditor on the lapses ascertained during his evaluation of the system of internal control is called.
10. The two principal grounds on which an auditor may issue a qualified report are (a).....and (b).....
11. Mention any two types of qualified audit report.
12. List two elements of a standard auditor's report.

Refer to Suggested Solutions in Appendix I, on page 297.

EMERGING ISSUES IN AUDIT AND ASSURANCE

8.0 LEARNING OBJECTIVES

After studying this chapter, readers should be able to understand:

- ◆ Transnational Audits.
- ◆ Local Standards in Relation to Transnational Audits.
- ◆ The Loss of Credibility in Financial Reporting.
- ◆ Business Failure in Relation Reporting Failure.
- ◆ The origins of Loss of Credibility.
- ◆ The Global Nature of the Loss.
- ◆ Recent Developments.
- ◆ Social and Environmental Audits.

8.1 TRANSNATIONAL AUDITS

A country, as a reporting jurisdiction, may set for itself high standards of accounting and audit practice. Such standards are expected to cover the local needs of entities within the country. The present reality is that countries are connected so closely in an increasingly global economy. The best standards and processes are therefore collaborative efforts that take into consideration worldwide international needs and requirements. The International Standards Organisation (ISO) sets standards which cover a wide range of areas, including even the most informal areas of personal services. These cover those areas which are necessary for governance and enterprise quality services which include auditing. These are covered by standards issued by the International Auditing and Assurance Standards Board (IAASB), a special arm of the International Federation of Accountants (IFAC). With the issue of any international standard, enterprises are expected to take steps to comply with the standards but it will require outside “auditors” to certify the compliance.

Compliance with International Standards on Auditing (ISA) which relate to transnational audits are expected to be at a higher level than the general ISO standards. This is so because:

- (a) The credibility of financial reporting is both a national and an international issue, with actions required at both levels. Although the

framework within which companies operate is still primarily national or home based, international action is necessary if the changes made at the national level are to produce both improved and more consistent practices.

- (b) Secondly, to improve the credibility of financial reporting, action will be necessary at all points along the information supply chain that delivers financial reporting to the market. Corporate management and boards of directors, that have the prime responsibility for financial reporting as well as auditors, standard setters, regulators and other participants in the reporting process such as lawyers, investment bankers, analysts and credit-rating agencies, all have important roles to play and improvements in practices to make in order to restore the credibility of financial reporting.
- (c) Thirdly, integrity, both individual and institutional, is essential as the absence of sterling quality has been a major contributor to the financial scandals and corporate failures of recent years whose effects cut across national boundaries.

Transnational audits are particularly relevant in relation to large firms of auditors. These firms are multi-national, but organised differently from their large clients, the multi-national corporations. They are networks of independent firms with common processes and basic policies and standards, but without common or central regulatory rules. Each independent firm is subject to national laws and professional regulations in the country in which it operates. The firms share certain central costs. When performing an audit work for a multi-national corporation, the headquarters office will assign a team and issue instructions such that work can be performed in line with the requirements of the client's home country. As a result, a large firm's name is associated with financial reports presented, using a wide variety of national standards; if these reports comply with the relevant national standards they will all receive "clean" opinions. This will continue to be the case until one set of accounting standards is widely accepted.

8.2 LOCAL STANDARDS IN RELATION TO TRANSNATIONAL AUDITS

Every country has its auditing standards for the reporting jurisdiction. In Nigeria, there is the Nigerian Standards on Auditing (NSA) issued by the Nigerian Auditing Standards Committee (NASC), a special committee of the Institute of Chartered Accountants of Nigeria (ICAN). To date, the committee has issued a total of 32 NSAs, on a variety of topics, ranging from "Objective and General Principles Governing an Audit of Financial Statements", issued in July, 2006 to "The Independent Auditor's Report on Special Purpose Audit Engagements", issued in December, 2008. The objectives of these standards are to provide an understanding of the basic principles of auditing and the guidelines for their application to specific situations. In doing this, the Nigerian Accounting Standards Board (NASB) takes into consideration the pronouncements of the

relevant International Standards on Auditing (ISA) issued by the International Federation of Accountants (IFAC) of which ICAN is a member. Where the guideline of an ISA is significantly at variance with the applicable law in Nigeria, the council of ICAN is expected to issue additional explanatory foreword to provide guidance on such differences.

Apart from the questions of adequacy of standards in individual countries, there are significant variations among reporting entities, leading to confusion and difficulty in comparing financial statements between countries. With investments across national boundaries now commonplace, this development increases the difficulty of making informed investment decisions as well as creating problems for preparers who have to apply more than one set of standards.

The difficulties at the national level may arise because:

- (a) Individual standards are weak;
- (b) They may be poorly grounded in principles;
- (c) They may fail to consider assets such as intangibles; or
- (d) They may have inadequate emphasis on forward-looking information or on risks.

Further factors that contribute to the weaknesses of local auditing standards may include:

- (a) Standard setters being subject to political pressures;
- (b) Having inadequate resources;
- (c) Having sources of finance which raise questions about their independence; and
- (d) Being insufficiently timely in responding to market needs.

These weaknesses in local auditing standards have led to weak or faulty financial reporting which in itself may be the major cause of corporate failure. In parallel with this, there has been great concern, in some cases outrage on the part of investors, regarding the “fairness” of the operation of a market system. These are in situations where shareholders have lost their investments, and employees and pensioners have lost their jobs and pensions, while those running the companies and seen as responsible for those losses, have enriched themselves even as their businesses collapsed. The scale of this issue is evidenced in the U.S. by a calculation that executives of 25 companies whose stock prices fell by 75% or more between January 1999 and May 2002, many of which had both business and reporting problems, “walked away” with \$23 billion (Fortune, September 2, 2002, page 64). Similar concerns about the level and terms of corporate compensation, even if involving smaller numbers, have arisen in other countries. These concerns have reduced the credibility of all those involved in the process of providing financial and other information.

8.3 THE LOSS OF CREDIBILITY IN FINANCIAL REPORTING

Failure of businesses in which deficiencies of financial reporting and corporate disclosure have figured prominently are not new phenomena. However, high-

profile cases of the recent past, such as Enron, WorldCom, Global Crossing, Adelphia Communications, HIH, Tyco, and Vivendi and most recently, Royal Ahold and HealthSouth, together with a host of smaller-scale examples worldwide such as Cadbury in Nigeria, have drawn far greater attention to this area. At the same time, there has been evidence of an increased frequency of re-stated financial statements. All these have had a negative and cumulative impact on the way informed opinion views the quality of financial reporting. This loss of credibility has been widespread across capital markets. Problems in one industry have been contagious, impacting other industries with similar negative characteristics. The increasingly global nature of the markets and businesses, has resulted in concerns crossing national boundaries.

A key factor in the scale of the problems was the unprecedented high level of share prices in many markets. Maintaining these price levels was a top management objective and when it became clear that the supposed level and trend of profitability justifying the levels had not existed, the fall in share prices was accentuated by a major re-rating of the shares. This then impacted share prices in similar companies.

Financial statements have historically been one of the main ways in which information has been provided by a company to its shareholders and investors considering whether to contribute capital. Reduced confidence in financial information and corporate disclosure produces an investor retreat and results in an increased cost of capital. This reduces the economy's productivity.

8.4 BUSINESS FAILURE IN RELATION TO REPORTING FAILURE

Almost all the high profile failures are the result of the combined effect of failures in business, governance and reporting. The business issue that should be communicated to users of the financial statements if not properly disclosed, governance structures will fail to prevent or detect this; hence, a reporting failure results. As an entity moves closer to business failure, the incentive to distort reporting increases and, therefore, the chance of reporting failure increases. A reporting failure on its own will rarely cause a business failure but can allow poor business practice to be extended and delay the confronting of difficult business decisions. However, there appears to be a close linkage between business failure and faulty reporting such that many examples of mis-reporting, particularly when large sums are involved, appear to be part of the management policies that produced the business problem.

The close relationship between business failure and reporting failure means that the issue of governance generally is closely linked with reporting failure. However, business failure is an inherent and inevitable feature of a market economy. Alternatively put, strengthened governance and reporting practices, and the improved credibility of financial information that should result, will not eliminate business failure, although any improvement should reduce the chances of failure arising from deception or lack of transparency.

8.5 THE ORIGINS OF LOSS OF CREDIBILITY

There has been a lengthy history of corporate failure linked to governance and reporting failure. The recent high profile corporate failures may have involved larger numbers, but many of the issues highlighted are similar to those raised by cases in past periods. The cumulative impact of high profile cases has led to a steady loss in the credibility of financial statements and the participants involved with producing and reporting on them.

The 1980's and 1990's have many examples of reporting failure, generally associated with governance and business failure. In the U.K., cases of failure include names such as Maxwell, BCCI, Polly Peck and Barings. In France, the collapse of Credit Lyonnais was reported. Germany had Metalgesellschaft and Schneider. In Australia cases of AWA, Bond, Spedley Securities and Tricontinental occurred, while in Canada, Canadian Commercial Bank, Castor Holdings and Roman Corporation collapsed. Japan has Yamaichi, while the U.S. has the many examples from the savings and loan industry as well as cases such as Cendant, Sunbeam, Waste Management, Wedtech, and ZZZZ Best.

The East Asian financial crisis in the second half of 1997 also raised questions about the reliability of financial statements and the role of the large international accounting firms in reporting on them. A report issued by the United Nations Conference on Trade and Development (UNCTAD) in March 1999 considered the corporate reporting implications of the crisis. The report stated that:

“The failure or near failure of many financial institutions and corporations in the East Asian region resulted from a highly leveraged corporate sector, growing private sector reliance on foreign currency borrowings and lack of transparency and accountability... . A crucial role was played by disclosure deficiencies.... And the lack of appropriate disclosure requirements indirectly contributed to the deficient internal controls and imprudent risk management practices of the corporations and banks.”

These concerns far-reaching as they were, at least in retrospect, were interpreted rather narrowly, as matters for some Asian countries and not the U.S., Western Europe, Japan, certainly “not for Nigeria” or elsewhere.

In the period to 2001, the stock markets in many of the developed countries had a long period in which prices rose rapidly to historically high levels. In certain sectors, such as telecommunications and e-business, the surge was particularly dramatic. The pressure to deliver performance in line with the expectations of the market was correspondingly high and, in many cases, increasingly focused on maintaining share prices in the short-term. The incentive was there for “creative accounting” and outright falsification to maintain high ratings. The problems arising from deceptive reporting went beyond national boundaries and the accounting profession is yet to recover from the shock waves created by loss of confidence.

The collapse of Enron and the related auditor issues are seen by many as the event that initiated the changed perception of the reliability of financial reporting. As the brief history set out here suggests, it might be better to consider Enron as the event that confirmed a trend and, by its sheer size, awoke many to issues that had been significant for some time. Enron now serves as the benchmark or reference point that gave the issues greater visibility. The larger, but much simpler, reporting failure at WorldCom and issues raised at Global Crossing, Tyco, Adelphia, and Xerox added further examples, reinforcing the perception that financial reporting was not to be relied upon.

8.6 THE GLOBAL NATURE OF THE LOSS OF CREDIBILITY

Recent U.K. cases include Independent Insurance and Equitable Life. In respect of Ireland's Elan, a pharmaceutical company, questions were raised in relation to accounting, auditor independence and governance issues. The large French multi-national Vivendi added misleading reporting to business and governance issues. ABB, the Swiss-Swedish engineering group, added significant governance and accounting issues to its huge business problems.

Other recent continental European examples include Comroad, where 97% of revenue came from a nonexistent company, Babcock-Borsig, Kirch, Philipp Holzmann and EM. TV in Germany, and Lernout & Hauspie in Belgium. Australia had HIH Insurance, with its substantial accounting misstatement issues. Governance and accounting questions at Korea's large conglomerates continued, with allegations that the SK Group had inflated profits at one subsidiary by \$1.2 billion. Most recently, the Dutch retailer, Royal Ahold, has been tagged Europe's Enron, given the large numbers involved and the reports of aggressive earnings management, accounting irregularities, ineffective governance, and questions on auditor performance.

It would be observed that all the examples cited were from the developed economies. This does not imply that the developing economies are free from the loss of credibility. Even before the loss became a worldwide phenomenon, users had placed no confidence in financial reporting emanating from the less developed economies mainly because:

- (a) These reports were not produced by the international firms;
- (b) They did not involve multinational corporations; and
- (c) Their impact on the international stage was minimal.

Each of the examples provides evidence of reporting failure. Many of the reports suggest the existence of fraud and all point to the failure of corporate governance mechanisms. Many question the effectiveness of the audit process. As the summary indicates, the cases that initiated the recent heightened level of concern were U.S. events, but the levels of the stock markets and industry factors provided rapid linkages to other markets. Governments and other bodies around the world have seen a need to take action, conduct reviews and commission reports. Some have claimed that "it could not happen here" even if history has shown otherwise.

Globalisation of markets continues to be a major factor both for goods and services and for the provision of finance. Securities offerings are no longer limited to an entity's home country, but are frequently offered in multiple jurisdictions. Securities of many companies are now traded on exchanges in a number of countries. For example, during the 1990's, the number of non-U.S. companies listed on a U.S. stock exchange, and therefore subject to SEC reporting, increased threefold to over 1200. Similar increases occurred in foreign listings in other markets.

However, regulation is, and is likely to remain, a national matter and therefore the standards which determine how financial statements are presented are national standards. A company with securities listed in more than one country will continue to be subject both to the rules in its home country and those in the other countries in which it is listed. The presence in the market of sets of information that are different, but each of which purports to be a fair presentation, undermines the credibility of each set. This increases the inefficiency of the market as well as adding unnecessary costs.

The solution to this is not to have every country adopt one country's standards. While prior to Enron, some argued — and not just those based in the U.S. — that the solution was for all countries to adopt U.S. accounting principles and associated practices. Adopting one country's standards is not likely to be acceptable politically even if it were possible to agree on which country's standards to adopt. The alternative is to agree on a "neutral" set of standards which can be accepted by every country and either adopted as the country's standards or incorporated into them.

8.7 RECENT DEVELOPMENTS

Changes aimed at improving the credibility of financial reporting did not start after the collapse of Enron. They have been ongoing for many years. Intensive efforts have been made in a number of the developed countries to review and address issues such as corporate governance, accounting standards and auditor performance, and at the international level to develop enhanced standards to guide the national processes of change. A typical example of such effort is the establishment of the Financial Stability Forum. The report of this forum focused on the international standard setters and on developments at the national level, particularly in those countries with well developed market economies, sets out some of the more significant developments in recent years; it aims to provide some background without attempting a comprehensive survey. Many of the more recent developments noted are still at the proposal stage while others, although they have been put in place, are so new that it is too early to assess their impact.

8.7.1 The Financial Stability Forum

The Financial Stability Forum (FSF) was established by the G7 Finance ministers in 1999 in an effort to improve the international financial

architecture. It was asked to focus on ways in which crises such as the East Asian financial crisis could be avoided or, if they did occur, the consequences could be minimised. The Forum comprises representatives of national Finance Ministries, central banks, other regulatory and government agencies and international institutions. It concluded very quickly that matters would be improved if all countries had strong market foundations with regulatory systems in areas such as banking, insurance and securities that were in line with best practices.

They moved on to identify best practices and from a list of over 60 standards or sets of rules, concluded that there were 12 standards that were the most important.

Included in the 12 standards are:

- (a) International Financial Reporting Standards, issued by IASB;
- (b) International Standards on Auditing, issued by IAASB;
- (c) The OECD Principles of Corporate Governance; the Core Principles for Effective Banking Supervision, issued by the Basel Committee on Banking Supervision;
- (d) The Objectives and Principles of Securities Regulation, issued by IOSCO;
- (f) The Insurance Core Principles, issued by the International Association of Insurance Supervisors; and
- (g) Principles on insolvency which are being developed by the World Bank.

The remaining key standards are of less direct relevance to financial reporting and cover transparency in monetary and fiscal policies, fiscal transparency, data dissemination, securities settlement systems and money laundering.

The World Bank and the IMF were given the job of assessing whether individual countries are complying with these standards. The World Bank, in its ROSC (Reports on Standards and Codes) process, has focused on accounting, auditing and corporate governance. Its reviews, primarily in developing countries, have identified many gaps between actual practices and the standards. The reviews have also attempted to identify the causes of non-compliance. From this, the World Bank has facilitated meetings of stakeholders, in both the public and private sectors, to develop plans to upgrade both standards and practices. In its twice yearly meetings and through regional meetings, the Financial Stability Forum has continued to look at ways in which the international organisations can increase the pace of change, through either encouragement and support or external pressure.

8.7.2 The Organisation for Economic Cooperation and Development

The OECD Principles of Corporate Governance, one of the Financial Stability Forum's 12 key standards, were issued in 1999 and cover five areas: the rights of shareholders, the equitable treatment of shareholders, the role of stakeholders, disclosure and transparency, and the responsibilities of the board. OECD has started preliminary work toward a 2004 assessment as to whether changes in the Principles are needed.

Although suggestions have been made for expanding the Principles to include detailed "rules" on such matters as the criteria for consolidation of subsidiaries and off-balance sheet finance, the consensus appears to be that the Principles are appropriately named and should not be converted into a detailed set of rules. The FSF has suggested that the Principles should be strengthened to reflect recent improvements in national practices and that more guidance should be provided on implementation and enforcement, major issues in this area as in others.

8.7.3 The International Organisation of Securities Commissions

IOSCO, the International Organisation of Securities Commissions, issued a revised set of objectives and principles for securities regulation, another of the FSF's 12 key standards, in February 2002. Among the 30 principles are those related to full, timely and accurate disclosure of financial results (by issuers), the need for high quality and internationally acceptable accounting and auditing standards, and the need for the regulator to have comprehensive inspection, investigation, surveillance and enforcement powers.

The guidance to regulators was expanded when it issued two statements relating to auditing in October 2002. The first statement, on auditor independence, supports the "threats and safeguards" approach underlying IFAC's Code of Ethics, but then indicates that a framework is not sufficient to protect investors without the clarity that comes with specific provisions on activities and relationships considered unacceptable regardless of any safeguards that might be applied. This statement also concludes that there should be requirements for audit firms to maintain internal systems and processes for monitoring, identifying and addressing threats to independence and for ensuring compliance with the standards. This statement also includes the requirement that a governance body, independent of management, should oversee the selection, appointment and remuneration of the auditor and the conduct of the audit.

The second statement sets out principles for auditor oversight, including the need for the audit firm's processes and systems to be assessed and evaluated by an external oversight body that is seen to act in the public interest. The body would oversee the process for the licensing of auditors, auditor independence and the implementation of auditing standards. It

should also establish a process for regular reviews of audit procedures and practices of firms that audit listed companies. All these functions could be performed by a professional body, as they are today in many countries, but where this is so, an independent public interest oversight body should also be in place.

8.7.4 The European Union

Among the more significant developments crossing national boundaries have been those within the European Union. Although the E.U. focused, from an early stage, on the importance of financial reporting as a key element in producing a common internal market, the impact of the 4th, 7th and 8th Company Law Directives in providing a high quality common approach to reporting was very limited as countries implemented the Directives 51 with minimum changes from their previous very different practices. Recent developments should produce both improvement and convergence in financial reporting.

The decision to require the use of IFRSs for the consolidated financial statements of listed companies and to allow individual countries to decide whether this requirement should be extended to other companies should improve the financial statements of many companies across the E.U. At the same time, it will put pressure on IASB to deliver on its program of strengthening its standards. The E.U. is putting in place a structure to give input to IASB during the development of standards and to formally approve them. IASB will want to have this approval and the E.U. will want to provide it; this will provide constructive tension in the process, which should be beneficial to all potential users.

In parallel with the decision-making on accounting standards, the European Commission has been focusing on issues related to the quality of auditing and to compliance with standards through its Committee on Auditing. This committee has representatives from each member country government and from the accounting profession. The deliberations in the committee have allowed the E.C. to issue recommendations on external audit quality control and auditor independence. In May 2003, the European Commission issued proposals for extensive and positive changes in corporate governance and auditing. The corporate governance proposals include requiring an annual corporate governance statement, establishing minimum standards for the composition and role of nomination, remuneration and audit committees, and providing greater transparency and shareholder influence in relation to directors' remuneration. The audit-related proposals include the adoption of ISAs, the strengthening of public oversight of the audit profession and reinforcement of the regulatory infrastructure. The E.C. will also analyse the economic impact of auditor liability regimes.

8.7.5 The International Federation of Accountants

Standards and regulations are today primarily national matters. The E.U. decision to use international standards in accounting and auditing instead of national standards is intended to change this. At the same time, this decision raises questions of how structures can, practically speaking, be developed or adjusted to support a multilateral approach.

In 2000, IFAC embarked on a four-point plan to strengthen its position as the international standard setter in the audit field and potentially as the international self-regulatory body for the profession.

- (a) The first area to be addressed was audit standard setting. Additional resources have been provided to IAASB, its membership has been widened and its processes have been made more transparent. Discussions continue with representatives of regulators and others as to whether additional changes are needed so that ISAs can receive the necessary acceptance from the regulatory community.
- (b) IFAC has also focused for the first time on whether its member-bodies are complying with IFAC's guidance as to best practice in running a professional body. An initial assessment of the issues has been made and the requirements of member-bodies are being codified and clarified by issuing Statements of Membership Obligations.
- (c) The large networks of accounting firms, which perform most of the international audits and most of the audits that have been subject to recent criticism, have been linked more closely to IFAC through the establishment of the Forum of Firms. The Forum is not part of IFAC, but its operational committee, the Transnational Auditors Committee, provides the link through being a committee of both IFAC and the Forum.
- (d) The fourth element in the plan for strengthening IFAC was to have been the establishment of a public oversight body with characteristics similar to the then existing U.S. Public Oversight Board. With the strong criticism of the U.S. Public Oversight Board post-Enron, this solution for providing public interest input was no longer considered credible, and discussions continue with stakeholders to determine whether there is an alternative approach to obtaining public-interest involvement which would be both beneficial and acceptable.

During this period of restructuring, IFAC has continued to develop new or improved standards in its public interest activities. The Code of Ethics on Auditor Independence, which provided major input to the European Commission's Recommendation on auditor independence, and the completion of a substantial body of International Public Sector

Accounting Standards, are two of the main examples. The IFAC Ethics Committee is now focusing on the remainder of the Code, including that part of it related to accountants in industry. The IFAC Board has also underlined its commitment to the public interest by requiring that each board member should confirm this in an oath of office.

8.7.6 The International Accounting Standards Board

The International Accounting Standards Committee (IASC) was founded over 25 years ago by the same accounting professional bodies that founded IFAC. This close association with the profession began to be questioned as IOSCO conducted its review of its standards to determine whether it was appropriate to endorse them. A Task Force with representatives of various stakeholders, including regulators, IFAC and IASC, concluded that IASC should become independent of the profession and that it should have substantially greater resources including a mainly full-time Board. The International Accounting Standards Board (IASB) was the result. IASB is responsible for the development of IFRSs, one of the 12 key FSF standards.

IFRSs and ISAs are different from the other standards in that they are the only two of the 12 which are developed by private sector bodies. This creates special issues in gaining acceptance by government bodies such as regulators. It means that in addition to accepting the appropriateness of the standards themselves, the regulators need to be satisfied as to the process by which the standards have been produced. This covers areas such as selection of board members, transparency of operation, input of stakeholders, finance, and public interest oversight.

The restructuring of IASC, to form IASB, appears to have established a basis for acceptance in the area of international accounting standards. IASB is in the midst of upgrading standards in response to concerns of IOSCO, which has endorsed IFRSs subject to resolution of certain issues, and the needs of the European Union, which will require the use of IFRSs for the consolidated financial statements of listed companies from 2005. IASB has also committed to reviewing IFRSs from the viewpoint of the smaller entity. Members of IASB have been given responsibility for liaison with the accounting standard setters in a number of countries to encourage both cooperation in the use of resources and convergence of standards.

8.7.7 National Developments

The national developments that have received the greatest visibility at the international level have been those in the U.S., where the Sarbanes-Oxley Act, which was passed in 2002, introduced additional requirements for management of listed companies, stronger corporate governance rules and major changes in the regulation of auditors. SEC regulations

will implement the provisions during 2003. However, there have also been significant developments in other countries, many of which pre-date Sarbanes-Oxley. In the U.K. a series of reviews, starting in 1992, the most recent of which reported in January 2003, has produced extensive changes in corporate governance requirements and in the regulatory structure impacting auditors.

France reviewed various aspects of corporate governance in the Bouton Report published in September 2002. Developments in Australia, Canada and Japan are also summarised to illustrate the extent of changes being put in place.

8.7.8 Requirements of Management

Sarbanes-Oxley introduces in the U.S. a number of restrictions relating to management that some other countries have had for a number of years. For example, in the interests of protecting auditor's independence, the CEO, CFO, Controller, and Chief Accounting Officer could not be employed by the company's audit firm during the one-year period preceding the audit. In the future, it will also be unlawful to make loans to directors and officers. Directors and officers are also required to disclose their share transactions by the end of the second business day, much more quickly than ever before. Sales of company securities by directors and officers are now prohibited when company pension fund members generally are barred from doing so during the so-called black-out periods.

The CEO and CFO are now required to prepare a statement to be filed with the quarterly and annual financial statements certifying the "appropriateness of the financial statements and disclosures contained in the report, and that those financial statements and disclosures fairly present, in all material respects, the operations and financial condition" of the company. Annual and quarterly reports are now required to disclose all material off-balance sheet transactions and other relationships with unconsolidated entities.

The SEC is also required to conduct a study of the appropriateness of accounting followed in this area. Management is now required to make and report an assessment of internal controls. The auditor will be required to report on the assessment. Each company is required to disclose whether it has adopted a code of ethics for its senior financial officers and to disclose its contents. The Act also introduces new provisions making it an offense to "fraudulently influence, coerce, manipulate, or mislead" an auditor. The SEC may also bar an individual from being a director or officer of an SEC registrant.

Finally, the CEO and the CFO are now required to repay any bonuses or other incentive or equity based payments and any profits made on the

sale of securities where the financial statements are found to be materially noncompliant in the following 12 months.

In 2001, the U.K. Auditing Practices Board issued a paper highlighting issues related to aggressive earnings management. Ireland proposes to introduce in 2003 a requirement for the directors to publish a statement that the company has complied with company, tax and other laws. This statement will need to be reviewed by the auditor.

8.7.9 Corporate Governance

The strengthening of corporate governance has been a key focus in many countries, including all the countries represented on the Task Force. The U.K. has devoted considerable attention to the strengthening of corporate governance, starting with the Cadbury Report in 1992. The resulting Code of Best Practices has been expanded and remains voluntary. However, the Financial Services Authority, in its role as the U.K. regulatory authority, requires that companies that do not comply should explain that fact. The Code covers such matters as the composition of the board, the responsibilities of directors and audit committees and the relationship with auditors. Following from the Turnbull Report in 1999, listed companies have also needed to report that they have processes for identifying, evaluating and managing significant risk.

Ireland proposes to make major changes in its corporate law in 2003, including strengthening the role of the audit committee with a wide scope, including larger non-listed companies. In May 2001, a French law introduced a new legal framework enabling companies to separate, for the first time and on a voluntary basis, the functions of the chairman and the chief executive. The law also contains provisions on shareholder rights, the responsibilities of the board, prevention of conflicts of interest, and allotment and disclosure of share options.

The Canadian Joint Committee on Corporate Governance, the Saucier Committee, which reported in November 2001, presented a comprehensive set of proposals covering what they identified as the five core functions of a board: choosing the CEO, setting the broad parameters within which management operates, “coaching” the CEO, monitoring and assessing the performance of the CEO, and providing assurance to the shareholders and stakeholders about the integrity of the company’s financial performance. Included in the detailed description of these core functions is approving a communications policy that includes a framework for investor relations and a public disclosure policy. The report also emphasises the importance of having the right directors, as well as directors who are independent and introduces the idea of an independent board leader where the chairman is not independent. The committee confirmed the importance of audit committee members being outsiders and unrelated as well as being financially literate, but concluded that it was not necessary to set detailed definitional rules along the lines subsequently introduced in the U.S.

The committee also concluded that the external auditors should be accountable to the board and the audit committee, and not management. Additionally, the committee concluded that where there was no internal audit function, this situation should be reviewed regularly by the audit committee.

Germany introduced its first comprehensive corporate governance code in February 2002. As in some other countries, the code is non-statutory but if a company chooses not to comply, it should disclose that fact. The detail of the code reflects Germany's dual board system of supervisory and management boards. The supervisory board, which has either one-third or one-half employee representatives, depending on the size of the company, may not have more than two members who are former members of the management board. The supervisory board is required to establish an audit committee whose chairman should not be the chairman of the supervisory board or a former member of the management board. The audit committee has a similar role to committees in other countries.

In Nigeria, the case is not different. As a 2001, the Securities and Exchange Commission (SEC) in collaboration with Corporate Affairs Commission (CAC) constituted a Committee to assess the strength of corporate governance practice in Nigeria. This effort resulted in the issuance in 2003, of the Code of Best Practices on Corporate Governance for publicly quoted companies. The code listed among other things, the composition and powers of the Executives of companies, role of Audit Committees, separation of powers between the Executive Management and the Board, with the effect that the Head of Management, i.e. the Managing Director/Chief Executive Officer should be different from the Head of the Board in order to avoid the concentration of dual powers on one individual. On the strength of the code of corporate governance issued by SEC and CAC, other regulatory agencies such as the Central Bank of Nigeria (CBN) and the Institute of Directors (IoD) issued similar codes in line with the Code of Best Practices on Corporate Governance issued by SEC/CAC. For example, the Central Bank of Nigeria issued in April 3, 2006, what is regarded as Code of Corporate Governance for Banks in Nigeria post-consolidation. The Code was all encompassing and for the first time sets the time limit of external auditors to a bank, and stipulated stiff penalties for erring directors for banks as well as external auditors. Readers are encouraged to study the details of the provisions of these Codes (SEC/CAC and CBN) in Appendix VIII of this pack (page 371).

Sarbanes-Oxley introduces an independence requirement for audit committee members. Committee members may not receive compensation from the company except as a director and may not be affiliated with the company. The company will now be required to disclose whether at least one member of the committee is a financial expert, make a

declaration that the Audit Committee members are independent, disclose the committee's charter and produce an annual audit committee report. The committee now becomes responsible for the appointment, compensation and oversight of any accounting firm employed by the company and has the authority to engage outside advisers. The provision of non-audit services rather than pre-approving them, and only requiring a majority of the committee to be independent.

On the other hand, it suggested that Audit Committees meet at least once a quarter with the external auditors.

The Higgs and Smith Reports in the U.K. on the role of non-executive directors and on Audit Committees issued in January 2003 make a number of recommendations for change, but still conclude that a voluntary Code, supported by disclosure which requires the company to indicate whether it is in compliance with the Code or to explain why it is not, is preferable to rules set by law. The Higgs Report confirms the desirability of separating the roles of Chairman and CEO. A draft provision of the Code states that a CEO should not go on to become Chairman of the same company. The report also confirms the provision of the current Code that there should be a senior independent director in addition to the Chairman.

The Higgs Report also suggests that the balance of the board should be such that at least half the Board, excluding the Chairman, are independent of the company. The classification of a director as independent or otherwise is a matter for the board to determine.

Among the criteria that would provide a definition of independence to assist the board are that the directors:

- (a) May not have been employees in the previous five years;
- (b) Could not have had material business relationships in the previous three years;
- (c) May receive no remuneration beyond a fixed fee;
- (d) Can have no family ties with directors, senior employees or advisers;
- (e) Can have no cross-directorships with other directors;
- (f) Cannot be a representative of a significant shareholder; and
- (g) Could not have served on the board for more than 10 years.

The New York Stock Exchange issued new rules in August 2002 incorporating the Sarbanes-Oxley requirements and making a number of them more precise.

The High Level Group of Company Law Experts presented their final report, the Winter Report, to the European Commission in November 2002. A key recommendation was that corporate governance issues are best

dealt with in national codes, rather than in legislation and that companies should be required to comply with a specified national code or explain non-compliance.

This report recommended a major role for the audit committee with a number of differences from the U.S. approach, including, for example, monitoring control system and the effectiveness of internal audit, recommending the appointment and remuneration of the external auditors, and reviewing their independence. The members of the committee should be independent, as defined above, and should include at least one with significant, recent, relevant financial experience.

The Toronto Stock Exchange introduced new rules for operation of audit committees in April 2002. The new rules implement many of the recommendations of the Joint Committee on Corporate Governance. All committee members are required to be unrelated and financially literate, with at least one member of the committee being required to have accounting or related financial expertise. The committee is required to have a charter and its functions are similar to those in other jurisdictions, but emphasis is put on discussion with the auditors regarding the quality as well as the acceptability of accounting policies.

Canada also introduced specific corporate governance guidance for federally regulated financial institutions in January 2003. In addition to considering the role of the audit committee, the guidance places substantial emphasis on the role of the board in relation to risk management and internal controls.

The Bouton Report, issued in France in September 2002, proposes a lengthy list of changes to increase the effectiveness of boards of directors. The report considers the composition of the board, including proposing an updated definition of independence, the need for the board to have an evaluation process, the operation of the audit, compensation and nominating committees, and various matters related to stock options. The definition of independence is similar to the Higgs definition. The report also devotes considerable attention to the relations between the board and the auditors. A Government proposal currently in the parliamentary process will merge two French regulatory bodies into a new independent Financial Markets Authority with responsibility for protecting investor rights and improving investor and saver protection.

Proposals issued in September 2002 and effective for 2003, make it compulsory for the first time for the 500 largest Australian listed companies to have Audit Committees. Members will be required to be independent and, as in Canada, be financially literate. Additionally, at least one should have accounting or related financial expertise. The proposals require the committees to have charters covering similar

ground to the U.K. in such areas as auditor effectiveness and independence and review of company financial statements, but in the light of some of Australia's recent corporate scandals they add a requirement to review and monitor related party transactions and their propriety.

Japan has strengthened its corporate governance system through amendments to its Commercial Code. The board of statutory auditor system has been enhanced by increasing the number of independent members required. Effective April 2003, listed companies have two options for their corporate structures: they may have, as before, a board of statutory auditors or have a board of directors with audit, nomination and compensation committees. If a company chooses to retain its board of statutory auditors, at least half of its members will need to be outsiders with no director or employee relationship with the company. If the board and committee structure is chosen, a majority of the members of each committee will need to be independent.

8.8 ACCOUNTING AND AUDITING STANDARDS

Country reviews in the area of accounting standards have, in general, confirmed the national structures for developing standards and have supported the role of IASB and the principle of convergence. Sarbanes-Oxley will require changes at the U.S. accounting standard setter, the FASB, specifically in relation to governance and funding, but the standard setter will remain a private sector body. The FASB will need to be more focused on keeping standards current and to consider the extent to which international convergence of standards is necessary or appropriate.

The U.K. review leaves the accounting standard setting process unchanged and confirms the preference for standards based on principles rather than the detailed rules-based approach of the U.S. The French review suggests that the annual report should summarise the company's procedures for identifying off-balance sheet commitments and assessing material risks as well as providing more specific disclosure of the information itself. While supporting the move to convergence of national and international accounting standards, the report is critical of the approach being taken by IASB "in seeking to impose fair value accounting" in relation to derivatives and more generally as to the lack of transparency in its standard-setting process. As part of its program to converge with international standards, Japan has introduced a requirement for fair value accounting of financial instruments.

8.8.1 Auditors and Auditing

Concerns regarding the competence and independence of auditors have arisen regularly in recent years and have been the subject of a number of committee reports. Although the conclusions in most of these earlier reports have either been superseded by events or repeated in later reports, one recent report that has not been fully implemented is worth

a brief mention. The U.S. Panel on Audit Effectiveness which reported in August 2000, was established by the now defunct Public Oversight Board. The panel performed a comprehensive and independent review of the way in which audit work is performed.

It considered audit procedure methodology, firm and external quality control. Among its many recommendations was that there needed to be extensive changes in the then existing U.S. peer review system, as well as many detailed changes in audit procedures, including a greater focus on fraud. Among its other recommendations, which are still relevant, was that the firms put greater emphasis on the performance of high quality work and that IFAC should establish an international self-regulatory system for the auditing profession. The disbandment of the Public Oversight Board and the delays in activating its successor has meant that many of the panel's recommendations have not been implemented.

Sarbanes-Oxley establishes a U.S. Public Company Accounting Oversight Board (PCAOB), appointed by and responsible to the SEC, with much wider powers than the Public Oversight Board. The PCAOB's powers cover the registration of accounting firms, the establishment of auditing, quality control, ethics and independence standards, the inspection of accounting firms and investigations and disciplinary proceedings against accounting firms. The Act sets out detailed requirements that the Board must impose on firms, including the requirement to retain records to support audit reports for a period of at least seven years and a requirement to perform second partner reviews and adopt quality control standards. Annual quality reviews will be required of all firms auditing more than 100 SEC registrants; other firms will need to be reviewed every three years.

The list of services that an auditor may not provide to an audit client has been extended by the inclusion of financial information systems design and implementation and internal audit outsourcing, and now covers:

- (a) Bookkeeping or other services related to the accounting records or financial statements of the client;
- (b) Financial information systems design and implementation;
- (c) Appraisal or valuation services;
- (d) Actuarial services;
- (e) Internal audit outsourcing services;
- (f) Broker or dealer, investment adviser or investment banking services; and
- (g) Legal services.

The lead partner and the reviewing partner must rotate the audit every five years. There will also be a study of the potential effects of requiring mandatory rotation of audit firms.

The auditor will also be required to hold more extensive and structured discussion with the Audit Committee, reporting all “critical accounting policies and practices to be used...all treatments of financial information within accepted accounting practice that have been discussed with management... ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the firm.”

The Act, as expanded by the proposals from the New York Stock Exchange and NASDAQ, requires the Audit Committee to be responsible for the appointment, compensation, and oversight of the work of the external auditor, including the resolution of disagreements between management and the auditor regarding financial reporting. The auditor is required to report directly to the audit committee. The audit committee should pre-approve any non-audit services that are provided by the auditor. The audit committee’s role is significantly extended to include reviewing:

- (a) Major issues regarding accounting principles and financial statement presentation;
- (b) Analyses prepared by management or internal audit, setting forth significant reporting issues and judgments made in the financial statements;
- (c) The effect of regulatory and accounting initiatives and off-balance sheet structures;
- (d) Earnings press releases and financial information and earnings guidance provided to analysts and rating agencies; and
- (e) Any audit problems encountered during the course of the auditor’s work, including management’s response.

The Ramsay Report issued in Australia in 2001 considers the independence of auditors in great detail. It recommended changes in a number of areas including:

- (a) Updating existing legislative requirements concerning the independence of auditors;
- (b) Mandatory disclosure of fees paid to auditors for non-audit services, together with an assessment by the audit committee that the services do not impair the auditor’s independence;
- (c) Mandatory audit committees for listed companies;
- (d) Requiring the professional accounting bodies to update their ethical codes relating to audit independence;
- (e) A two-year cooling-off period for retired partners of accounting firms who have had audit involvement with a client before they could become a director of that company;
- (f) Mandatory rotation of audit partners every seven years; and

- (g) The establishment of a new monitoring body, the Auditor Independence Supervisory Board, independent of the accounting professional bodies, to oversee the audit profession.

In September 2002, as part of a wider program of corporate law reform, the Australian Government proposed changes in the law relating to auditor independence. These proposals are based largely on the conclusions of the Ramsay Report and are intended to be in place by the end of 2003.

The U.K. proposals reorder the regulatory and standard-setting bodies under a restructured Financial Reporting Council, which will be given statutory authority and whose chair and deputy chair will be appointed by the Government. The Council will have responsibility for:

- (a) The previously independent Accounting Standards Board, which will otherwise remain unchanged;
- (b) The Auditing Practices Board, which will add auditor ethics and independence to its role;
- (c) The Financial Reporting Review Panel, which will, in the future, take a more proactive role in searching for cases of failure to comply with accounting standards;
- (d) An Investigations and Discipline Board, which will consider serious public interest cases of alleged failure by auditors; and
- (e) A Professional Oversight Board, which will take over from the professional bodies responsibility for the quality inspection process of firms auditing public interest entities.

The U.K. review rejected firm rotation but supported the profession's decision to follow the U.S. by reducing the rotation period for the lead partner, but not for other partners, to five years. The review confirmed the E.U. recommendation on restrictions on non-audit services, including the "threats and safeguards" approach. The review also proposes greatly enhanced transparency on the part of audit firms, including the publication by all firms with listed audit clients, of an annual report providing information on the firm's policies and procedures, especially those related to audit quality and the management of threats to independence, and management and financial information.

The U.K. has also given attention to the relationship between auditors and the board and the audit committee with the Auditing Practices Board, issuing an Auditing Standard (SAS 610), *Communication of Audit Matters to Those Charged with Governance*, in 2001. France has given significant attention to this area over a number of years, starting with the Le Portz Reports in 1992 and 1999. The Bouton Report, issued in September 2002, highlights the French view that its system of joint audits greatly reinforces auditor independence as it should result in all the key issues being reviewed twice. Having a fixed appointment of six years is a further reinforcement.

The report rejects compulsory firm rotation, whilst supporting partner rotation, and concludes that the audit committee should oversee a tendering process at the end of the six years. The report takes a strong line on the provision of non-audit services in concluding that, with the exception of ancillary work, the auditor should carry out no other work for the client.

France is proposing compulsory rotation of audit partners after each six-year fixed term. The soon-to-be established Financial Markets Authority will be required to set up a new audit oversight body, the Council of Statutory Auditors. The new Council will, among other matters, be required to ensure that there is a strict separation of the provision of audit and non-audit services to audit clients. New legislation has recently been passed in the Japanese Diet based on a December 2002 report from a subcommittee of the Financial System Council. Auditor oversight is to be enhanced by having the professional body's (JICPA) system of quality control review monitored by an independent third-party board, the CPA and Auditing Oversight Board (CPAFOB), to be established within the Financial Services Agency (FSA). The FSA will also have a general right to inspect audit firms and require firms and the JICPA to make improvements. The new law focuses on auditor independence. Rules similar to those in place in other countries have been introduced relating to prohibition of certain non-audit services, rotation of engagement and review partners, restriction of employment of former engagement partners and disclosure of audit and non-audit fees.

A further area of change in Japan relates to increasing the number of CPAs. The objective is to provide the capacity to permit an increased volume and quality of auditing.

In parallel with the various national reviews and reports, the accounting firms have also taken action. Three of the four largest firms have now disengaged from performing information systems installation and design work by selling or spinning off that element of their practices.

8.9 ANALYSTS

Sarbanes-Oxley requires the relevant self-regulatory organisations to adopt conflict-of-interest rules for research analysts that recommend equity investments, but otherwise the Act is silent. The most recent U.K. reviews have not considered the role of analysts, although the securities regulator, the Financial Services Authority, has issued a discussion paper on the conflicts arising in relation to investment research.

The French regulator issued new provisions in April 2002 aimed at strengthening the independence of analysts by managing conflicts of interest and disclosures and by establishing procedures for disseminating research. Effective April 2003, enhanced self-regulatory rules covering the activities of

securities analysts were implemented in Japan. Analysts are required to be institutionally independent from investment banking operations, their compensation should not be linked to the performance of investment business, and the analysts and their firms are required to disclose any conflicts of interest relating to the companies they report on. Firms are required to establish review processes which ensure the objectivity and integrity of research reports. Those reports must not be disclosed to companies before publication.

The German Society of Investment Analysts and Asset Management adopted a new Code of Professional Conduct in February 2003. The Code focuses on independence and integrity and requires the disclosure of conflicts of interest. Canada has also introduced new standards to deal with the potential conflicts of interest impacting investment analysts. The Australian Securities and Investments Commission is currently investigating the practices of analysts to determine whether changes in regulations are required. IOSCO is also currently considering the principles that should be applied to investment analysts and credit-rating agencies.

8.9.1 Other Changes

Sarbanes-Oxley (discussed in Chapter 6) requires the SEC to set minimum standards for professional conduct for lawyers practicing before it. The SEC is also to conduct a study of those professionals — accountants, investment bankers, investment advisers, brokers, dealers and lawyers—who may have aided and abetted the violation of securities laws including the filing of materially misleading financial statements. Reviews in other countries do not appear to have considered the role of these other participants.

8.10 NATIONAL RESPONSES IN RELATION TO INTERNATIONAL NEEDS

International needs are most likely to be met if national changes move national standards to the international benchmark standards. Generally, the international standards are principles-based rather than rules-based. In a country with a bias towards rules-based standards, it is possible to have a standard which is intended to be in line with the international standard, but with detailed rules which narrow the application of the principles and therefore end by not complying with the international standard.

Detailed rules are also a source of unimportant but aggravating differences which make it difficult for a company to comply with standards in more than one jurisdiction. The recent emphasis on having board members who are independent, but with different definitions of independence in different reporting jurisdictions, has produced such differences. Another popular change in regulation requires that an audit committee have financially literate members and that at least one member should have accounting or related financial expertise. The New York Stock Exchange is leaving the definition of financially literate to the board of each company; the Toronto Stock Exchange

is also leaving the definition to the board, but will require disclosure of the assessment; NASDAQ has concluded that it is necessary to define financial literacy. Defining accounting or related financial expertise is being left to the board in Canada.

These differences in corporate governance codes or regulations only matter to companies if they are listed in more than one country and are required to comply with each national set of rules.

Where the national rules, although different, complied with a benchmark standard, Sarbanes-Oxley does not recognise this approach as far as the U.S. is concerned.

The situation with accounting standards is of still more concern. A recent survey of knowledgeable investors (McKinsey Global Investor Opinion International needs are most likely to be met if national changes move national standards to the international benchmark standards. Survey on Corporate Governance 2002) showed 90% of investors supporting a single set of accounting standards, but with 78% of those in Western Europe concluding that the standards should be IFRSs while 76% of those in North America thought that the single set should be U.S. generally accepted accounting principles. If this difference of view prevails with the national standard setters, there will continue to be a major credibility issue, with at least two sets of standards being used to produce financial statements that present fairly.

8.11 SOCIAL/ENVIRONMENTAL AUDITS

Social Audits have to do with the extent to which a company gets involved and interacts with the society in which it operates including the welfare of its employees. In this regard, a company does not just operate for profit, even though this may be the primary motive, but a company cannot operate in isolation. Social audit will therefore consider:

- (a) The company's policy on staff incentives, pensions and welfare, recreational facilities and conveniences;
- (b) The company's pricing policy, product safety, quality control, warranty effectiveness, advertising integrity, debt settlement and collection methods; and
- (c) Environmental protection policies and safety measures.

Businesses have grown in size and scope. Consequently, they have made great impact on the lives and well-being of individuals and the society in which they operate. Ordinarily, the primary concern of corporate governance focuses on:

- (a) Customers;
- (b) Suppliers;
- (c) Government;
- (d) Competitors; and
- (e) Labour unions.

In addition to these, there has been a growing interest in the way businesses interface with their environment. This has become paramount as the success and continued existence of business may not depend on the profit achieved or its service delivery to customers, but its relationship with the society at large.

There are external considerations to social audit. This has to do with public perception of the organisation which determines the reputation of the company and a guide to the quality of its products and service delivery.

Social audit also extends to environmental audit where the auditor assesses and reports on the extent to which the organisation works to protect the environment in the interest of future generations. In extreme cases, where damage is done to the environment as a direct consequence of industrial activities, pressure groups of 'green movements' are known to have taken strong actions to coerce corporate governance to be more environmental friendly.

8.11.1 Health And Safety Of Employees

Beyond the law relating to factory regulations and safety, there is an added responsibility on the part of management to consider the health and welfare of employees as paramount in its overall corporate responsibilities. The factors which are indicators of management concerns for the health and safety of employees include:

- (a) A key officer being responsible for promoting this function;
- (b) A health committee of senior representatives of each work area;
- (c) Health and safety being firmly on the agenda of board meetings;
- (d) Safety training for line managers and operatives;
- (e) Suitable publications and safety signs located across the organisation;
- (f) A policy that locates responsibility for health and safety with management;
- (g) A risk-based approach that seeks to identify key potential problem areas;
- (h) A budget for the use of health and safety experts wherever necessary;
- (i) A zero-accident policy that is fully supported throughout the organisation; and
- (j) A procedure for investigating the cause of accidents, near-accidents and relevant incidents.

8.11.2 Business Ethics and Code of Conduct

Companies now pay a great deal of attention to its corporate code of conduct and business ethics. This may be raised to a strategic level and advertised just like any other products or services of the company. The auditor should objectively assess the extent of standards of ethics demonstrated by the management to be adopted by employees down the line. This has the unquantifiable benefit of discouraging fraud on

the part of staff. Part of the business ethics which may make remarkable impact on the staff is the policy of equal opportunity for all regardless of race, religion, gender or physical disabilities. The auditor will also need to assess mechanisms in place for staff selection and appraisal for staff elevation.

8.11.3 Environmental Pollution

The bottom line in environmental audit is management's concern and reaction to matters relating to the physical impact of its business activities in terms of pollution.

This may include river pollution, wildlife destruction, chemical emission, soil excavation, dumping of rubbish and uncontrolled disposal of toxic waste. The ability to strike a balance and be accorded high rating in matters relating to social audit is a good measure of responsible corporate image and social conscience of an organisation.

8.12 SUMMARY AND CONCLUSIONS

Recent cases of failure in financial reporting led to the loss of credibility in financial reporting and the audit processes. These reporting failures were interpreted as being partly responsible for the failure of large corporations with disastrous consequences. The recent failure of such large corporations which were seen as safe and stable has caused regulatory authorities, standard setters and governments to issue rules and regulations, which may not be entirely new but which at least re-inforced existing rules for corporate governance and auditors. These rules are applicable to all corporate entities but they are particularly relevant to corporations whose activities transcend national boundaries, thus placing greater burden on the auditors of such corporations. Social audits have to do with the corporate image of an organisation in its relation with its employees and the society in which it operates. Social audits consider such matters as employee's health and welfare, the business ethics and code of conduct adopted by the organisation and the attitude of the organisation to the environment.

Refer to Comprehensive Questions and Suggested Solutions in Appendix II, page 303.

8.13 REVISION QUESTIONS

8.13.1 MULTIPLE CHOICE QUESTIONS

1. Social audit does not extend to one of these
 - (A) Employee health and safety
 - (B) Transaction audit
 - (C) Corporate code of conduct and business ethics
 - (D) Equal opportunities
 - (E) Environmental pollution.

2. Large firms of auditors are multinationals made up of a net work of independent firms
 - (A) With common processes and basic policies.
 - (B) Whose operations are limited to specific regions.
 - (C) Who hold large stocks in multinational corporations.
 - (D) Whose quality control standards are higher than the medium-size firms.
 - (E) Who operate independent of the local standards.

3. Multinational firms are those that carry out transnational audits and such
 - (A) are independent of the local laws and regulations.
 - (B) are not expected to operate under the professional rules of any particular country.
 - (C) are not liable to any supervisory bodies.
 - (D) must operate subject to national laws and professional rules in more than one country.
 - (E) are expected to buy the stocks of of the multinational corporations.

4. The applicable auditing standards in Nigeria is called
 - (A) Nigerian International Standards on Auditing.
 - (B) Nigerian Auditing Standards.
 - (C) Nigerian Standards on Auditing.
 - (D) Auditing Standards for Nigeria.
 - (E) Standards for Nigerian Audits.

5. One of the short comings of national Auditing Standards is that
 - (A) standards setters may be subject to local political pressures.
 - (B) the investment in the local stock exchanges may not be adequate.
 - (C) investments in foreign stocks are better than local ones.
 - (D) local standards setters do not belong to professional bodies.
 - (E) local standards setters do not travel abroad frequently.

6. The weaknesses of local standards have led to
 - (A) local CEOs becoming very corrupts.
 - (B) companies to adopt these standards.
 - (C) multinational audit firms do not adopt these standards.
 - (D) multinational corporations collapse more frequently than small firms.
 - (E) weak or faulty financial reporting.

7. The frequent cases of restatement of financial statements has brought about
 - (A) the collapse of large corporations.
 - (B) the frequent resignation of chief executives.
 - (C) the reporting standards being abandoned.
 - (D) financial statements being used by more people.
 - (E) loss credibility in financial reporting.

8. The most widely publicised case that prompted the changed perception and reliability of financial reporting and hence the need to restore that credibility was the
 - (A) collapse of Xerox.
 - (B) collapse of Vivendi.
 - (C) collapse of Enron.
 - (D) collapse of Tyco.
 - (E) collapse of BCCI.

9. Recent efforts to restore credibility in financial reporting have been undertaken by the following except one
- (A) the European Union.
 - (B) the African Union.
 - (C) the International Organisation for Securities Commission.
 - (D) the Organisation for Economic Cooperation and Development.
 - (E) the International Federation of Accountants.

8.13.2 SHORT ANSWER QUESTIONS

10. Two typical examples of collapse of large multinational corporations are _____ in the US, and _____ in France.
11. High profile cases of business failure have been the combined effects of: (a) _____, (b) _____ and (c) _____.
12. Two strong incentives for creative accounting are pressures to: (a) _____ and (b) _____.

Refer to suggested solutions to revision questions in Appendix I, page 297.

INFORMATION TECHNOLOGY ISSUES IN ADVANCED AUDIT AND ASSURANCE

9.0 LEARNING OBJECTIVES

After studying this chapter, readers should be able to understand:

- ◆ Internal Control in a Computer Environment.
- ◆ IT Governance.
- ◆ IT Control Activities.
- ◆ Systems Evaluation and Procedural Controls.
- ◆ IT Risk Assurance Methodologies and Process.
- ◆ Disaster Recovery.
- ◆ Networking (Protocols and Standards).
- ◆ Communication Risks.

9.1 INTRODUCTION

In this chapter, we will further advance the discussion already commenced in the companion study pack, paper 6 - Audit and Assurance. Information Technology issues in the areas of IT General Controls (ITGC), IT risk assessment and Auditors role in Systems Development Life Cycle (SDLC) as well as IT governance issues will be discussed.

9.2 IT GENERAL CONTROLS (ITGC)

ITGC represent the foundation of the IT control structure. They help ensure the reliability of data generated by IT systems and support the assertion that systems operate as intended and that output is reliable. ITGC usually include the following types of controls:

- (a) **Control Environment**, or those controls designed to shape the corporate culture or “tone at the top” as enunciated by COSO.
- (b) **Change management procedures** - controls designed to ensure changes, meet business requirements and are authorised.
- (c) **Source code/document version control procedures** - controls designed to protect the integrity of program code
- (d) **Software development life cycle standards** - controls designed to ensure IT projects are effectively managed.
- (e) **Security policies, standards and processes** - controls designed to secure access based on business need.

- (f) **Incident management policies and procedures** - controls designed to address operational processing errors.
- (g) **Technical support policies and procedures** - policies to help users perform more efficiently and report problems.
- (h) **Hardware/software configuration**, installation, testing, management standards, policies and procedures.
- (i) **Disaster recovery/backup and recovery procedures**, to enable continued processing despite adverse conditions.

9.3 IT APPLICATION CONTROLS

IT application or program controls are fully-automated (i.e., performed automatically by the systems) and designed to ensure the complete and accurate processing of data, from input through output. These controls vary based on the business purpose of the specific application. These controls may also help to ensure the privacy and security of data transmitted between applications. Categories of IT application controls may include:

- (a) **Completeness checks** - controls that ensure all records were processed from initiation to completion.
- (b) **Validity checks** - controls that ensure only valid data is input or processed.
- (c) **Identification** - controls that ensure all users are uniquely and irrefutably identified.
- (d) **Authentication** - controls that provide an authentication mechanism in the application system.
- (e) **Authorisation** - controls that ensure only approved business users have access to the application system.
- (f) **Problem management** - controls that ensure all application problems are recorded and managed in a timely manner.
- (g) **Change management** - controls that ensure all changes on production environment are implemented with preserved data integrity.
- (h) **Input controls** - controls that ensure data integrity fed from upstream sources into the application system.

9.4 IT GOVERNANCE

9.4.1 Governance Issues

IT Governance is a subset discipline of Corporate Governance focused on information technology (IT) systems, their performance and risk management. IT Governance is a set of processes and functions (carried out in a structure of relationships as depicted in Figure 9.4.2) used in ensuring that the enterprise's IT operations are in the proper direction and under control towards the achievement of its goals and objectives.

Modern IT governance implies a system in which all stakeholders, including the board, internal customers, and in particular departments

such as finance, have the necessary input into the decision making process as against the traditional system which defers all key decisions to the company's IT professionals only.

This prevents IT professionals from independently making and later being held solely responsible for poor decisions. It also prevents critical users from later finding that the system does not behave or perform as expected.

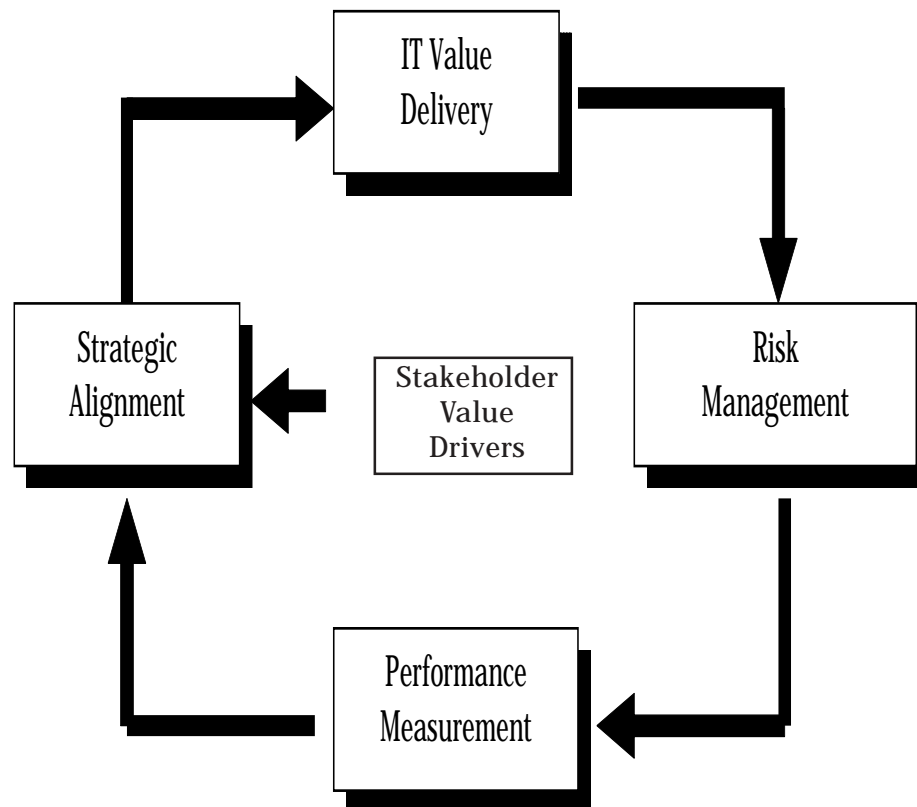


Figure 9.1: IT Governance Structure of Relationships

9.4.2 IT Governance Framework

IT Governance should operate within the following framework to achieve its goals and objectives:

- (i) The board, not the IT function, should be the prime driver for IT governance. It should provide a framework for governance for a standardised communication interface and channel, for governance, along with simple rules to align and inform everyday decisions and actions toward sustainable financial results;
- (ii) As with the corporation as a whole, sustained financial results should be the objective, prime driver for IT decisions and actions;
- (iii) Govern assets with the purview of IT governance (infrastructure, clients and external stakeholders, internal people and process, including suppliers and partners, and value creation). Governance should include managing the current and propelling toward the future state of the enterprise;

- (iv) Since governance is behaviour-driven, emphasis in implementing this framework should be on changing behaviour rather than introducing or changing work artifacts. Roles should be set out, including expected behaviour changes, not just for the board and top management, but for auditors (IT, security, financial), internal staff and external entities (such as suppliers); and
- (v) Other IT governance activities (such as IT service continuity management) and frameworks (such as the IT Infrastructure Library) should be aligned within the corporate governance framework, including program office, project, financial/investment processes, service-level management, business/IT alignment, security and IT audit/conformance, and IT service management processes.

9.4.3 Level of IT Oversight in the Organisation

IT oversight function in an organisation comprises the following:

- (i) Evaluation of IT Governance effectiveness. This is to ensure that there is adequate control of the board over the decisions, directions and IT performance;
- (ii) Evaluation of human resource management and the operating organisation structure in the IT environment. This is to ensure that they support the organisation's strategic objectives;
- (iii) Evaluation of the strategies and processes adopted for IT operations to ensure they align with the organisation's overall objectives;
- (iv) Evaluation of IT operational policies, standards and procedures for their development and implementation, to ensure their support for the IT strategy and compliance with regulatory and legal standards;
- (v) Evaluation of the practices of IT resource investment, use and allocation to ensure alignment with the organisation's overall strategies and standards;
- (vi) Evaluation of the organisation's risk management practices to ensure its proper implementation; and
- (vii) Evaluation of management practices to ensure that they comply with the organisation's IT strategies.

9.4.4 Knowledge of IT in the Oversight Board

Knowledge of IT is required in the oversight board if the board will be effective in its functions. The following are the levels or areas of IT knowledge required in the IT oversight board:

- (i) The reasons behind IT strategies, policies and standards and their essential elements;
- (ii) The frameworks within which the IT governance operates;
- (iii) The processes involved in the development, implementation and maintenance of IT strategies, policies and standards;

- (iv) The organisation's IT architecture and its impact and significance in setting long-term strategic directions;
- (v) The operations of the IT control frameworks (e.g. COBIT, COSO,);
- (vi) The IT risk management methodologies and tools;
- (vii) IT international standards and guidelines; and
- (viii) Quality management strategies and policies.

9.5 IT CONTROL ACTIVITIES

IT control activities are derived from the IT control framework – COBIT discussed below.

9.5.1 COBIT (Control Objectives for Information and Related Technologies)

COBIT is an IT governance tool that has been of tremendous benefits to IT professionals and has contributed immensely to effective control of information systems. Linking information technology and control practices, COBIT consolidates and harmonises standards from prominent global sources into a critical resource for management control professionals and auditors. As such, COBIT represents an authoritative, up-to-date control framework, a set of generally accepted control objectives and a complementary product that enables the easy application of the Framework and Control Objectives, referred to as the Audit Guidelines.

COBIT applies to enterprise-wide information systems, including personal computers, mini-computers, mainframes and distributed processing environments. It is based on the philosophy that IT resources need to be managed by a set of naturally grouped processes in order to provide the pertinent and reliable information which an organisation needs to achieve its objectives. With the addition of the management guidelines, COBIT now supports self-assessment of strategic organisational status, identification of actions to improve IT processes and monitoring of the performance of these IT processes. Since the first edition of COBIT was released in 1997 it has been sold and implemented in over 100 countries of the world.

COBIT has been developed as a generally applicable and accepted standard for good information technology (IT) security and control practices that provides a reference framework for management, users and information system audit as well as control and security practitioners.

9.5.2 The Purpose of COBIT

The purpose of COBIT is to provide management and business process owners with Information Technology (IT) governance model that helps in understanding and managing the risks associated with IT. COBIT helps to bridge the gaps between business risks, control needs and technical

issues. It is a control model to meet the needs of IT governance and ensure the integrity of information and information system.

9.5.3 The Users of COBIT?

COBIT is being used by those who have the primary responsibilities for business processes and technology; those who depend on technology for relevant and reliable information, as well as those providing quality, reliability and control of information technology.

9.5.4 Application of COBIT in Business process

COBIT is business process oriented and therefore addresses itself in the first place to the owners of these processes. Generic business model refers to core processes such as procurement, operations, marketing, sales, etc., as well as support processes (human resources, administration, information technology). As a consequence, COBIT is not applied only by the IT department, but also by the business as a whole.

The above approach stems from the fact that in today's enterprises, the process owners are responsible for the performance of their processes of which IT has become an integral part. In other words, they are empowered, but also accountable.

As a consequence, the business process owners bear the final responsibility for the information technology as deployed within the confines of business processes. Of course, they will make use of services provided by specialised parties like the traditional IT department or the third party service provider. COBIT provides the business process owners with a framework which should enable them control all the different activities underlying IT deployment. As a result, they can gain reasonable assurance that IT will contribute to the achievement of their business objectives. Moreover, COBIT provides the business process owners with a generic communication framework to facilitate understanding and clarity among the different parties involved in the delivery of IT services.

Furthermore, the addition of the Management Guidelines in the third edition of COBIT provides management with a set of tools. These allow self-assessment in order to make choices for control implementation and improvements over IT, measure the achievement of goals and the proper performance of IT processes. The Management Guidelines include maturity models, critical success factors, key goal indicators and key performance indicators to support managerial decision making.

9.5.5 COBIT Overview

COBIT, issued by the IT Governance Institute and now in its third edition, is increasingly internationally accepted as good practice for control over information, IT and related risks. Its guidance enables an enterprise to implement effective governance over the IT that is pervasive and intrinsic

throughout the enterprise. In particular, COBIT's Management Guidelines component contains a framework which responds to management's need for control and measurability of IT by providing tools to assess and measure the enterprise's IT capability for the 34 COBIT IT processes. The tools include:

- (a) Performance measurement elements (outcome measures and performance drivers for all IT processes) ;
- (b) A list of critical success factors that provides succinct, non technical best practices for each IT process; and
- (c) Maturity models to assist in benchmarking and decision-making for capability improvements.

COBIT components include:

- (i) Management Guidelines;
- (ii) Executive Summary;
- (iii) Framework;
- (iv) Control Objectives;
- (v) Audit Guidelines; and
- (vi) Implementation Tool Set.

The components are briefly discussed, as follows:

9.5.6 Management Guidelines

To ensure a successful enterprise, one has to effectively manage the union between business processes and information systems. The new *Management Guidelines* are composed of **Maturity Models**, to help determine the stages and expectation levels of control and compare them against industry norms. **Critical Success Factors**, to identify the most important actions for achieving control over the IT processes; **Key Goal Indicators**, to define target levels of performance; and **Key Performance Indicators**, to measure whether an IT control process is meeting its objective. These *Management Guidelines* will help answer the questions of immediate concern to all those who have a stake in enterprise success.

Executive Summary

Sound business decisions are based on timely, relevant and concise information. Specifically designed for time pressed senior executives and managers, the COBIT consists of an executive overview which provides thorough awareness and understanding of COBIT's key concepts and principles. Also included is a synopsis of the *Framework*. It provides more detailed understanding of these concepts and principles, while identifying COBIT's four domains (Planning & Organisation, Acquisition & Implementation, Delivery and Support, and Monitoring) and 34 IT processes.

Framework

A successful organisation is built on a solid framework of data and information. The **Framework** explains how IT processes deliver the information that the business requires to achieve its objectives. This delivery is controlled through 34 high-level control objectives, one for each IT process, contained in the four domains. The *Framework* identifies which of the seven information criteria (effectiveness, efficiency, confidentiality, integrity, availability, compliance and reliability), as well as which IT resources (people, applications, technology, facilities and data) are important for the IT processes to fully support the business objective.

Audit Guidelines

To achieve desired goals and objectives one has to constantly and consistently audit one's procedures. *Audit Guideline* outlines and suggest actual activities to be performed corresponding to each of the 34 high-level IT control objectives, while substantiating the risk of control objectives not being met. *Audit Guidelines* are invaluable tool for information system auditors in providing management assurance and/or advice for improvement.

Control Objectives - The key to maintaining profitability in a technologically changing environment is how well control is maintained.

COBIT's **Control Objectives** provide the critical insight needed to delineate a clear policy and good practice for Information Technology controls. Included are the statements of desired results or purposes to be achieved by implementing the specific and detailed control objectives throughout the 34 Information Technology processes.

Implementation Tool Set

Implementation Tool Set contains Management Awareness and IT Control Diagnostics, Implementation Guide FAQs, case studies from organisations currently using COBIT and slide presentations that can be used to introduce COBIT into organisations.

The new Tool Set is designed to facilitate the implementation of COBIT, relate lessons learned from organisations that quickly and successfully applied COBIT in their work environments, and lead management to ask about each COBIT process: Is this domain important for our business objectives? Is it well performed? Who does it and who is accountable? Are the processes and control formalised?

9.6 IT CONTROLS GOVERNANCE

Information technology controls (or **IT controls**) are specific activities performed by persons or systems designed to ensure that business objectives are met. They are a subset of an enterprise's internal control. IT control objectives

relate to the confidentiality, integrity, and availability of data and the overall management of the IT function of the business enterprise.

IT controls are often described in two categories: **IT general controls** (ITGC) and **IT application controls**. ITGC include controls over the information technology (IT) environment, computer operations, access to programs and data, program development and program changes. IT application controls refer to transaction processing controls, sometimes called “input-processing-output” controls. Information technology controls have been given increased prominence in corporations listed in the United States by the Sarbanes-Oxley Act. The COBIT Framework (Control Objectives for Information Technology) is a widely-used framework promulgated by the IT Governance Institute, which defines a variety of ITGC and application control objectives and recommended evaluation approaches.

IT departments in organisations are often led by a Chief Information Officer (CIO) who is responsible for ensuring that effective information technology controls are utilised. Chief information officers are responsible for the security, accuracy and the reliability of the systems that manage and report the company’s data, including financial data. Financial accounting and Enterprise Resource Planning systems are integrated in the initiating, authorising, processing, and reporting of financial data and may be involved in Sarbanes-Oxley compliance, to the extent that they mitigate specific financial risks.

9.7 IT RISK ASSESSMENT AND MEASUREMENT

In conducting IT risk measurement and impact analysis, consideration should be given to the advantages and disadvantages of quantitative versus qualitative assessments. The main advantage of the qualitative impact analysis is that it prioritises the risks and identifies areas for immediate improvement in addressing the vulnerabilities. The disadvantage of the qualitative analysis is that it does not provide specific quantifiable measurements of the magnitude of the impacts, therefore making a cost-benefit analysis of any recommended controls difficult.

The major advantage of a quantitative impact analysis is that it provides a measurement of the impacts’ magnitude which can be used in the cost-benefit analysis of recommended controls. The disadvantage is that, depending on the numerical ranges used to express the measurement, the meaning of the quantitative impact analysis may be unclear, requiring the result to be interpreted in a qualitative manner. Additional factors often have to be considered to determine the magnitude of impact.

9.7.1 A Quantitative Approach to Risk Analysis

This includes:

- (a) Quantitative analysis uses risk calculations that attempt to predict the level of monetary losses and percentage of chance for each type of threat.

- (b) Quantitative risk analysis also provides concrete probability percentages when determining the likelihood of threats.
- (c) Each element within the analysis (asset value, threat frequency, severity of vulnerability, impact damage, safeguard costs, safeguard effectiveness, uncertainty, and probability items) is quantified and entered into equations to determine total and residual risks.
- (d) Purely quantitative risk analysis is not possible, because the method attempts to quantify qualitative items, which are always uncertainties in quantitative values.

9.7.2 Sample Steps for a Quantitative Risk Analysis

Step 1: Assign values to assets - For each asset, to determine its value, answer the following questions

- (a) What is the value of this asset to the company?
- (b) How much does it cost to maintain?
- (c) How much does it make in profits for the company?
- (d) How much would it be worth to the competition?
- (e) How much would it cost to re-create or recover?
- (f) How much did it cost to acquire or develop?
- (g) How much liability are you incurring for the protection of this asset?

Step 2: Estimate potential loss per threat- To estimate potential losses posed by threats, the following questions should be answered:

- (a) What physical damage could the threat cause and how much would that cost?
- (b) How much loss of productivity could the threat cause and how much would that cost?
- (c) What is the value lost if confidential information is disclosed?
- (d) What is the cost of recovering from this threat?
- (e) What is the value lost if critical devices were to fail?
- (f) What is the single loss expectancy (SLE) for each asset, and each threat?

Step 3: Perform a threat analysis- Take the following steps to perform a threat analysis:

- (a) Gather information about the likelihood of each threat taking place from people in each department, past records and official security resources that provide this type of data; and
- (b) Calculate the annualised rate of occurrence (ARO), which is how many times the threat can take place in a 12-month period;

Step 4: Derive the overall loss potential per threat-To derive the overall loss potential per threat, do the following:

- (a) Combine potential loss and probability;
- (b) Calculate the annualised loss expectancy (ALE) per threat by using the information calculated in the first three steps;
- (c) Choose remedial measures to counteract each threat; and
- (d) Carry out cost/benefit analysis on the identified countermeasures.

Step 5: Reduce, transfer, or accept the risk- For each risk, you can choose whether to reduce, transfer or accept the risk:

- (1) Risk reduction methods:
 - (a) Install security controls and components;
 - (b) Improve procedures;
 - (c) Alter environment;
 - (d) Provide early detection methods to catch the threat as it is happening and reduce the possible damage it can cause;
 - (e) Produce a contingency plan of how business can continue if a specific threat takes place, reducing further damages therefrom;
 - (f) Erect barriers to the threat; and
 - (g) Carry out security-awareness training.
- (2) Risk transfer - take insurance to transfer part of the risk.
- (3) Risk acceptance - live with the risks and spend no more money toward protection.

9.7.3 Quantitative risk analysis metrics

- (a) Single loss expectancy (SLE) - The amount of loss due to a single occurrence of a threat.
- (b) Annualised loss expectancy (ALE) - The estimated loss per annum.
- (c) Exposure factor (EF) - Represents the percentage of loss a realised threat could have on a certain asset.
- (d) Annualised rate of occurrence (ARO) - It is the value that represents the estimated frequency of a specific threat taking place within a one-year time-frame. It can range from 0.0 to 1.0.

The example below shows the relation between the four metrics discussed above:

- (a) Asset value * exposure factor (EF) = SLE
 Example: If a data warehouse has asset value of ₦150,000, and if it is estimated that if a fire were to occur, 25 percent of the warehouse would be damaged, then $SLE = 0.25 * 150,000 = 37,500$.
- (b) SLE * Annualized rate of occurrence (ARO) = ALE. If ARO is 0.1 (indicating once in ten years), then the $ALE = 37,500 * 0.1 = 3,750$. This informs the company that if it wants to put in controls

or safeguards to protect the asset from this threat, it can sensibly spend 3,750 or less per year.

9.7.4 Advantages of a quantitative method

- (a) It is easier to automate and evaluate;
- (b) It is used in risk management performance tracking;
- (c) It provides credible cost/benefit analysis; and
- (d) It shows clear-cut losses that can be accrued within a year.

9.7.5 Disadvantages of a quantitative method

- (a) Calculations are more complex. Can management understand how these values were derived?
- (b) Without automated tools, this process is laborious.
- (c) There is a big need to gather detailed information about environment.
- (d) Its standards are not available. Each vendor has its own way of interpreting the processes and their results.

9.7.6 Qualitative approach to risk analysis

- (a) In qualitative approach, one walks through different scenarios of risk possibilities and rank the seriousness of the threats and the validity of the different possible countermeasures.
- (b) The qualitative analysis techniques include judgment, best practices, intuition and experience.
- (c) Qualitative risk analysis techniques are:
 - (i) Delphi - A group decision method used to ensure that each member gives honest opinion of what he or she believes will be the impact of a particular threat. This method is used to obtain an agreement on cost, loss values and probabilities of occurrence, without individuals having to agree verbally;
 - (ii) Brainstorming;
 - (iii) Storyboarding;
 - (iv) Focus groups;
 - (v) Surveys;
 - (vi) Questionnaires;
 - (vii) Checklists;
 - (viii) One-on-One meetings; and
 - (ix) Interviews.

9.7.7 Qualitative Advantages are:

- (a) It requires simple calculations;
- (b) It involves a high degree of guesswork;
- (c) It provides general areas and indications of risk; and
- (d) It provides the opinions of the individuals who know the processes best.

9.7.8 Qualitative Disadvantages are:

- (a) The assessments and results are basically subjective;
- (b) It usually eliminates the opportunity to create a dollar value for cost/benefit discussions;
- (c) It is difficult to track risk management objectives with subjective measures; and
- (d) Its standards are not available. Each vendor has its own way of interpreting the processes and their results.

9.8 COMPUTER DISASTER RECOVERY ISSUES

Computer disaster recovery issue addresses the question of business continuity should the system fail and to what extent can the system continue to operate without the critical systems in place. In major complex system environments, the plans usually referred to as 'back-up' range from simple data 'backup' procedures to creating recovery centres such as establishing 'hot sites', 'cold sites' or 'warm sites'. Sometimes organisations in similar industries may go into what is referred to as "trust relationship." This is the weakest in the chain of recovery strategies due largely to its loose legal colouration.

To understand how severe the impact of a disastrous event could be, the following case would be examined:

The Northridge Earthquake in January 17, 1994; 4:31a.m. The company involved was Great Western Bank, with \$44.6 billion in assets, 300 retail branches in California, 120 retail branches in Florida, 200 residential real estate lending offices throughout the U.S, 258 consumer finance offices primarily in the Southern U.S.

Damage was highlighted as follows: 3,500 employees without office space, hundreds of employees without homes, 15 to 17 Great Western buildings unusable, two of which were lost long-term, no water, no power. Recovery; the company announced an on-site recovery, live within four hours. Their bank examiners called right away to find out what they were doing, and they were able to say "We're having a cup of coffee and reading the Wall Street Journal, how about you?"

Brief discussion of the key alternative recovery strategies are highlighted below:

- (a) **Dedicated contingency facilities ("hot sites"):** Fully equipped computer facilities for use in the event of one of its subscribers or customers suffering a computer disaster. Periodic computer testing time is made available to customers. Costs associated with third party 'hot sites' are usually very high but justifiable for critical applications. When properly planned, insurance coverage will usually off-set the cost incurred for using this type of facility. Basic subscription cost, monthly fee, activation cost for actual emergency and hourly or daily usage charges.

These charges will usually vary across various vendors, as some of them will usually impose high activation cost to discourage frivolous use of the facility. Companies which can afford to build their own recovery facilities will generally free themselves from the encumbrances of leased facilities.

- (b) **Empty shell facilities (“cold sites”):** A fully prepared computer room maintained by an organisation or a vendor. Includes data communication systems, security systems, air conditioning, humidity controls, raised floors, storage and office space, and electrical power. In the event of a disaster, the computer vendor delivers the required hardware and equipment to the empty shell facility. Usually, empty shell facilities also provide off-site storage of computer files (programs and data), Documentation, supplies and source documents, activation of this site may take several weeks.
- (c) **Warm Sites:** These are partially configured sites, usually with network connections and selected peripheral equipment such as: disk drives, tape drives and controllers, no main computer, sometimes a warm site is equipped with a less powerful CPU than the one originally used. The idea behind a ‘warm site’ is that the computer can be obtained quickly for emergency installation.
- (d) **Rolling recovery sites:** this uses the concept of “computer rooms on wheels,” where a relocatable, self-contained recovery site with environmentally conditioned space (including raised floors, air conditioning, fire protection, diesel power generators, and adequate security) provided by an organisation for a fee for emergency computing and telecommunication line purposes.

The idea is to set up a data centre in a parking lot near the damaged building. Some of the advantages of a rolling cold site telecommunication can be reconnected from a point where the communication lines terminated at a manhole. Doing that saves cost in both time and money of travelling to the nearby hot site.

Other alternatives include:

- (e) ‘Vendor back-up’ facilities where major hardware vendors offer their facilities to selected customers in the event of a major computer disaster.
- (f) **Company multiple sites:** based on the concept of redundancy; each site is configured to support the company’s combined computer processing.
- (g) **Commercial service bureaus:** these provide backup and recovery services for their users or customers.
- (h) **Mutual aid agreements:** “one organisation agrees to provide back-up and recovery facilities for another organisation with a compatible hardware and software configuration, and vice versa.....” when earthquake

destroyed its network in January 1994, the campus ran its administrative database for several months from a sister campus. It worked out well, but it would have been better to have it set up before the earthquake.” (Sue Curzon, vice provost for California State University at Northbridge).

9.9 AUDITORS’ ROLE IN SYSTEMS DEVELOPMENT LIFE CYCLE

Systems Development Life Cycle (SDLC), or **Software Development Life Cycle** is a terminology used in systems engineering and software engineering. It refers to the process of creating or altering systems, and the models and methodologies that people use to develop these systems. The concept generally refers to computer or information systems.

In software engineering the SDLC concept underpins many kinds of software development methodologies. These methodologies form the framework for planning and controlling the creation of information systems; the software development process.

Systems Development Life Cycle (SDLC) is any logical process used by a systems analyst to develop an information system, including requirements, validation, training, and user ownership. A SDLC should result in a high quality system that meets or exceeds customer expectations, reaches completion within time and cost estimates, works effectively and efficiently in the current and planned information technology infrastructure, and is inexpensive to maintain and cost-effective to enhance.

Computer systems have become more complex and often (especially with the advent of Service-Oriented Architecture) link multiple traditional systems potentially supplied by different software vendors.

To manage this level of complexity, a number of system development life cycle (SDLC) models have been created: “waterfall,” “fountain,” “spiral,” “build and fix,” “rapid prototyping,” “incremental,” and “synchronise and stabilise.” Although the term SDLC can refer to various models, it typically denotes a ‘waterfall methodology.’ Readers wishing to learn details about these development models may consult the ISACA Technical Review Manual 2002 - 2009.

In project management a project has both a life cycle and a “systems development life cycle,” during which a number of typical activities occur. The project life cycle (PLC) encompasses all the activities of the project, while the systems development life cycle focuses on realising the product requirements.

9.10 SYSTEMS DEVELOPMENT PHASES

Systems Development Life Cycle (SDLC) adheres to important phases that are crucial for developers, such as planning, analysis, design, and implementation, as depicted in figure 9.11 below. There are several Systems Development Life Cycle Models in existence.

The oldest model, that was originally regarded as “the Systems Development Life Cycle,” is the ‘waterfall model’: this is a sequence of stages in which the output of each stage becomes the input for the next. These stages generally follow the same basic steps but many different waterfall methodologies give the steps different names and the number of steps seems to vary between four and seven. There is no definitively correct Systems Development Life Cycle model, but the steps can be characterised and divided in several steps.

Figure 9.2 Systems Development Life Cycle (SDLC) Phases

9.11 AUDITORS’ ROLE IN SDLC

In any SDLC project, the auditor is a subject-matter expert (SME) for risk and controls (what may go wrong on process and make recommendations to mitigate such risks). In such a circumstance, the auditor may play other roles such as found in the IT governance process, as follows:

- (a) Serving as a specialist in the SDLC Strategy Committee to offer advice on matters pertaining to controls;
- (b) The Auditor should be a member of the IT steering committee as key advisor;
- (c) The Auditor should ascertain the management framework for IT governance, e.g. COBIT, COSO;
- (d) He should get involved in the business plan development. The strategic alignment need makes this imperative; and
- (e) He should assess the maturity capability of the organisation with respect to IT governance and controls.

The Auditor should assess the performance measurement framework with respect to all SDLC projects using Balanced Score Card (BSC) approach.

9.12 SUMMARY AND CONCLUSIONS

IT General Controls ensure the reliability of data generated by IT systems and support, IT application controls and accurate processing of data, from input through output. IT is a subset of corporate governance focussed on IT systems, their performance and risk management.

Steps in quantitative risk analysis include assigning value to assets, estimating potential loss per threat, performing a threat analysis, deriving the overall loss potential per threat and reduce, transfer or accept the risk.

Recovery strategies include hot sites, cold sites, warm sites and rolling recovery sites.

Refer to Comprehensive Questions and Suggested Solutions in Appendix II, page 303.

9.13 REVISION QUESTIONS

9.15.1 MULTIPLE CHOICE QUESTIONS

1. The following is true of IT governance except
 - (A) The IT function must be the prime driver.
 - (B) Sustained financial results the objective and the prime driver.
 - (C) Roles must be set out for Auditors.
 - (D) Emphasis in implementing the framework must be on changing behaviour.
 - (E) The board function must be prime driver.

2. One of the following is not true of an IT control activities with respect to COBIT.
 - (A) Control is limited to personal computers
 - (B) Coordinates and harmonise standard.
 - (C) It represents an authoritative, up-to-date framework.
 - (D) It applies to enterprise-wide information system
 - (E) It is based on resources that IT resources need to be managed by a set of naturally grouped processes.

3. The components of COBIT include the following except
 - (A) Management guidelines.
 - (B) Framework.
 - (C) Processing tools.
 - (D) Control objectives.
 - (E) Implementation tools.

4. One of these is not an advantage of Quantitative method.
 - (A) Provide credible cost / benefit analysis.
 - (B) Without automated tools, the process is extremely laborious.
 - (C) Is easier to automate and evaluate.
 - (D) Used in risk management performance.
 - (E) Tracking.

5. One of these is not a recovery strategy, when considering computer disaster recovery.
 - (A) Hot site.
 - (B) Cold site.
 - (C) Warm site.
 - (D) Cool site.
 - (E) Rolling site.

9.13.2 SHORT ANSWER QUESTIONS

1. Controls that ensures that data integrity fed from upstream sources into the application system are referred to as ——.
2. Controls over IT environment, computer operations as well as access to programs are some of the ——— of COBIT.
3. The qualitative method of Risk analysis, shows clear cut losses that can be accrued within one year's time True / False.
4. The system that addresses the question of business continuity, should the system fail.

Refer to Suggested Solutions in Appendix I, on page 297.

APPENDICES

APPENDIX I

SUGGESTED SOLUTIONS TO REVISION QUESTIONS

CHAPTER 1

1. See 1.2 (a - j)
2. See 1.3
3. See 1.5
4. See 1.8
5. See 1.10
6. See 1.11
7. See 1.12.1
8. See 1.13.2
9. See 1.13.3
10. See 1.13.8(a)
11. See 1.13.8(b)
12. Audit risk is the term given in relation to the risk that the auditor will draw an invalid opinion or conclusion. (*Refer to Chapter 1.15 for full details*)
13. Elements of audit risk are:
 - (a) **Inherent risk** - derives from the characteristics of the client and of its environment prior to the determination of the internal control in operation;
 - (b) **Control risk** - derives from the view point that the internal control system may not prevent or detect material mis-statement or errors and
 - (c) **Detection risk** - emphasises that the auditors substantive audit tests and procedure and his review of the financial statements will not detect material mis-statements or errors.
Audit risk is, therefore, the product of IR x CR x DR
14. Refer to chapter 1.16.1
15. Refer to chapter 1.16.2
16. Refer to chapter 1.16

CHAPTER 2

1. C
2. E
3. D
4. B
5. D
6. (i) Continuous
(ii) Periodic
7. Development

8. (i) Formal (that is, from outside), or
(ii) Informal (that is, in-house)
9. B
10. B
11. D
12. A
13. C
14. (i) An assertion based engagement
(ii) A direct reporting engagement
15. (i) Data
(ii) Systems and procedures
(iii) Behaviour
16. (i) Unsolicited
(ii) Client
17. Engagement letter
18. Contraventions
19. (i) Management
(ii) Employees
20. (i) Care
(ii) Diligence
(iii) Skill

CHAPTER 3

1. B
2. C
3. D
4. C
5. A
6. E
7. B
8. C
9. A
10. D
11. A
12. C
13. C
14. D
15. E
16. E
17. B

18. C
19. A
20. D
21. A
22. C
23. C
24. D
25. E
26. Public Accounts
27. Federal Civil Service Commission
28. Accountant-General of the Federation
29. Transcripts
30. Fund Accounting
31. Economy Audit, Efficiency Audit and Effectiveness Audit.
32. Full-time, Part-time
33. Due Process
34. Losses and Investigation Division
35. The Accountant-General of the Federation
36. Independent Corrupt Practices and Related Offences Commission (ICPC)
37. Economic and Financial Crimes Commission (EFCC)
38. (i) Independent Corrupt Practices and Other Related Offences Commission.
(ii) Economic and Financial Crimes Commission

CHAPTER 4

1. C
2. D
3. E
4. A
5. E
6. B
7. A
8. D
9. C
10. D
11. B
12. A
13. D
14. C
15. B
16. E
17. Permanent file.

18. Investigation
19. (i) Preparation
(ii) Field Work
(iii) Reporting
20. Reporting accountant
21. Litigation Support
22. Receivership
23. Debenture
24. A joint audit is an assignment that is carried out by more than one audit firm at the same time and for the same financial statements.
25. (i) By the court
(ii) Voluntarily
(iii) Subject to the supervision of the court
26. See paragraph 4.3.2.2 (d) & (j)
27. See paragraph 4.4.

CHAPTER 5

1. A
2. B
3. A
4. C
5. A
6. B
7. D
8. D
9. D
10. (i) Mind
(ii) Appearance
11. Ethics.
12. (i) Fundamental Principles.
(ii) Statements.
13. Principal auditors.
14. Peterside Atedo.
15. Yes, Section 359 requires that companies should set up audit committees.
16. This is because good corporate governance has become an acceptable international practice and there is the need for corporate organisations in Nigeria to align with international best practices.
17. See 5.3
18. See 5.5
19. See 5.7.1

20. The chairman of the committee should be a non-executive director and should be qualified to serve in the committee.
21. Any two of the following:
- (a) Ascertain whether the accounting and reporting policies of the company are in accordance with legal requirements and agreed ethical practices.
 - (b) Review the scope and planning of audit requirements.
 - (c) Review findings on management matters in conjunction with the external auditors and departmental responses thereon.
 - (d) Keep under review the effectiveness of the company's system of accounting and internal control.
 - (e) Make recommendation to the board in regard to the appointment, removal and remuneration of the external auditors of the company, and
 - (f) Authorise the internal auditor to carry out investigations into any activities of the company which may be of interest or concern to the committee.

CHAPTER 6

1. D
2. C
3. A
4. B
5. D
6. Enron and Worldcom
7. Money Laundering Act 1995; Miscellaneous Offences Act 1985; Failed Banks (Recovery of Debts) and Financial Malpractices in Banks Act 1994; Advance Fee Fraud and Other Fraud Related Offences Act 1995 and Banks and Other Financial Institutions Act 1991.
8. Reviewed
9. Audit Paper retention;
Concurring Partner's approval;
Scope of Internal Control testing;
Audit Quality Control standard;
Structure and Procedure.
10. True

CHAPTER 7

1. D
2. C
3. E
4. B
5. A
6. B
7. B
8. A

CHAPTER 8

1. B
2. A
3. D
4. C
5. A
6. E
7. E
8. C
9. B
10. Cendant and Credit Lyonnais
11. (a) Failure in business
(b) Failure in governance
(c) Failure in reporting

CHAPTER 9

1. E
2. A
3. C
4. B
5. D
6. Input control
7. General control
8. True
9. Disaster recovery
10. Risk acceptance

APPENDIX II

COMPREHENSIVE QUESTIONS AND SUGGESTED SOLUTIONS

QUESTION 1

- (a) You are the officer in charge of the Public Practice Monitoring Unit of the Institute of Chartered Accountants of Nigeria (ICAN). Tony Okonkwo and Gabriel Fagade, who both qualified as chartered accountants six years ago, have approached you, seeking advice on certain issues regarding their proposal to set up in practice together.

They have obtained a practising licence from ICAN and intend to undertake small audits and render some other non-audit jobs. They have decided to call their practice *OKONKWO FAGADE & CO.*

They seek your advice generally on the issue of obtaining professional work, especially the aspect of tendering. You are required to state clearly the rules guiding the issue they have raised.

- (b) In conducting any specialised audit, when should an auditor report to a regulatory body? Illustrate your answer by stating the particular type of organisation and the regulatory body involved.

SOLUTION TO QUESTION 1

- (a) As the officer in charge of the Public Practice Monitoring Unit of the Institute of Chartered Accountants of Nigeria (ICAN), my advice to Tony Okonkwo and Gabriel Fagade will be based on the following:

(i) **General guidance on the issue of obtaining professional work**

Advertising and publicity for chartered accountants in public practice, that is, auditors, are covered under Statement No. 8 of the Professional Code of Conduct for Members. The Institute appreciates that auditors are in business and, therefore, need to advertise their services, and seek publicity for their products and achievements. The Institute, therefore, gives the following guidance on advertising and publicity:

A member is allowed to seek publicity for and advertise his/her services, achievements and products in any way consistent with the dignity of the profession.

- ◆ In doing so, he/she should not project an image inconsistent with that of a professional person bound to high ethical and technical standards.
- ◆ Advertisements should be clearly distinguishable as such.
- ◆ Advertisements should comply with the law and be legal, decent, clear, honest and truthful.
- ◆ If reference is made in promotional material to fees, members should not make comparison in such material between their fees and the fees of other accounting practices, whether members or not.
- ◆ Promotional material should not make disparaging references to or disparaging comparison with the services of others. For example, claims of size or quality are subjective and may be difficult to substantiate and therefore should be avoided.

Unsolicited promotional or technical material should not be sent to a non-client by facsimile transmission or other electronic means.

- ◆ In relation to audit or other financial reporting work, a member should not make an unsolicited personal visit or telephone call to a person who is not a client with a view to obtaining professional work from the non-client.

(ii) **Tendering**

The guidelines in Statement No. 8 of ICAN's Professional Conduct for Members, titled "Obtaining Professional Work", tendering should commence when a firm has only been approached by a prospective client and the partners have decided that their firm is capable of carrying out the assignment at a reasonable fee.

Therefore, whenever the firm of OKONKWO FAGADE & CO is approached by a prospective client, these partners will have to consider many factors, including:

- ◆ Whether they want to do the work, considering all the necessary ethical factors.
- ◆ Whether they are not disqualified by any statutory provisions from carrying out the assignment.
- ◆ Whether the firm has available the appropriate calibre of staff for the job, and if not what will be required to get the appropriate staff.
- ◆ Whether the proposed timetable for the work fits with the firm's current work plan.
- ◆ Whether non-accounting specialist skills are necessary, and if so which ones are required.
- ◆ Whether staff shall need further training for the work, and if so how much will such training cost.
- ◆ What fees to quote for the work.

A tender (which is the audit proposal) does not have a particular format. The format is usually a function of what the prospective client wants the audit firm to do. However, there are usually some vital matters which should be included in the tender while it could be in the form of a document either sent to the prospective client or presented by members of the audit firm at an agreed time and date. Some of the important matters are:

- ◆ An assessment of the needs of the prospective client such as audit, taxation and accounting.
- ◆ The proposed approach to the engagement.
- ◆ The assumptions made to support the proposed approach.
- ◆ An outline of how the firm intends to meet those needs, including the key staff to be involved.
- ◆ The fee and the basis on which it has been calculated or estimated.
- ◆ A brief outline of the firm.

It should be noted that tendering should be handled professionally, no assumptions of familiarity with the prospective client should be made. It should be borne in mind that the prospective client should have invited other firms to tender as well; and this simply implies that the tender being submitted should be comparable with what the other firms might submit. It should also be competitive enough.

- (b) In conducting any specialised audit, an auditor should report to a regulatory body when certain events that warrant reporting to a regulatory body have occurred. Illustrating with an example of a bank as a type of organisation and Central Bank of Nigeria (CBN) as the regulatory body involved, Section 29 of the Banks and Other Financial Institutions Act (BOFIA), 1991 provides for the appointment of a qualified person as "the approved auditor" of a bank, such appointment being approved by the CBN.

The approved auditor shall immediately report to the CBN, whenever in the course of his duties as an auditor of a bank, he is satisfied that:

- (i) There has been a contravention of BOFIA, or that an offence under any other law has been committed by the bank or any other person; or
- (ii) Losses have been incurred by the bank which substantially reduce its capital funds; or
- (iii) Any irregularity which jeopardizes the interest of depositors or creditors of the bank, or any other irregularity has occurred; or
- (iv) He is unable to confirm that the claims of depositors or creditors are covered by the assets of the bank.

QUESTION 2

- (a) Outline the techniques for carrying out a value-for-money audit.
- (b) Give examples of the problems that may be encountered in carrying out a value-for-money audit in the public sector.

SOLUTION TO QUESTION 2

- (a) Value-for-money (VFM) audit is carried out with a view to ascertaining whether an establishment pursues optimal values with adequate consideration for economy, efficiency and effectiveness in its quest for resource management. It is also referred to as comprehensive audit or efficiency audit. The techniques for carrying out a VFM audit can be outlined as follows:
 - (i) Analysis of performance indicators such as financial ratios and unit costs of the establishment, with comparative figures for the previous periods and in respect of similar establishments. A trend analysis should be done, and significant differences highlighted through the trend analysis should be investigated further. This initial analysis is aimed at identifying the areas that need specific attention.
 - (ii) Management and systems review for the purpose of investigating the ways in which objectives are established, policies implemented and results monitored. This will enable the VFM auditors to ascertain how efficiently these processes have been carried out without necessarily having to concern themselves with the review of the objectives and policies themselves.
 - (iii) Analysis of planning and control processes for the purpose of ascertaining how the establishment has been monitoring performance against the plan, reviewing and reporting its operating results, and how members and officers have been alerted on the need for remedial action whenever required. An example is checking how the Vote Book has been used in controlling planned expenditure.
 - (iv) Efficiency assessment which may involve specific investigation into a few activities with high unit cost, or poor performance measures or suspected poor management with a view to ascertaining the reasons for the adverse performance indicators and identifying the appropriate remedial action.
 - (v) Effectiveness review for the purpose of ascertaining whether or not the activities or programmes are achieving the objectives for which they have been undertaken. This usually involves discussions with service managers and committee members on the details of each particular activity especially regarding why the activity is undertaken, why it is done in the way it has been done, what other alternatives have been considered and why such other alternatives have been rejected and how is performance measured.
 - (vi) Reporting on the VFM audit – it is very important at this stage to discuss the draft report in detail with the officers (service managers) and committee members before it is finalised and presented.

- (b) Examples of the problems that may be encountered in carrying out a value-for-money audit in the public sector are:
- (i) Inadequacy in the means of measuring the corporate objectives in the public sector, for instance, to what extent is the welfare of the public maximised?
 - (ii) Lack of a complete view of the report of activities and state of affairs in the public sector, resulting from the non-use of accrual basis of accounting.
 - (iii) Continuous gap in professional skill requirements for the Auditor-General's office.
 - (iv) Inadequacies in the accounting and internal control systems in the public sector.
 - (v) Lack of commitment to the overall achievement of goals by the managers in the public sector.

QUESTION 3

- (a) You are the Chief Internal Auditor of Optimum Bank Plc, which operates fifty (50) branches located all over the country. In preparing your audit plan, you are considering carrying out detailed audit tests on a rotational basis. You also consider that all branches should be covered over a period of three years but that more frequent attention should be given to those where the "audit risk" demands it.
- (b) You are required to detail the factors which you would consider in order to evaluate the audit risk attaching to each branch.
- (c) What do you understand by a 'forensic investigation and audit'?

SOLUTION TO QUESTION 3

- (a) As the Chief Internal Auditor of Optimum Bank Plc which operates fifty (50) branches located all over the country, I will pay particular attention to the evaluation of risk in preparing my audit plan. Risk may be evaluated by considering:
- (i) The potential size of the event, and
 - (ii) The probability of an event.

As regards audit assignment, the event concerned is undetected material error or fraud. In an attempt to evaluate risk in the context of the audit of a bank that operates fifty (50) branches located all over the country, the factors which I would consider in order to evaluate the audit risk attaching to each branch are as follows:

- (i) Factors influencing size:
 - ◆ Relative size of branch in terms of revenue, number of transactions, turnover of accounts, and average value of account balances.
 - ◆ Statistics of losses through fraud and errors.
 - (ii) Factors influencing probability:
 - ◆ Experiences derived from previous audits and the conclusion of previous audit reports.
 - ◆ Strengths and weaknesses in the system of internal control for the bank as a whole and for each of the branches especially in respect of physical controls, personnel control, authorisation and approval procedures, accounting and financial control, and data processing controls.
 - ◆ The location of the branches (for example high risk areas).
 - ◆ Rate of compliance with statutory and regulatory requirements.
 - ◆ Rate of staff turnover in each branch.
- (b) What I understand by a forensic investigation and audit:
 "Forensic", according to the Webster's Dictionary means, "belonging to, used in or suitable to courts of judicature or to public discussion and debate." Flowing from this and according to Alan Zysman, "forensic investigation is the utilisation of specialised investigative skills

in carrying out an inquiry conducted in such a manner that the outcome will have application to a court of law". Thus a forensic investigation may be based in various fields such as accounting, engineering, medicine, or some other discipline.

On the other hand, "forensic audit is an examination of evidence regarding an assertion to determine its correspondence to established criteria carried out in a manner suitable to the court". An example would be a forensic audit of sales records to determine the quantum of rent owing under a lease agreement, which is the subject of litigation.

A forensic audit is quite distinct from either internal audit or external audit. Both forensic investigation and forensic audit are examples of a forensic accounting assignment. A typical approach to a forensic accounting assignment, as suggested by Alan Zysman will include the following steps:

- (i) Meet with the client.
- (ii) Perform a 'conflict check.'
- (iii) Perform an initial investigation.
- (iv) Develop an Action Plan.
- (v) Obtain the relevant evidence.
- (vi) Perform the analysis, which in turn will be dependent on the nature of the assignment and may involve:
 - ◆ Calculating economic damages;
 - ◆ Summarising a large number of transactions;
 - ◆ Performing a tracing of assets;
 - ◆ Performing present value calculations, utilising appropriate discount rates;
 - ◆ Performing a regression or sensitivity analysis;
 - ◆ Utilising a computerized application such as a spread sheet, data base or computer model; and
 - ◆ Utilising charts and graphics to explain the analysis.
- (vii) Prepare the report which may include:
 - ◆ Nature of the assignment;
 - ◆ Scope of the investigation;
 - ◆ Approach used;
 - ◆ Limitations of scope; and
 - ◆ Findings and/or opinion.

Schedules and graphics necessary to properly support and explain the findings.

QUESTION 4

Identify and discuss the major attributes of public sector audit, specifying the various areas of peculiarity of the audit function.

SOLUTION TO QUESTION 4

The major attributes of public sector audit, specifying the various areas of peculiarity of the audit function in that sector.

The functions and scope of responsibilities of the Auditor-General for the Federation and those of his counterparts in other parts of the world have shown that there are about three main types of audit in the public sector. It is important to say that the primary objective of the public sector is not to generate profit but to render services. The audit types are:

- (a) Regulatory Audit
- (b) Financial Audit; and
- (c) Value-for-Money Audit

(a) **Regulatory Audit**

This type of audit (otherwise referred to as Compliance Audit) is conducted with a view to ensuring that expenditure has been incurred on approved services and in accordance with the enabling statutory provisions and regulations governing the particular expenditure. The following are the documents that the auditor of a public sector organisation may require in conducting a regulatory audit:

- (i) The Nigerian Constitution (latest edition).
- (ii) Civil Service Rules.
- (iii) Treasury Circulars.
- (iv) Establishment Circulars.
- (v) Official Gazettes of Government.
- (vi) Financial Instructions.
- (vii) Budgets.
- (viii) Financial Acts.

An example of this type of audit is the audit conducted on each project or contract.

(b) **Financial Audit**

Financial Audit is the type of audit that is conducted in order to ensure that the accounting and financial control systems are efficient and operating properly; and that financial transactions have been correctly authorised and accounted for. In other words, it is to ensure that the financial statements and accounts have been prepared to present a true and fair view of the state of affairs of the establishment concerned and in respect of the period covered by the audit.

This is the type of audit conducted on the treasury accounts of the Federation from time to time.

(c) **Value-for-money (VFM) Audit**

VFM audit is carried out with a view to ascertaining whether an establishment pursues optimal values with adequate consideration for economy, efficiency and effectiveness in its quest for resource management. It is also referred to as comprehensive audit or efficiency audit. VFM audit has three elements and they are:

- (i) Economy audit which is aimed at examining whether the organisation has acquired the resources required for its activities and programmes at the lowest cost, and to highlight examples of wasteful or extravagant expenditure.
- (ii) Efficiency audit which is aimed at confirming that there is a positive relationship between the level of services provided and the resources used to achieve that level, highlighting examples of unrewarding expenditure.
- (iii) Effectiveness audit which is aimed at examining the extent to which a programme or project or activity undertaken for the purpose of meeting established policy goals has met the desired result.

Furthermore, public sector audit can be divided into three major categories as indicated below:

- (i) Audit of the Treasury Accounts, as prepared by the Accountant-General of the Federation.
- (ii) Audit of Ministries/Departments and Agency Accounts.
- (iii) Audit of accounts of parastatals.

The main objectives of auditing of treasury accounts are to ascertain whether:

- (a) The financial statements have been prepared in accordance with generally accepted government accounting principles; and
- (b) The information contained in the financial statements is properly classified, reliable, accurate and complete.

The audit of the accounts and financial statements prepared by the Accountant-General is carried out through the Federal Sub-Treasury as a function under the Treasury Accounts Division of the Ministerial Department in the Office of the Auditor-General for the Federation.

The main objectives of auditing the accounts of Ministries/Departments and agencies are to ascertain whether:

- (a) All receipts and revenue emanating from the operations of the period under review are collected and properly accounted for;
- (b) The accounting system in operation provides financial information that is reliable and free from material errors to facilitate the preparation of the accounting and financial statements required by law;
- (c) The activities and programmes are conducted and expenditure are made in an effective, efficient and economical manner and in compliance with the requirements of applicable laws and regulations;
- (d) The Ministry/Department or agency is carrying out only those activities or programmes authorised by the National Assembly and is conducting them in the manner contemplated to accomplish the objectives intended.
- (e) The resources of the Ministry/Department or agency, including funds, property and personnel are adequately controlled and utilised in an effective, efficient and economical manner; and
- (f) The accounting and financial statements presented to the prescribed authorities (the Accountant-General) disclose properly the information required to various groups of both internal and external users.

There are appropriate divisions under the Ministerial Department of the Office of the Auditor-General for the Federation to handle the audit of various types of Ministries/Departments and agencies. These include the following:

- (a) Revenue Audit Division to handle the audit of all revenue Ministries/Departments (Federal Ministry of Petroleum Resources, Customs and Excise, Federal Inland Revenue Service).
- (b) Self-Accounting Ministries/Departments/Divisions which are responsible for the audit of the transactions and accounts of self-accounting Ministries/Departments (Ministry of Education, Ministry of Communications).
- (c) Defence and Security Division responsible for the audit of the transactions and accounts relating to the Ministry of Defence, the Armed Forces of the Federation, Police and other security agencies of Government.

The objectives of auditing the accounts of Government parastatals are to ascertain whether:

- (a) proper accounting records have been kept;
- (b) all revenue are duly collected and properly accounted for;
- (c) adequate controls exist to ensure the safety and proper use of the organisation's funds and assets;
- (d) the organisation's management comply reasonably with the general level of probity and public accountability;
- (e) the organisation's executive officer carries out only those functions and operations for which the corporation was established;
- (f) proper accounts have been prepared in accordance with the financial and accounting clauses as provided for in the respective legal instruments setting up the corporation; and
- (g) the balance sheet shows a true and fair view of the corporation's state of affairs as at the end of each financial year while the income and expenditure statement also shows a true and fair view of the results of operation for the period.

Section 85(3) of the 1999 Constitution provides that the Auditor-General for the Federation shall not audit the accounts of or appoint auditors for government statutory corporations,

commissions, authorities, agencies, including all persons and bodies established by an Act of the National Assembly, but the Auditor-General is authorised to:

- (a) provide such bodies with:
 - (i) a list of auditors qualified to be appointed by them as external auditors and from which the bodies shall appoint their external auditors, and
 - (ii) guidelines on the level of fees to be paid to external auditors; and
- (b) comment on their annual accounts and auditor's reports thereon.
The Auditor-General however shall have power to conduct periodic checks of all these government parastatals [Section 85(4)]. It is clear, therefore, that the audits of the parastatals are carried out by firms of professional accountants who are considered qualified to perform such audits.

Such audited accounts, signed by the boards of the parastatals, along with the auditor's domestic reports on them are forwarded to the Auditor-General for the Federation for vetting. Thereafter, he certifies the accounts that are subsequently submitted to the National Assembly with his certificate and report known as Auditor-General's Certificate and Auditor-General's Report, respectively.

The peculiarities of public sector accounting make the procedures required for public sector audit to be unique to some extent. There are certain procedures of auditing in the public sector which can be regarded as similar to those in the private sector, (for example, verification of assets, bank reconciliation, payment vouchers, imprest, salaries and wages, and store audit). There are procedures that are particularly necessary because of the fact that public sector accounts are involved. Examples of these peculiar procedures are in respect of the following:

- (a) Revenue
- (b) Vote Book
- (c) Contract
- (d) Cash Book
- (e) Control of Security Documents

QUESTION 5

- (a) What is the role of the Auditor-General for the Federation?
- (b) What are the functions of internal audit in the public sector?

SOLUTION TO QUESTION 5

(a) **The role of the Auditor-General for the Federation**

Section 85 of the 1999 Constitution provides that there shall be an Auditor-General for the Federation. The role of the Auditor-General is to ensure that there is accountability by the executive arm of the government to the legislative arm for the proper administration of the activities, functions, operations and programmes of the government and its various agencies.

Apart from the provisions of the 1999 Constitution, the Audit Act, 1958 also provides that the Accountant-General of the Federation should furnish the Auditor-General for the Federation with the country's financial statements within seven months after the close of each financial year. The Audit Act, 1958 further provides that the Auditor-General for the Federation shall audit the accounts of all accounting officers and of all persons entrusted with the collection, receipt, custody, issue or payment of Federal Public monies or with the receipt, custody, issue, sale, transfer or delivery of any stamps, securities, stores or other property of the Government of the Federation. He is responsible for carrying out surveys of the cash, stamps, securities, stores or other properties of government that are held by such officers or persons.

The Auditor-General shall examine the accounts relating to public funds and property, ascertain whether the objectives of government auditing are met, and ascertain whether in his opinion:

- (i) The accounts relating to public funds have been properly kept;
- (ii) All public money has been fully accounted for and the rules and procedures applied are sufficient to secure effective check on the assessment, collection and proper allocation of revenue;
- (iii) Essential records have been maintained and the rules and procedures applied are adequate to safeguard and control public property and funds; and
- (iv) Money has been expended for the purposes for which it was appropriated and the expenditure have been made as authorised.

In addition to being responsible for the auditing of the accounts of the Accounting Officers and all persons entrusted with various assets of government, the Auditor-General may also undertake the examination of the accounts of any organisation that receives funds from the government, such as statutory corporations, parastatals and voluntary agencies. For the purpose of performing such functions, the Auditor-General or any person authorised by him in that behalf shall have access to all the books, records, returns and other documents relating to those accounts and in the exercise of his functions under the 1999 Constitution, he shall not be subject to the direction or control of any other authority or person.

The Auditor-General shall, within ninety days of receipt of the Accountant-General's financial statements, submit his reports under Section 85 of the 1999 Constitution to each House of the National Assembly and each House shall cause the Public Accounts Committee to consider the reports.

The following points should be noted:

- (a) The Office of the Auditor-General for the Federation has a branch office in each State of the Federation.
- (b) The officers of the Auditor-General for the Federation at the State level are referred to as the Federal Auditors to distinguish them from the Internal Auditors who are the staff of the Internal Audit Department of the Ministry/Department or Agency.

(b) The functions of internal audit in the public sector

The Internal Audit Department/Unit of any Ministry/Extra-Ministerial Department or agency (depending on whether they are self-accounting or sub-accounting units) is responsible for the pre-payment audit of all the financial transactions of the Ministry/Department. The Chief Internal Auditor is responsible to the Accounting Officer and he is required to submit to his Accounting Officer and the Auditor-General for the Federation the following documents:

- (a) Detailed audit programme.
- (b) Monthly Internal Audit Report.
- (c) Half-yearly Internal Audit Report.

The third type of report should also be submitted to the Accountant-General of the Federation.

The Accounting Officer of each Ministry or Extra-Ministerial Department is required, by the provisions of Financial Regulations 2201, to ensure that, subject to the availability of staff, an Internal Audit Unit is established to provide a complete and continuous audit of the accounts and records of revenue, expenditure, plant, allocated stores, and unallocated stores, where applicable.

The general responsibilities of the Internal Audit Department at the various levels of government, as contained in the existing Financial Regulations are to:

- (i) carry out a continuous examination of all accounting books and records maintained in the Ministry/Department;
- (ii) determine the adequacy of the internal control system;
- (iii) ensure that an adequate system of securities exists in the Ministry/Department;

- (iv) check all payment vouchers originating from any section of the Ministry/Department before payments are made;
- (v) check the reliability of the accounting and reporting systems;
- (vi) carry out any special review or assignment which may be required by management; and
- (vii) cooperate with and assist the Office of the Auditor-General for the Federation in making available necessary documents for the final audit of the establishment.

QUESTION 6

- (a) Draw up a typical outline of the work programme of a Reporting Accountant.
- (b) State the main features of the work programme regarding the examination of financial forecasts that are included in a prospectus.

SOLUTION TO QUESTION 6

- (a) **A typical outline of the work programme of a Reporting Accountant** is as shown below:

(i) **General Information to be obtained**

- ◆ History and nature of business.
- ◆ Share capital and borrowed money (or debt capital).
- ◆ Management.
- ◆ Employees.
- ◆ Premises, plant and machinery or property, plant and equipment.
- ◆ Raw materials and supplies.
- ◆ Sales.
- ◆ Other matters.

(ii) **Work to be done**

- ◆ Preliminary Enquiries.
- ◆ Profits.
- ◆ Net Assets.
- ◆ Taxation.

(iii) **Profit Forecast and Cash Flow Statement Preparation**

- ◆ Preliminary enquiries.
- ◆ Accounting principles.
- ◆ Forecasting procedures.
- ◆ Assumptions.
- ◆ Detailed examination of profits forecast.
- ◆ Detailed examination of cash flow statement.

(iv) **Miscellaneous**

- ◆ Prospectus check list.
- ◆ Verification check list.
- ◆ Completion Board Meeting.
- ◆ Letter of consent.
- ◆ Comfort letter.
- ◆ Use of firm's name.

The ICAN Auditing Guidelines provide as appendices the following:

- (a) Contents of a prospectus for companies applying for full listing on the Nigerian Stock Exchange.
- (b) Contents of Accountant's Report.
- (c) Specimen Accountant's Report.
- (d) Specimen profit forecast letter.

- (e) Specimen letter of comfort
- (f) Specimen letter of consent

(b) The main features of the work programme regarding the examination of financial forecasts that are included in a prospectus are as shown below:

The statement of profit forecast and working capital adequacy, that is, the financial forecasts are undoubtedly the most important part of a prospectus. Though the directors are solely responsible for the profit forecast and the assumptions on which it is based, the Reporting Accountant should take special care in regard to this section of his work.

The following are the main features of the work programme:

- (i) Review of underlying assumptions and outline of the company's forecasting structure and methods; for example, the existence of a budget corporate plan and its regular revision. Assumptions should be stated in clear and unambiguous terms to assist the reader in assessing the reasonableness of the forecast and its inherent uncertainties.
- (ii) Review the accounting policies adopted in preparing the forecast and ensure they are consistent with those normally utilised by the company for preparing its annual accounts.
- (iii) Compare the detailed results of the company for, say, the preceding three years, with a view to ascertaining the trend and assessing the extent to which the company's past experience in forecasting indicates that its projections can be relied upon.
- (iv) Compare the forecast under review, with any earlier projection made in respect of the same or overlapping period and obtain explanations for any material changes.
- (v) When reviewing the cash forecast the following factors should be carefully considered:
 - ◆ The assumptions used are the same as those adopted for the profit forecast;
 - ◆ The changes in level of stock and work-in-progress, debtors and creditors, appear reasonable, having regard to the budgeted level of trading or operation;
 - ◆ Items such as capital expenditure, investment, taxation and dividends, are included in the correct period;
 - ◆ Recently announced fiscal legislations and regulations have been taken into account;
 - ◆ The proforma balance sheet at the end of the profit forecast period reconciles with both profit and cash forecasts.
- (vi) Obtain written confirmation from bankers and other loan creditors in respect of the overdraft and loan facilities assumed to be available during the period of the forecast.

Note:

In his report, the Reporting Accountant should avoid giving any impression that the forecast is accurate since profit projections, by their nature, are based on subjective judgements. The Reporting Accountant should, however, review the underlying assumptions to ensure that there are no material omissions or unrealistic assumptions.

QUESTION 7

- (a) Section 410 of the Companies and Allied Matters Act, Cap. C 20, LFN 2004 provides that an application to the court for the winding up of a company shall be made by the presentation of a petition. State any five categories of persons that can present such a petition.
- (b) State and explain any four of the fundamental principles of ethical standards provided in the Institute's *Code of Professional Conduct for Members*.
- (c) Identify and discuss any three possible threats to an auditor's independence and state the possible safeguards to each of the threats you have identified.

SOLUTION TO QUESTION 7**(a) Any five categories of persons that can present such a winding up petition:**

Section 410 of CAMA provides that an application to the court for the winding up of a company shall be by the presentation of a petition by some categories of persons. Five of The categories of persons who can petition are the following:

- (i) The company.
- (ii) A creditor, including a contingent or prospective creditor of the company.
- (iii) The official receiver.
- (iv) A contributory.
- (v) A trustee in bankruptcy to, or a personal representative of, a creditor or contributory.
- (vi) The Corporate Affairs Commission under Section 323 of the Act.
- (vii) A receiver, if authorised by the instrument under which he was appointed; or
- (viii) All or any of these parties, together or separately.

(b) Any four of the ethical standards as contained in the ICAN Code of Professional Conduct for Members

The ethical standards as contained in the ICAN *Code of Professional Conduct for Members* are Fundamental Principles and Statements:

The Fundamental Principles are drawn from the duties owed by all members of the profession, whether in practice or not. They are framed in broad and general terms and constitute basic advices on professional behaviour. The fundamental principles are the following:

- (i) Behave with integrity in all professional and business relationships. Integrity implies not only honesty but fair dealing and truthfulness.
- (ii) Strive for objectivity in all professional and business judgements. Objectivity is the state of mind which has regard to all considerations relevant to the task in hand but no other.
- (iii) Not accept or perform work which he or she is not competent to undertake unless he/she obtains such advice and assistance as will enable him/her to competently carry out the work.
- (iv) Carry out his or her professional work with due skills, care, diligence and expedition and with proper regard for the technical and professional standards expected of him as a member.
- (v) Conduct himself or herself with courtesy and consideration towards all with whom he comes into contact during the course of performing his work.

Statements provide more elaboration on what is expected of members in certain circumstances.

(c) Any three possible threats to an auditor's independence and their respective possible safeguards.

An auditor should always approach his work with objectivity and independence. The approach should be in the spirit of independence of mind, whereby auditors express opinions independently of the entity and its directors. However, it has been observed that it is not always an easy task for the auditor to exercise this independence; there are usually some matters, which may threaten or appear to threaten the independence of an auditor. The three possible threats to an auditor's independence and their respective safeguards are the following:

- (i) **Undue dependence on an audit client.** Public perception of independence may be put in jeopardy if the fees from any one client or group of connected clients exceed 15% of gross practice income or 10% in the case of listed or other public interest companies. This general observation needs modifying in the cases of new practices. ICAN has put this percentage at 25%. (ICAN 1998).
- (ii) **Family or other personal relationships.** It is desirable to avoid professional relationships where personal relationships exist. Examples of personal relationships

- include mutual business interests with members of the group comprising the client, the audit firm, officers or employees of the client, partners or members of staff of the audit firm.
- (iii) **Beneficial interests in shares and other investments.** In general, partners, their spouses, and minor children should not hold shares in or have other investments in client companies. An audit staff member should not be employed on an audit if the staff member or some person connected with him has a beneficial interest in the audit client. Some company articles require the auditor to have a qualifying shareholding. In such cases the minimum only should be held and the holding should be disclosed in the accounts.
 - (iv) **Loans to and from clients.** An auditing practice or anyone closely connected with it should not make loans to its clients nor receive loans from clients. The same applies to guarantees. Overdue fees may in some circumstances constitute a loan.
 - (v) **Acceptance of goods and services.** Goods and services should not be accepted by a practice or anyone closely connected with it unless the value of any benefit is modest. Acceptance of undue hospitality poses a similar threat. A bottle of Scotch wine at Christmas is acceptable but a weekend in Paris will probably not be.
 - (vi) **Actual or threatened litigation.** Litigation or threatened litigation (for example, on auditor negligence) between a client company and an audit firm will mean the parties being placed in an adversarial situation which clearly undermines the auditor's objectivity.
 - (vii) **Influences outside the practice.** There is a risk of loss of objectivity due to pressure from associated practice bankers, solicitors, government or those introducing business.
 - (viii) **Provision of other services.** This is acceptable in principle but care should be taken.
 - (ix) **Receipt of reward from a third party other than the client.** Auditors should not allow their judgement to be swayed by the receipt of a commission, fee or other reward from the third party as a result of advising a client to pursue one course rather than another. If a commission is to be received the accountant should either give it to the client or, with the client's express or implied consent, retain it. If it is to be retained then the fact of a payment of commission, and the amount or how it is to be calculated, should be disclosed to the client, preferably in the letter of engagement. The client should assent to retention.

Audit firms should review on an annual basis every client to determine if it is proper to accept or continue an audit engagement, bearing in mind actual or apparent threats to both audit objectivity and independence. The *Rules of Professional Conduct for Members of ICAN* should always be followed.

Possible safeguards to threats to Auditor's Independence

There are various safeguards available to offset the different types of threats enumerated above. Auditors should always consider the use of safeguards and procedures which may negate or reduce threats. They should be prepared to demonstrate that in relation to each identified threat, they have considered the availability and effectiveness of the safeguards and procedures and are satisfied that their objectivity in carrying out the assignment will be properly preserved.

- (a) **Safeguards and Procedures in individual Firms**
The safeguards and procedures might include the environment of the practice firm within which the professionals operate so as to offset any threat to objectivity. Though it is not possible to provide an exhaustive list of these factors, auditors should expect where possible to have developed the following characteristics in their firms. Where they have been developed, they will provide the necessary safeguards.

- (i) Chartered accountants are taught from the outset of their training contracts to behave with integrity in all their professional and business relationships and strive for objectivity in all professional and business judgement. These factors rank highly in the qualities that chartered accountants have to demonstrate prior to admission to the profession.
- (ii) Engagement partners should have sufficient regard for their own career and reputation to be encouraged towards objectivity and effective use of safeguards.
- (iii) Within every firm, there should be strong peer pressure towards integrity. Reliance on one another's integrity should be the essential force which permits partners to entrust their public reputation and personal liability to each other.
- (iv) Firms should diligently guard their reputation for impartiality and objectivity. It is the foundation for their ability to practise and gain work over the medium and long term, and they should not permit a member of the firm to risk it for short-term benefit or gain.
- (v) Firms of all sizes should have established strong internal procedures and controls over the work of individual principals, so that difficult and sensitive judgement is reinforced by the collective views of other principals, thereby also reducing the possibility of litigation.

(b) Safeguards And Sanctions Built Into The Structure Of The Profession Itself.

These might include:

- (i) The long standing code of ethics of the profession, of which the ***"Rules of Professional Conduct for Members"*** forms part. Where appropriate, these rules impose specific prohibitions where the threat to the auditor's objectivity is so significant, or generally perceived to be so, that no other appropriate safeguards would be effective.
- (ii) The ethical support provided by the Institute.
- (iii) The reinforcement given to the above safeguards by a 'policing system' which reacts to complaints, whether by members of the public or members of the profession, investigates the background to the cases, and where necessary, commences disciplinary proceedings against an offending member. Together with monitoring, the system ensures that a firm's past conduct and current procedures are likely to come under close scrutiny if the conduct of practising members gives rise to challenge over their exercise of these guidelines.
- (iv) The active monitoring procedures conducted by the profession for activities such as auditing. On behalf of the Institute, the Professional Practice Monitoring Committee may visit firms which conduct audits and examine firms' compliance with guidelines and practice.

QUESTION 8

You are the principal auditor of Colour Holdings Plc, a company listed on the Stock Exchange, which has a number of subsidiaries in Nigeria and in some neighbouring West African countries. All the subsidiaries are involved in the manufacture or distribution of ink and paints of all colours and have accounting periods similar with those of the holding company.

You are required to state the audit steps you will take in the process of carrying out the consolidation of the accounts.

SOLUTION TO QUESTION 8

As the principal auditor of Colour Holdings Plc, which has a number of subsidiaries in Nigeria and in some neighbouring West African countries, the audit steps that I will take in the process of carrying out the consolidation of the group's accounts are as follows:

- (a) Check the transposition from the audited accounts of each subsidiary to the consolidation schedules.
- (b) That adjustments made on the consolidation are appropriate and comparable with those of the previous year. This will involve:
 - (i) Recording the dates and costs of acquisitions of subsidiaries and the assets acquired.
 - (ii) Calculating goodwill and pre-acquisition reserves arising on consolidation.
 - (iii) Preparing overall reconciliation of movements on reserves and minority interests.
- (c) Check for business combinations:
 - (i) Whether combination has been appropriately treated as an acquisition or uniting of interests.
 - (ii) The appropriateness of the date used as the date of combination.
 - (iii) The treatment of the results of investments acquired during the year.
 - (iv) If acquisition accounting has been used, that the fair value of acquired assets and liabilities is reasonable when compared with the ascertainable market value by use of an expert.
 - (v) Goodwill has been calculated correctly and if amortised, whether period of amortisation is reasonable.
- (d) Check for disposals:
 - (i) The appropriateness of the date used as that for disposal. This can be ascertained from sales documentation.
 - (ii) Whether the results of the investment have been included up to the date of disposal, and whether figures used are reasonable.
- (e) Consider whether previous treatment of existing subsidiaries is still correct, taking level of influence and degree of support into consideration.
- (f) Verify the arithmetical accuracy of the consolidation workings.
- (g) Review the consolidated accounts for compliance with the legislation, accounting standards and other relevant regulations. The following peculiarities of the case at hand should be noted:
 - (i) All the subsidiaries are involved in the manufacture or distribution of the same products (that is, ink and paints of all colours); hence, all of them are to be consolidated.
 - (ii) Group companies have accounting periods coinciding with those of the holding company.
 - (iii) Ascertain if accounting policies of the subsidiaries differ because foreign subsidiaries might be operating under different rules.
- (h) Review the consolidated accounts to confirm that they give a true and fair view under the prevailing circumstance.

QUESTION 9

You have been invited to carry out the audit of a multi-million naira old people's home project undertaken by a German organization, financed solely by donations from non-governmental organisations in that country.

Outline the steps you will take:

- (a) in your assessment of the system of internal control as is applicable for the local operations;
- (b) in the verification work you need to carry out in the audit of the financial statements, and
- (c) in the nature and contents of your report.

SOLUTION TO QUESTION 9

- (a) The audit of a charity home funded solely by donations from a non-governmental German organisation will involve the following assessment of internal control of the operations of the local project:
- (i) Obtain a copy of the charter of the sponsor organisation in Germany. This should be reviewed critically in order to ensure that the local operation conforms with the articles of the charter.
 - (ii) Check procedure for fund transfer from the sponsor organisation to the local organisation. Such transfer of funds should be in the registered name of the local organisation, not negotiable to the account of the payee only.
 - (iii) Since such fund transfers are expected to be lump sums and limited in number, it will be necessary to vouch the entire transfers.
 - (iv) Proper control should be established over the expenditure of the organisation, such that all expenditure are duly authorised and properly documented on standard payment vouchers.
 - (v) Wherever practicable, all payments should be made by cheques crossed not negotiable to the account of the payee.
 - (vi) The most important factor in the internal control of the local organisation is the integrity and honesty of the operators of the local charity.
 - (vii) The financial statement and returns should be in the format required by the overseas sponsor organisation.
- (b) In verifying the financial statements of the local operation, the auditor should carry out the analysis of the expenditure of the organisation in order to ensure that all payments have been appropriately described and are in agreement with the guidelines from the sponsor organisation. It will be necessary to ascertain the validity of the payments by ensuring that payments have actually been made to the recorded payee and for purposes disclosed in the payment vouchers.
- (c) It is important that the auditor should not only report on the truth and fairness of the financial statements, but also the honesty and integrity of the local operators.

QUESTION 10

In respect of an insurance company which carries out life business, outline the verification work you will carry out in respect of the following:

- (a) Death claims paid.
- (b) Payment of endowment policies on maturity.
- (c) Unearned premiums carried forward.

SOLUTION TO QUESTION 10

- (a) (i) As a first step in the audit of death claims paid by an insurance company which carries out life business, the auditor should obtain perfect understanding of the system of internal control relating to the recognition, acceptance and payment of claims on death. This will include:
- ◆ The method of reporting deaths.
 - ◆ The procedure for obtaining death certificates by the personal representative of the deceased whose life was insured.
 - ◆ Proving a will in a solemn form or obtaining any letter of administration in case of an insured who died intestate.
 - ◆ The general procedure for the payment of death benefits.

- (ii) The auditor should obtain a schedule of death claims and in this respect:
- ◆ Check to ensure that claims are in respect of bona fide policy holders by tracing to the policy book.
 - ◆ Check the cast to ensure arithmetical accuracy.
 - ◆ Agree individual claims with sums assured by reference to the policy any related correspondence.
 - ◆ Check calculation of claims to ensure consistency with company policy and any special terms of the policy contract.
 - ◆ Payment of claims should be checked to the bank records, confirming proper authorization for the payments. These should also be in the names of the beneficiaries, the executors to the wills or the personal representatives of the deceased as is applicable.
 - ◆ The auditor should confirm proper documentation. It will be necessary to check death claims of prior years and compare with the current ones in order to assess the reasonableness of the level of claims. Beneficiaries may be contacted to confirm the payments.
 - ◆ Check claims reported and paid in the immediate succeeding period in order to confirm that these do not include deaths which occurred in earlier periods which should have been provided for appropriately.
- (b) In respect of endowment policies paid at maturity, the auditor should assess the system of internal control relating to endowment policies, especially payments on maturity. The auditor should then obtain a schedule of endowment policies paid during the year and in respect of this:
- ◆ Check the cast to confirm arithmetical accuracy.
 - ◆ Generally scrutinise the list for any invalid policies or possible duplications.
 - ◆ Trace each policy to the related policy documents.
 - ◆ Check amounts paid to ensure that these are in agreement with sums assured,
 - ◆ Check payment vouchers for valid approvals.
 - ◆ Check ultimate payments to the relevant cash records.
 - ◆ Check cancellation of policy subsequent to payments.
 - ◆ Check to confirm that any endowment maturing during the year which has not been paid has been provided for.
- (c) Unearned premium is the portion of premium income which was collected during the year but which represents a future period. In the financial statement of an insurance company, this forms part of the current liabilities. The objective of the verification work carried out by the auditor in respect of provision for unearned premium is to ensure that the method adopted by the insurance company:
- (i) is appropriate for its circumstances;
 - (ii) is generally acceptable; and
 - (iii) is consistent with prior years.

The auditor should:

- ◆ Examine and evaluate the company's method of recognising premium income in order to ensure that proper 'cut-off' has been observed.
- ◆ Check the computation of premium income for the period in order to ensure that this includes provision for unearned premium brought forward from the prior year, less unearned premium carried forward at the year end.
- ◆ Test, on a sample basis, individual policies for the calculation of unearned premium, ensuring that this is in agreement with the stated policy of the company.
- ◆ Confirm from management, that based on experience the method of computation of unearned premium is adequate in the circumstances.
- ◆ Confirm the consistency of computation by reference to prior year's working papers. Where there has been a change in the method, the fact should be disclosed in the

- financial statements, together with the reason for the change, and the effect on the financial statements.
- ◆ Ensure proper disclosure, as part of the accounting policies of the company, the method of computing unearned premium.

QUESTION 11

What would you consider to be the special features of a hospital establishment from the point of view of an auditor?

SOLUTION TO QUESTION 11

- (a) In addition to dispensing drugs at a price to patients (which would have been an ordinary trading concern), a hospital renders other specialised services to the patients. Hence the revenue of a hospital establishment may appear under the following headings:
- Consultation.
 - Drugs.
 - Surgery.
 - Nursing Care.
 - Bed Fee.
 - Feeding.
 - Delivery Charges.
 - Mortuary Fees, and
 - Sale of Cards.
- (b) Apart from analysis of the charges to a patient into the appropriate headings, there is also the problem of matching costs with related revenue in cases where a patient's admission extends from one accounting year to another. Hence where a hospital has the policy of receiving advance payments from patients, there is always the problem of apportioning them to the different periods to which they relate.
- (c) There is also the problem of high incidents of bad debts for a hospital establishment especially in cases of patients who die in the course of treatment.
- (d) Owing to the peculiar nature of the services of a hospital, unavoidable weaknesses may exist in the internal control system. For instance, patients such as the victims of road accidents or armed robbery attacks may be admitted at irregular hours of the night.
- (e) A hospital, being a specialised establishment, is likely to have sophisticated equipment whose value may be out of proportion to the size and whose real value will depend on the condition. It will require specialised skills to determine the effect of obsolescence on these equipment. Furthermore, these equipment might have been provided by philanthropic organisations, individuals or charities, some of whom may be foreign based. In such situations it may be difficult to establish the full monetary value of these equipment for accounting purposes.
- (f) Stocks will consist of drugs, dressings and disposable items, some of which will have expiry dates. Apart from the problem of examining these items individually in order to determine the expiration dates, the auditor may lack the skills to determine the condition of the items; hence, he may have to rely on the opinion of experts.
- (g) Apart from normal creditors for supplies made or services rendered, the liabilities of a hospital may include contingent liabilities for pending litigation or claims for negligence arising out of faulty medical treatment or application of wrong drugs. In addition to identifying the existence of such claims, there is also the difficulty of estimating the value of the claims.

QUESTION 12

Outline the steps you would adopt in the audit of a large hotel establishment, with particular reference to the peculiar aspects of the internal control system.

SOLUTION TO QUESTION 12

A hotel establishment renders services to its customers which may include accommodation, restaurant, bar, laundry, telephone and fax, car hire discotheque, recreation and conference space, each of which may have distinct costs and hence separate revenue.

In order to carry out the audit of a large hotel establishment, the auditor should first identify all sources of revenue to the hotel and evaluate each in terms of control over the revenue generated.

- (a) In respect of guests for accommodation, he should assess the check-in procedure in order to ensure adequate controls over
- ◆ Initial deposits required.
 - ◆ Billings for the rooms.
 - ◆ Refunds for deposits not utilised.

He should check the daily cash summaries and agree with the daily guest charts to confirm the guests have been billed as is appropriate. He should agree the daily collections with the relevant bank paying-in slips to ensure that the day's collections have been lodged intact into the bank account. He should agree the refunds made to the relevant bills and deposits and check the payments to the imprest cash book. For credit customers, he should identify the individual charges to the monthly bills.

- (b) In respect of restaurant services, he should ascertain the costing method for meals served and check the bills on a sample basis to the cash receipt book. He should agree individual bills to the menu and confirm calculations for additional charges, such as service charge and VAT.
- (c) The telephone and fax should be checked to the telephone log and traced therefrom to the individual guest bills.
- (d) The hire of conference halls should be vouched by reference to the related correspondence in order to ensure adequate billing and effective collection.
- (e) The bar account should be verified by carrying out a physical stock check and overall test of the bar purchases and daily sales.
- (f) The assets and liabilities of the hotel are verified in the normal way. The assets will comprise mainly of furniture and equipment and debtors for bills not yet paid.

QUESTION 13

You are the manager in a firm engaged in the audit of a medium-sized manufacturing company. Owing to simultaneous engagements in other assignments, you are unable to spend adequate time with the staff engaged in the audit of the company.

- (a) What specific control procedure would you adopt to ensure that staff engaged in the audit perform to the required standards?
- (b) Outline the points to which your attention will be focused during your review.

SOLUTION TO QUESTION 13

- (a) As a manager in charge of the audit engagement and who cannot spend considerable time with the staff engaged in the audit, the following are the effective control measures necessary to ensure that staff carry out the audit to the required high standard:
- (i) Work performed by each staff should be adequately documented.
 - (ii) All working papers should be initialed by staff responsible for their production.
 - (iii) There should be a checklist to ensure the completion of all aspects of the work.
 - (iv) Audit queries should be separated into two: those in respect of which the client is expected to provide additional information and those requiring superior opinion.
 - (v) Review points raised by the supervisor should be properly disposed of and documented.
- (b) The manager's review will deal with the following points:
- (i) Whether working papers comply with the firm's audit standards,
 - (ii) Whether working papers are suitably indexed and cross referenced,
 - (iii) Whether all schedules agreed with the relevant figures in the financial statements,
 - (iv) Whether all necessary letters of confirmation have been received,
 - (v) Whether the letter of representation covers all applicable points,
 - (vi) Whether the accounts comply with all statutory requirements and standards,
 - (vii) Whether the accounting policies adopted by the company are appropriate and consistent,
 - (viii) Whether the audit programmes have been duly completed and all audit queries raised during the work have been acknowledged and appropriate responses received,
 - (ix) Whether there are any points that put the auditor on enquiry, and hence to be further dealt with by the appropriate level of authority,
 - (x) Whether there are any key points which could lead to a qualified report.

APPENDIX III

CASE STUDY AND SUGGESTED SOLUTION

QUESTION 1

Mr. Henry Akintola has been in practice for many years. He is now very anxious to develop more income areas to be able to see his children through University education. Amongst the new ventures he has been offered are:

- (a) The audit of his brother's new company.
- (b) A 35% share in a new company being formed by a client to market computer software and peripherals.
- (c) An agency with a mortgage company that expects him to agree to an illuminated sign of the company in his office window; and
- (d) A back duty case on which client has offered him 30% of the sum saved if he will negotiate a reduction in the estimated assessment.
- (e) Dairo, his assistant, has been offered a part time job, by a client company, keeping the client's books.

Required:

- (a) How may Mr. Akintola enlarge his practice?
- (b) How should he deal with the matters stated above?

SUGGESTED SOLUTION 1

- (a) Mr. Akintola should try to enlarge his practice by developing other accounting services which do not constitute conflict of interest, hence a threat to his independence and objectivity as statutory auditor to his existing or future clients. Such services may be in the areas of receivership, company secretarial services and taxation advisory services. The ethics of the accounting profession does not permit him to solicit for audit clients, but he can certainly engage in limited advertisement to publicise his firm to potential clients.
- (b) All the matters stated above, except (d), to represent a client in a back duty case for a thirty percent commission. On grounds of family ties, it will be unethical to accept to act as auditor to a brother's company. A 35% share in a new company will amount to substantial holding in a company to which his firm is the auditor. An accountant's office should not bear illuminated advertisement signs, not even for the accountant's business.

The part-time job offered to Mr. Akintola's clerk is personal. It is immoral for Mr. Akintola to convert the clerk's to the firm's earnings.

QUESTION 2

Mr. Chuks Nwachukwu is the audit partner of COOL MOTION Nigeria Limited. The directors have asked him to prepare and audit the financial statements for the year ended 31 March 2004. They have also asked him to assist them to install a new computer system, select a new chief executive and discuss at a board meeting the dividend to be paid. The company is also subject to a probable take-over bid and persuades Mr Nwachukwu to act for them in rebutting statements made by the take-over bidder.

On the audit, Mr. Nwachukwu finds that the company systematically breached rules on exporting goods to a certain country in Western Europe, contrary to the laws and he suspects that some cash receipts in certain subsidiary companies may be bogus.

Required:

- (a) What jobs can Mr Nwachukwu accept?
- (b) What should Mr Nwachukwu do about the exports and the cash receipts?

SUGGESTED SOLUTION 2

- (a) Mr. Nwachukwu would not have breached any rules of professional conduct by accepting to prepare financial statements for a company to which he is the audit partner, provided that the work does not include keeping the records. He could also accept to install a new computer system for the company if he has the technical competence to do so. He may source for a new chief executive if he is asked to do so. To discuss the amount of dividend to be proposed by the board falls within his audit responsibilities. Mr. Nwachukwu should accept to examine, and if necessary, reconstruct financial statements to be used for the purpose of negotiating with a prospective buyer.
- (b) If the breach in export laws has led to mis-statements in the financial statements, Mr. Nwachukwu is under obligation to make that known in his report and effect the necessary corrections for the financial statements to be fairly stated. Where the directors object to this, he should resign. He should carry out necessary investigations in order to confirm that fictitious collections from a subsidiary have not been used to boost the overall earnings of the group. Where this is the case, he should reflect necessary adjustments to neutralise the manipulation.

QUESTION 3

Intercontinental Computers Plc is a company making, importing and retailing computers and software. It has branches in different locations in Nigeria and the West African sub-region. It has recently suffered from declining sales, excess stocking of outdated computer systems and software and had survived by cutbacks and retrenching both management and junior workers.

The auditors, Thomas Adebami & Co., are planning the audit of the accounts for the coming year.

Required:

Outline the stages required in the audit of the accounts of Intercontinental Computers Plc noting, in particular, the difficulties or requirements which the audit will entail.

SUGGESTED SOLUTION 3

Bearing in mind that the problem of the company is in the area of inventory, the auditor should carry out all necessary procedures to ensure that stocks are correctly identified as to description and quantity and that they have been valued, using acceptable accounting policy. Specifically, the auditors should

- (a) hold preliminary discussions with the management, with a view to ascertaining the exact situation in view of the recent set-backs, and to include in their audit plans a strategy to ensure that stocks are properly stated in the financial statements.
- (b) obtain a copy of the company's year-end stock taking instructions and study same carefully with a view to confirming that it includes the appropriate procedures for identifying slow moving and obsolete stocks.
- (c) plan to attend on the day of the stock taking in order to observe the exercise, noting particularly that staff engaged in the exercise are correctly identifying obsolete and slow moving stocks. The auditor should make note of same in the stock sheets.
- (d) carry out test counts and recounts to confirm the accuracy of the count.

- (e) use the services of experts to help in the identification of stock items, especially those that are known to be obsolete.
- (f) check for the treatment of obsolete stocks, with particular reference to provisions that have been made for them.
- (g) watch out for any manipulations or errors in the valuation of stocks.
- (h) cover a significant number of branches in his visits in order to confirm that stock manipulations had not taken place in any of them during the stock taking exercise.

QUESTION 4

Exquisite Interiors Limited operates a large shop in the city of Abuja. The company sells expensive furniture and interior decoration accessories. Normally customers see the furniture items in the shop and place orders for delivery in the company van within three weeks. Delay occurs because each sale results in a purchase order from one of the suppliers. On placing an order, the customer pays by cash, cheque or signs hire purchase agreement. There are four sales assistants, a van driver and a cashier in the shop. The accounting and purchasing functions are done by the manager and a part-time bookkeeper.

The directors of the company have other businesses and review the company's operations once a month at an all-day board meeting.

Required:

- (a) Identify the types of internal control measures that will be appropriate for the company.
- (b) Identify some tests of controls that the auditor could perform.
- (c) Consider the auditor's attitude to the system.

SUGGESTED SOLUTION 4

- (a) With a "large shop", Exquisite Interiors Limited, should put in place the following internal control measures:
 - (i) There should be proper segregation of duties, especially with respect to the accounting and purchasing functions. There should be a separation such that the accounting and purchasing functions are performed by different persons whose jobs do not overlap.
 - (ii) With four sales assistants, there is need to ensure that the orders are approved by a more responsible official and sales invoices checked prior to the payment by the customer in case of cash sales, and approval in the case hire purchase or credit sales.
- (b) The auditor should perform the following tests of controls:
 - (i) Check the cash sale invoice booklets for any omissions or duplications. If any invoices are cancelled, the original copies of such invoices should be attached to the book copy and clearly marked "cancelled."
 - (ii) Check the cash sale invoices serially into the daily cash sheets, ensuring that there are no omissions or carry-overs.
 - (iii) Check lodgements into the bank statements, ensuring that the daily collections are paid intact into the bank account. Watch out for any 'teeming and lading' and obtain satisfactory explanations for any cash not lodged into the bank on the appropriate dates.
- (c) The sales of the company are on the basis of specific orders, leading to specific purchases of different amounts. Since the sales are not of standard amounts, there is considerable room for manipulation by the sales assistants who appear not to be supervised. The auditor should therefore be cautious in his examination, bearing in mind that staff may have committed fraud which he will conceal. He should adopt an attitude of professional skepticism.

QUESTION 5

Akpan Essien MBA, FCA is about to commence the audit of Hosanna Health Foods Limited. The company has been established for 7 years and has been fairly successful. Essien has not encountered many problems in the past, except for debt collection and bad debts sustained. A feature of the accounts each year has been the large amount of stock. The management is good. The monthly accounts are regularly prepared by Hakeem Badru, FCA, who was 'head-hunted' from the auditors. The accounts are disaggregated for management purposes into dried goods, tinned goods and specialty imports.

Required:

- (a) To what extent can Akpan engage in analytical techniques?
- (b) Devise analytical techniques, using financial and non-financial data for verifying the expenses incurred on the running of the vans. The company has 25 vans.

SUGGESTED SOLUTION 5

- (a) In the audit of Hosanna Health Foods Limited, the auditor can make use of analytical reviews to determine the following:
 - (i) The proportion of the sales that have been contributed by each of the three lines: dried goods, tinned goods and specialty imports,
 - (ii) The proportion of cost of sales that have been contributed by each of the three lines;
 - (iii) The gross profit on sales for each line.
- (b) The analytical techniques that may be used to verify "motor van expenses" are;
 - (i) sales per mile covered;
 - (ii) sales per litre of fuel consumed;
 - (iii) sales per day;
 - (iv) sales per 1000 maintenance cost;
 - (v) sales per van in the year.

QUESTION 6

Kleen Products Limited is a wholesaler of household improvement goods with a network of 10 depots spread across the country. The auditors, Hassan Olowu & Co, are conducting the final audit of the financial statements for the year ended 31 December, 2004 in March 2005.

The financial statements reveal the following:

	2004	2003
	N'000	N'000
Turnover	26,250	25,250
Gross Profit	6,038	5,558
Net Profit	640	970
Stock	3,113	2,578
Debtors	3,680	3,028
Creditors	2,153	2,495

The auditors discovered the following:

1. The company is owned by the Chaaba family and controlled by Mohammed, a very dominating character who is the first son of the company founder.
2. Mohammed is negotiating for a renewal of overdraft facilities and a loan to expand turnover.
3. In the interim audit, the wages caption (with 62 employees) was found to have very weak controls. The limited tests at that time did not show major errors.
4. A routine test on the sales representatives' expenses has just revealed that 20 of the 37 items were not supported by vouchers and appeared to be of expenses not actually incurred. The Accountant responsible for payments referred the auditors to Mohammed who told them to mind their own business but that all such expenses were properly paid.

5. The auditors have discovered that certain stock lines were sold but not purchased. They suspect that the items were stolen goods. The sales value of these goods is not determinable without an analysis of the thousands of sales invoices.

Required:

Discuss the implications of the figures in the accounts and all the other data for the auditors and the audit of the 2004 financial statements of the company.

SUGGESTED SOLUTION 6

There are chances that sales might have been manipulated to show a higher turnover in view of the renewal of overdraft facility that the company was negotiating. Mohammed, being a domineering character, could have been using the sales representatives to make fictitious payments to himself. The extracts from the accounts above show that while both sales and gross profit increased slightly, net profit decreased by a much higher margin, suggesting manipulation in the figure of expenses.

The figure for debtors is increasing, suggesting that the company may be having difficulties with debt recovery or fictitious invoices might have been included. Creditors' balance is decreasing, showing that probably suppliers are withholding credit.

QUESTION 7

Eva Builders Merchants Limited has ten branches in the various parts of the country. In its financial year ended 31 March, 2005, the company made a total turnover of ₦90million, the net profits before tax were ₦9million and net assets of ₦36million. During a routine visit to one of the biggest branches, the audit trainee accidentally overheard the accountant at the branch being thanked by a customer and given cash for some goods. The trainee's suspicion was aroused and further investigations and questioning revealed that the accountant and the general manager had systematically defrauded the company of some ₦1.5million over the previous two years, by selling goods for cash at a discount or by misappropriating cheques. In both cases, no invoices were ever raised or if they were, then, they were suppressed.

The Board was informed and the two employees were dismissed from service but not prosecuted. The company eventually recovered ₦750,000 from them.

Required:

Consider this case from the point of view of:

- (a) Materiality.
- (b) Internal control and the audit.
- (c) Previous years.
- (d) The Annual Accounts.
- (e) Accounting Records.
- (f) The Auditor's Report.
- (g) Reports to outsiders (for example, the police).
- (h) Reports to management.

SUGGESTED SOLUTION 7

In relation to the net profit of ₦9 million, ₦1.5 million stolen by the staff is a material amount. That they were able to steal as much as ₦1.5 million without being detected shows that the internal control system is very weak. Similar losses might have occurred in the other branches. This fraud was discovered only by chance. Such fraud could therefore have occurred in the previous year without being uncovered. The sales in the annual accounts might have been exaggerated as a result of fictitious recordings. The accounting records are unreliable. The auditor needs to qualify his report on the grounds of uncertainty as the figure of sales cannot be determined with any

degree of reasonableness. It is not the duty of the auditor to report the fraud to the police, but he is under obligation to management and to the shareholders.

QUESTION 8

You are the manager responsible for prospective clients and you have visited Hallmark Publishing Plc, which publishes a small range of fiction novels. The chief executive who also happens to be the majority shareholder is Halladu and he has asked your firm to make a proposal for the company's audit and other services.

During the initial meeting with the chief executive, you ascertained the following:

1. The company's turnover has increased by about 15% a year for the last four years.
2. Halladu is a dominating personality who is ambitious.
3. The company has recently paid very large sums of money to three relatively unknown authors for new books which Halladu thinks will be successful.
4. The company has borrowed so much from its bankers and a major repayment of the loan is due in a couple of months. The company is already at the limit of its overdraft facility as a result of the advances given to the three authors. Halladu is about to negotiate with another bank with an overseas link for additional finance.
5. Most of the company's novels are published in the UK with an exchange rate which is not favourable to Nigeria.
6. The company recently bought a very complex computer system to control its affairs. Halladu has confessed that he does not understand the system and the company's computer system's manager has left for the US for 'green pasture.'
7. The company has recently agreed to sponsor an adventurer to the sahara desert in the Middle East, by road, and the cost of this is not yet clear. The company has a Hummer Jeep which Halladu uses and intends to give to the adventurer for the expedition.
8. The company has recently received a writ of summons from a person who alleges that he has been defamed by a novel published by the company. The latter has a large stock of this book and is contesting the issue.
9. The company has no formal management accounting system but the new systems will readily supply this when working.
10. Halladu wishes to maintain the company's high share price so that he can use the shares to take over a major competitor.
11. The company recently took over an ailing printing company. Halladu is of the belief that the company can be 'turned around.'

Required:

- (a) Identify and describe the principal business risks relating to Hallmark Publishers.
- (b) Recommend an appropriate strategy for the first audit of Hallmark Publishers.
- (c) Suggest measures that Hallmark Publishers could implement immediately to improve its accounting procedures and financial controls.

SUGGESTED SOLUTION 8

- (a) The principal business risks to which Hallmark Publishers is exposed to are contingent liabilities arising from:

- (i) infringement of copyright and plagiarism;
 - (ii) improperly negotiated contracts, and
 - (iii) improper internal control system relating to expenses and capital projects;
 - (iv) management override of controls.
- (b) The auditor will need to carry out detailed verification work for this company in view of the absence of a good system of internal control and for management's override of controls. He should review all existing contracts and commitments with a view to ascertaining to what extent these agreements have exposed the company to liability.
- (c) To improve accounting procedures and financial controls, the company should:
- (i) Establish a proper organisation structure, assigning specific duties to qualified persons.
 - (ii) Employ a competent person to edit all manuscripts before publication in order to avoid infringement of copyright plagiarism.
 - (iii) Subject to normal review and approval, all contracts and expenses.

QUESTION 9

Sewage Nigeria Plc is a quoted company heavily engaged in the waste disposal industry. It also engages in land excavation in the oil servicing sector. The company sees itself as performing very unpleasant duty, which the rest of the public is quite unwilling to do, but for the money in the business. Thus, the company has acquired a reputation for being unfriendly environmentally and has noticed with dismay its share price falls in the capital market, despite making good profits and having excellent future prospects in business.

Required:

- (a) Suggest factors which might have caused the company's reputation and share price to fall.
- (b) Suggest an action programme for improving the company's public image.
- (c) What possible mis-statements may occur in the financial statements as a result of environmental factors?
- (d) How might the auditor approach the audit?

SUGGESTED SOLUTION 9

- (a) The company does not give consideration to social and environmental matters, despite its impressive profit performance. Consequently, it acquired the reputation of bad corporate image, hence investors are inclined to ignore its shares for the fear that some problems relating to the company's environmental policies may occur and which are capable of causing the collapse of the entity.
- (b) The company should undertake public enlightenment campaigns backed up by specific actions, to improve the environment in which it operates. Staff should be made to participate more in the decision-making processes of the company which will also guarantee the improvement of their welfare.
- (c) It is possible that the financial statements do not disclose the contingent liability relating to the company's poor environmental policies.
- (d) The auditor should enquire of management and the company's solicitors the existence of any litigations relating to environmental matters. Full provision should be made in the accounts with adequate disclosure in the notes about the nature and extent of such contingent liabilities.

APPENDIX IV

AUDIT PLANNING MEMORANDUM

INTRODUCTION

If effective planning decisions are to be properly implemented, it is important that they are satisfactorily recorded, for the benefit of the entire audit team. The auditor's operational guidelines state: "The auditor will need to ensure that all audit staff are briefed regarding the enterprise's affairs and the nature and scope of the work they are required to carry out. The preparation of a memorandum setting out the outline audit approach may also be helpful". Therefore, in practice, the preparation of the planning memorandum is seen as an established audit planning procedure. In practice, it is advisable for the memorandum to be prepared by the audit team leader and approved by the audit partner before the field audit work commences.

PLANNING MEMORANDUM

Prepared by: Date: Reviewed by: Date:
--

Client:

Period ended:

Audit objectives:

- (i) To familiarise staff with client's organisation and practices.
- (ii) To provide a basis for the efficient administration and review of the audit.
- (iii) To ensure that:
 - ◆ The client's accounting systems are satisfactorily ascertained and recorded, and internal controls identified and evaluated.
 - ◆ Our audit programmes are designed to highlight and test critical aspects of the audit

Audit procedures

The procedures to be carried out are set out in detail, as follows:

- (i) The report is in two sections, which are to be completed and reviewed at the principal planning stages, stated thus:

Section A: This is completed prior to commencing the interim (transactions) audit. The manager completing this section will need to familiarise himself with those of the job by referring to the correspondence, permanent and previous year's audit files.

Section B: This is done at the completion of the interim audit, to plan for the final audit. The partner's review of this section should be carried out after completion of his review of the interim audit working papers.

(If we do not carry out a separately defined interim audit Section A only of the memorandum will be completed prior to the commencement of our field work).

- (ii) A copy of the completed memorandum should be retained in the current audit file and a further copy carried forward in the following year's file.
- (iii) As limited space is provided on the face of the memorandum, the right hand column may be used, with discretion, merely as a means of cross referencing to detailed supporting working papers.

SECTION A

PLANNING MEMORANDUM		<i>Planned date</i>	<i>Actual date</i>
1.	<p>Job Timetable Give provisional dates of timing of audit work: Planning meeting with client. Commencement of interim audit. Conclusion of interim audit. Management letter (interim). Stocktaking attendance. Debtors/creditors circularisation. Commencement of final audit. Conclusion of post balance sheet event review. Audit panel (hot) review (if mandatory). Formal meeting with client to approve. Financial statements and discuss audit report. Letter of representation finalised.</p>		
2.	<p>Job timetable Auditor's report signed. Management letter (final). De-briefing meeting (The 'actual date' column will be completed as soon as possible after the conclusion of each phase of the audit to enable the timetable and allocation of staff resources to be reconsidered and amended expeditiously as the audit progresses).</p>		
3.	<p>Changes since previous audit Sources include audit and correspondence files, discussions with partner, pre-audit meeting with client.</p> <p>(a) In the nature of the client's business (for example, changes in product range terms of sales etc.) (b) In the management structure or key financial accounting personnel. (c) In the accounting system (including those resulting from previous management letters). (d) In external requirements (for example, IAS, SAS statutes, rules etc.) (Consider the impact of the answers the answers to the above questions in conjunction with our client risk evaluation questionnaire).</p>		
4.	<p>Planning decisions (a) The main changes in the audit programme from the previous period are: (give both changes in tests and in sample size). (b) Indicate on an audit area basis whether it is intended to seek reliance on internal controls:</p>		

PLANNING MEMORANDUM		<i>Planned date</i>	<i>Actual date</i>
	<p>Sales and debtors, Purchases and creditors. Stock and work-in-progress salaries and wages, bank and cash, fixed assets, Others (specify)</p> <p>(c) Indicate those areas in which material errors have been identified in previous periods and audit emphasis to be placed thereon.</p> <p>(d) The following systems areas are to be flowcharted.</p> <p>(e) The following sections of the permanent file are to be created/updated.</p> <p>(f) Specialist assistance required. Nature: Timing:</p> <p>(g) Prepare a summary of schedules and other details that client staff will provide for us.</p> <p>(h) Where we provide accountancy services indicate whether:</p> <p>i. Our accountancy and audit work has been planned to avoid duplication of work:</p> <p>ii. Staff engaged on the accountancy work have been briefed as to the assurance that will be placed on their work and the audit objectives that are relevant.</p> <p>(i) State briefly other services we provide for the client and their impact on nature and timing of audit.</p>		
5.	<p>Other auditors (joint, primary, secondary)</p> <p>(a) Identify, as appropriate, primary, secondary or joint auditors.</p> <p>(b) State briefly the liaison with other auditors:</p> <p>i. At the planning stage of the audit:</p> <p>ii. During the transactions audit</p> <p>iii. At the final audit.</p> <p>(c) Where we are primary auditors: State briefly the method by which the firm will be satisfied about the quality and reliability of the work of other auditors (for example, review of audit plans, working paper review, questionnaire). Indicate whether we are adopting a rotational reviewing approach.</p> <p>(d) State timetable for:</p> <p>i. Review of other auditors' plans;</p> <p>ii. Despatch of questionnaires:</p> <p>iii. Receipt of audited financial statements:</p> <p>iv. Receipt of completed questionnaires</p> <p>v. Agreement of inter-company balances</p> <p>vi. Review of other auditors working papers.</p> <p>(e) State briefly:</p> <p>i. Whether we are aware of any reason why we should not rely on the work and report of any secondary auditors; and</p> <p>ii. Our audit approach in such circumstances</p>		
6.	<p>Internal audit department</p> <p>(a) Indicate to what extent we are able to reduce the level of our audit tests by relying on relevant internal audit work.</p>		

<p>PLANNING MEMORANDUM</p> <p>(b) State briefly the liaison with the internal auditors: i. At the planning stage of the audit: ii. During the transactions audit: iii. At the final audit.</p> <p>Briefing instructions (a) State any particular sequence in which the work is to be carried out (b) State any specific points which require particular attention or parts to be done by a specific person</p>	<i>Planned date</i>		<i>Actual date</i>				
	<p>(c) Insert date when briefing meeting with audit team held and names and levels of staff</p> <table border="1"> <tr> <th>Date</th> <th>Name</th> <th colspan="2">Level</th> </tr> </table>				Date	Name	Level
Date	Name	Level					
<p>(d) Levels of materiality and bases (NB this does not imply that any error should be ignored. All errors and exceptions are to be recorded in the working papers and evaluated).</p> <p>Partner’s signature approving levels.....</p> <p>8. Supervision and review</p> <p>(a) State any particular stages (for areas of difficulty) where the senior is to refer back to the manager. (b) State how, and at what stages, it is proposed to supervise and review the transactions audit.</p> <p>9. Financial ratios/going concern evaluation (a) From the most recent management information, abstract the following ratios (if management information not reliable or available include such observations in 8(b)below)</p> <p>Return on capital employed: Operating profit Operating assets</p> <p>Efficiency: Operating assets Turnover</p> <p>Current assets Turnover</p> <p>Fixed assets Turnover</p> <p>Profitability: Operating profit Turnover</p> <p>Gross profit Turnover</p> <p>Production Costs Turnover</p> <p>Distribution costs Turnover</p>	Profit and loss account (potential adjusting entries)		Balance Sheet (potential reclassification entries)				
	Amount	Basis Guideline 5% anticipated pre-tax profits	Amount	Basis (Guideline 5% share capital reserves)			
	Management Accounts To..... %						
		Budget For year %	Previous Year (actual) %				
		<i>Planned date</i>					
		<i>Actual date</i>					

PLANNING MEMORANDUM	<i>Planned date</i>		<i>Actual date</i>
<p style="text-align: center;">Administrative expenses Turnover</p> <p>Solvency: Current assets Current liabilities</p> <p style="text-align: center;">Current assets – stock and work-in-progress Current liabilities</p> <p style="text-align: center;">Trade creditors Purchases x 365</p> <p style="text-align: center;">Trade debtors Turnover x 365</p> <p>(b) State the specific audit steps to be taken in the light of the trends disclosed (8a) above.</p> <p>(c) In the light of review of management accounts in 8(a) above, interim accounts if available and discussions with management and staff, consider whether there is any evidence that the enterprise may be unable to continue in business. Where formal forecast and budget systems exist review them in this context.</p> <p>Provisional evaluation: Satisfactory / Unsatisfactory</p> <p>(d) Where evaluation above is ‘unsatisfactory’ state:</p> <p style="margin-left: 20px;">i. The nature of the problem and the indicators:</p> <p style="margin-left: 20px;">ii. Any mitigating factors:</p> <p style="margin-left: 20px;">iii. Management’s plans to overcome the problem: and</p> <p style="margin-left: 20px;">iv. Specific audit procedures to be carried out, and the timing thereof.</p> <p>10. Time budget State briefly the reasons for significant variances in current year budget with budget and actual time of previous year</p>			
	Management Accounts To.....%	Budget for year %	Previous Year (Actual)%

SECTION B

<p>1. Additional changes ascertained during the transactions audit.</p> <p>(a) In the nature of the client’s business, management structure or key financial/accounting personnel.</p> <p>(b) In the accounting systems that will require modification of the audit approach to the final audit.</p> <p>(c) State the audit time consequences and areas involved in respect of planned transactions audit work carried forward to the final audit.</p> <p>2. Planning decisions</p> <p>(a) The main changes in the balance sheet audit programme from that previously approved are (give both changes in tests and in sample sizes).</p> <p>(b) The main changes in the time budget from that previously approved are:</p> <p>(c) Identify those audit areas in which we intend to limit our substantive balance sheet audit work subsequent to our evaluation and compliance testing of internal controls and substantive testing of transactions: Sales and debtors Purchases and creditors Stock and work in progress Salaries and wages Bank and cash Fixed assets Others (specify)</p> <p>(d) Indicate those areas in which errors and weaknesses have been identified and detail the final audit emphasis to be placed thereon.</p> <p>(e) The following sections of the permanent file are to be created updated.</p> <p>3. Briefing instructions</p> <p>(a) State any particular sequence in which the work is to be carried out.</p> <p>(b) State any specific points, which require particular attention or parts to be done by a specific person.</p> <p>(c) Insert date when final audit briefing with audit team held and names and levels of staff briefed:</p> <p>(d) Levels of materiality and bases (NB). This does not imply that any error should be ignored. All errors and exceptions are to be recorded in the working papers and evaluated. Partner’s signature approving levels...</p>	Management Accounts to.....%	Budget for year %	Previous year (actual)%
	Date	Name	Level
	Profit and loss account (potential adjusting entries)		Balance sheet (Potential reclassification entries)

<p>4. Supervision and review</p> <p>(a) State any particular stages(or areas of difficulty) where the senior is to refer back to the manager.</p> <p>(b) State how and at what stages, it is proposed to supervise and review the final audit work.</p>	Amount ₦	Basis (Guidelines 5% draft per tax profits)	Amount	Basis (Guidelines 5% share <i>capital</i> reserves)
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APPENDIX V

EXAMPLE OF AN ENGAGEMENT LETTER

This form of letter is generally appropriate for client companies. It is not intended to be used in relation to every company, as it should be tailored to specific circumstances.

Dear Sirs,

1. Following our appointment as auditors of the company and in confirmation of our recent meeting with... (named officials) of the company, we set out below what we consider to be the basis on which we are to act as auditors and the respective areas of responsibility of the company and of ourselves. We also refer briefly to the other services that we can provide at your request/have arranged with you to provide (delete as appropriate).
2. **AUDIT**
Our function as auditors under the Companies & Allied Matters Act, Cap. C 20, LFN 2004, is to examine and report to the members on the accounts presented to us by the directors. The Companies & Allied Matters Act 2004 requires you, as directors of the company, to maintain prescribed accounting records and prepare accounts, giving a true and fair view of the state of the company's affairs at the date of the balance sheet, and of the profit or loss for the year ended on that date; complying with the Companies & Allied Matters Act. You are also responsible under the Companies & Allied Matters Act 2004 for making available to us, for the purposes of our audit, all the company's accounting records and all other records and related information, including minutes of all directors' and shareholders' meetings, and of all relevant management meetings (include if appropriate). In the event that the company's management asks us to provide services additional to the audit, the legal obligation of both auditors and directors are unchanged.
3. We shall, as required by the law, report to the members whether in our opinion the accounts of the company which we have audited give a true and fair view of the company's affairs at the date of the balance sheet, and of the profit (or loss) and cash flows for the year ended on that date, and where required the value added statement, and whether the accounts comply with the Companies & Allied Matters Act and other statutes such as the Bank and Other Financial Institutions Act 1991, the Insurance Act 2003. In arriving at our opinion we are required by law to consider certain matters that we only report to members where we are not satisfied or where certain information is not disclosed in the accounts. We are also required to report whether the company complied with the applicable guidelines of the Productivity, Prices and Incomes Board.
4. We shall also report, in accordance with our professional obligations, if in any significant respect the accounts do not comply with the relevant International Accounting Standards and Statements of Accounting Standards unless, in our opinion, non-compliance is justified.
5. **REPRESENTATIONS BY MANAGEMENT**
Whilst most of the information required for our audit will be obtained from company records, we shall necessarily have to rely in certain instances, on representations made to us by senior management where judgements are involved or the information is not readily available from company records.

At the conclusion of the audit, we will normally request the managing director, or an appropriate director, to sign, on behalf of the board, a formal letter to us confirming these representations.

6. DOCUMENTS ISSUED WITH THE ACCOUNTS

In order to assist us with our audit of the accounts, we will also ask to see, before we sign our audit report, any documents or statements which will be issued with the accounts, for example, the review by the chairman and the directors' report. If it is proposed that any documents or statements, other than the audited accounts, which refer to our name are to be circulated to third parties, please consult us before they are issued.

7. AUDIT APPROACH

(This paragraph should be adapted as necessary, at the auditor's discretion, to reflect the planned audit strategy. An example of such adoption is given below).

"Our audit will be conducted in accordance with generally accepted auditing standards, the Auditing Standards issued from time to time by The Institute of Chartered Accountants of Nigeria and the International Federation of Accountants and will have regard to relevant local and international auditing guidelines."

Furthermore, it will be conducted in such a manner as we consider necessary to fulfil our responsibilities and will include such tests of transactions and of the existence, ownership and valuation of assets and liabilities as we consider necessary. We shall obtain an understanding of the accounting system in order to assess its adequacy as a basis for the preparation of the financial statements and establish whether proper accounting records have been maintained.

We shall expect to obtain such relevant and reliable evidence as we consider sufficient to enable us draw reasonable conclusions therefrom. The nature and extent of our tests will vary according to our assessment of the company's accounting system, and may cover any aspect of the business operations. We shall report to you any significant weaknesses in, or observations on, the company's systems which come to our notice and which we think should be brought to your attention.

8. IRREGULARITIES AND FRAUD

The establishment and maintenance of an adequate system of internal control is the responsibility of the directors, with whom rests the responsibility for ensuring compliance with statutory and other regulations, including those in relation to taxation, and for the prevention and detection of irregularities and fraud: we are not required to search specifically for such matters and our audit should not therefore be relied on to disclose them.

However, we shall plan our audit so that we have a reasonable expectation of detecting material mis-statements in the account resulting from fraud or error or breach of regulations.

(Substitute the following for the above if, in the case of a proprietor managed business; significant reliance is to be placed on the proprietor's supervision).

The establishment and maintenance of an adequate system of internal control is the responsibility of the directors, with whom rests the responsibility for ensuring compliance with statutory and other regulations including those in relation to taxation and the prevention and detection of irregularities and fraud. We appreciate that the present size of your business renders it uneconomical to create a system of internal control based on the segregation of duties in the running of your company.

We understand that the chief executive is closely involved with the control of the company's transactions. We are not required to search specifically for irregularities and fraud and our audit should not therefore be relied on to disclose them. In the light of the above however, we shall

- (a) plan our audit so that we have a reasonable expectation of detecting material misstatements in the accounts resulting from fraud or error or breaches of regulations;
- (b) in planning and performing our audit work take account of the chief executive's supervision. Further, we may ask additionally for confirmation in writing that the transactions undertaken by the company have been properly reflected and recorded in the books of accounts.

Our audit report on your company's financial statements may refer to the above confirmation.

9. **REPORTING TO MANAGEMENT**

(See below concerning the adoption of this paragraph)

We shall report to management, usually in writing, any significant matters which come to our notice which we think should be brought to the company's attention. For the reasons given in paragraphs 7 and 8 above (as appropriate) the letter will not necessarily deal with all shortcomings.

Letters will be addressed to the managing director (adapt if an appropriate alternative arrangement has been agreed) unless you inform us in writing that they should be addressed differently.

(Substitute the following for the above if our evaluation of internal control is limited, for example, in the circumstances referred to in paragraph 8).

We shall report to management, usually in writing, any significant matters which come to our notice which we think should be brought to the company's attention. However, as explained at the meeting referred to in paragraph 1 above (amend as appropriate) we will not be carrying out a detailed evaluation of the internal control in your system. The comments in our report to management may not therefore be a comprehensive record of all weaknesses that may exist. Letters reporting matters that come to our attention will be addressed to the managing director (adapt if an appropriate alternative arrangement has been agreed) unless you inform us in writing that they should be addressed differently.

INTERNAL AUDIT

Note: If reliance on work done by an internal audit department is contemplated the letter should normally explain

- (a) the work that internal audit will carry out (for example, recording the systems, internal control evaluation, compliance tests);
- (b) the way we intend to review this work (for example, by file review, re-performance of tests at a limited level);
- (c) the fact that the extent of our reliance is dependent on the independence of internal audit, the quality of their staff, the adequacy of their preparation of working papers and completion of audit programmes, and their use of documentation compatible with the firm's approach;
- (d) the method of agreeing the detailed arrangements each year;
- (e) the role of the firm in reviewing reports written by internal audit;
- (f) the procedures for the maintenance of common files. It may often be appropriate to set out the arrangements in more detail and agree them in writing with the Chief Internal Auditors. Such agreement may need to be made afresh each year.

10. **OTHER AUDITORS**

(A paragraph along the following lines should be included where the client has subsidiaries audited by other auditors).

Our reporting responsibilities in connection with the accounts of the group are identical to those set out in paragraph 3 in respect of the company. In carrying out our duties under this heading, we shall make such enquiries of the other auditors and review their work to such an extent, as we consider necessary in order to form our opinion on the group accounts. However, the responsibility to your company, as shareholders, for the audits of such subsidiaries remains with the auditors of the subsidiaries concerned.

(Where the auditor is also the tax consultants the following paragraph should be included).

11. **TAXATION**

We shall prepare a computation of profits in respect of each accounting period adjusted in accordance with the provisions of the current taxation legislations, for the purpose of assessment to income, capital gains and excess profit taxes. After your approval, this will be submitted to the Federal Inland Revenue Service (FIRS) as the company's formal return. We shall lodge notice of appeal against excessive or incorrect assessments to tax where notice of such assessments is received by us. Where appropriate, we shall also make application for postponement of tax in dispute and advise as to appropriate payments on account. To ensure strict compliance with statutory requirements, it is ideal for all letters from FIRS to be sent direct to us. However, any letter from the FIRS (notice of assessment in particular) sent to you direct should immediately be sent to us together with the envelope in which the letter is forwarded to you by FIRS.

12. Your staff will deal with all other tax returns, for example, PAYE returns but we shall be pleased to advise on any of these matters if so requested. For example, we can advise on compliance with statutory regulations in relation to PAYE by conducting a mock PAYE audit.

13. We shall be pleased to advise you generally on matters relating to the company's tax liabilities, the implications of particular business transactions, and on related matters which you refer to us, such as NPF, employee benefits and pensions (for example, pension schemes, share option arrangements, salary structures), withholding taxes, capital gains tax and capital transfer tax.

(Where the auditor is not the tax consultant the following paragraph should be substituted).

You shall be responsible for the preparations of your tax computations and the filing of the appropriate returns with the FIRS. In the course of our audit, we shall carry out such checks as would ensure that the taxation figures in the accounts are fairly stated.

14. **OTHER SERVICES**

(This paragraph should be tailored for individual clients, and in some cases may be expanded, abbreviated or removed and the matter dealt with separately by the auditor).

We shall be pleased, to provide, if requested, other services such as:

- (a) reports for special purpose (for example, for acquisition of other business, mergers or re-organisations and investigations into specific aspects of the business or into irregularities and fraud);
- (b) management consulting services;
- (c) accountants' reports in support of returns or claims (e.g. insurance claims and exchange control returns);
- (d) advising on the implementation of and changes to computer operations, including mini and micro computers, and on the controls within the data processing department, including those relating to security;
- (e) those offered by our business services groups, including advice on the formation of companies, secretarial matters, accounting records, possible sources of finance and the presentation of financial data in a format acceptable to those responsible for granting finance.

15. **FEES**

Our fees are based on the degree of responsibility and skills involved and the time necessarily spent on the work. Unless otherwise agreed, fees will be charged separately for each class of work stated above and will be billed at appropriate intervals during the course of the year.

Agreement of terms (covering letter should state the firm's preference that the letter of confirmation be signed on behalf of the board).

16. Would you please confirm in writing your agreement to the terms of this letter, which will remain effective from one audit appointment letter to another until it is replaced. If the contents are not in accordance with your understanding of the arrangements made, we shall be pleased to receive your observations and give you any further information you may require.

Yours faithfully,

APPENDIX VI

STANDARD FORMATS OF AUDIT REPORTS

6.1 UNQUALIFIED AUDITOR'S REPORT

TO THE MEMBERS OF (Name of Company)

We have examined the financial Statements set out on pages xx to yy and obtained all the information and explanations, which we considered necessary.

Respective responsibilities of the directors and auditors

The company's directors are responsible for the preparation of the financial statements. It is our responsibility, as auditors, to form an independent opinion, based on our audit, on these statements and to report our opinion to you.

Basis of Opinion

We conducted our audit accordance with generally accepted auditing standards.

An audit includes examination, on test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors, in the preparation of the financial statements, and of whether the company's accounting policies are appropriate to its circumstances, consistently applied and adequately disclosed.

We planned and performed our audit in such a way as to obtain all the information and explanations, which we considered necessary to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material mis-statement. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion, the financial statements, which have been prepared on the basis of the accounting policies set out on page zz, give a true and fair view of the state of affairs of the company at 31 December, 2001 and of its profit and cash flow statement for the year ended on that date. The books of accounts have been properly kept and the financial statements, which are in agreement therewith, comply with the Companies and Allied Matters Act, Cap. C20, LFN 2004 and conform with generally accepted accounting principles in Nigeria.

Lagos, Nigeria
(Date)

(Name of Audit Firm)
(Chartered Accountants.)

6.2 UNQUALIFIED REPORT OF THE JOINT AUDITORS TO A BANK'S SHAREHOLDERS

TO THE MEMBERS OF (Name of Bank)

We have audited the financial statements of (Name of Bank) as at 31 December, 2002 set out on pages xx to yy which have been prepared on the basis of the accounting policies on pages yy and zz.

Respective Responsibilities of Directors And Auditors

In accordance with the Companies and Allied Matters Act, the bank's directors are responsible for the preparation of the financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of Opinion

We conducted our audit in accordance with the International Standards on Auditing issued by the International Federation of Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations, which we considered necessary to provide us with sufficient evidence to give a reasonable assurance that the financial statements are free from material mis-statement. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the financial statements and assessed whether the bank's books of account had been properly kept. We obtained all the information and explanations we required for the purpose of our audit and have received proper returns from branches not visited by us.

An analysis of insider related credits as required by the Central Bank of Nigeria is as set out in Note XXX in accordance with Circular BSD/1/2001.

Contravention

During the year ended 31 December 2002, the bank contravened certain sections of the Central Bank of Nigeria's circular. The particulars thereof and the penalties paid thereon are set on Note XX.

Opinion

In our opinion, the bank has kept proper books of accounts and the financial statements are in agreement with the books. The financial statements drawn up in conformity with the generally accepted accounting standards in Nigeria, give a true and fair view of the state of affairs of the bank as at 31 December 2002, the profit and cash flow for the year ended on that date, and have been properly prepared in accordance with the provisions of the Banks and Other Financial Institutions Act 1991, and relevant circulars issued by the Central Bank of Nigeria, and the Companies and Allied Matters Act, Cap. C20, LFN 2004.

**(Name of Audit Firm)
(Chartered Accountants)**

**(Name of Audit Firm)
(Chartered Accountants)**

**Lagos, Nigeria
(Date)**

APPENDIX VII

ISSUE DOCUMENTS

(A) CONTENTS OF A PROSPECTUS FOR COMPANIES APPLYING FOR FULL LISTING ON THE NIGERIAN STOCK EXCHANGE.

Unless where otherwise approved by the Stock Exchange, the prospectus should be as detailed as possible and contain the minimum information contained below and any additional information that may from time to time be required by the Stock Exchange.

- (a) The full name of the company
- (b) A Statement, where applicable, that application has been made under Section 553 of the Companies & Allied Matters Act to the Council of the Stock Exchange to deal in and for listing of the Security;
- (c) The authorised, issued and un-issued share capital together with the amount paid-up and description and nominal value of the shares.
- (d)
 - (i) The authorised loan capital of the company and any of its subsidiaries, the amount issued and outstanding or agreed to be issued, or if no loan capital is outstanding, a statement to that effect.
 - (ii) Particulars of any bank overdrafts, guarantees and similar commitments of the company and any of its subsidiaries as at the latest convenient date or, if there are no such commitments, a statement to that effect.
- (e) The full name, address and description of every director and, if required by the Council, particulars of:
 - (i) any former Christian names and surnames;
 - (ii) of his nationality; and
 - (iii) his nationality of origin if his present nationality is not the nationality of origin.
- (f)
 - (i) the full name and professional qualification of the Company Secretary, and
 - (ii) the situation of the company's registered office and of the transfer office, if different.
- (g) The names and addresses of the bankers, brokers, solicitors, registrar and trustees (if any).
- (h) The name, address and professional qualification of the auditors and of the reporting accountants.
 - (i) If the application is in respect of shares;
 - (ii) The voting rights of shareholders.
 - (iii) If there is more than one class of shares, the rights of each class of shares as regards dividend, capital redemption and the creation or issue of further shares ranking in priorities to or *pari pasu* with each class other than ordinary shares.
 - (iv) A statement as to the consents necessary for the variation of such rights.
- (j) The provisions or a sufficient summary of the provisions of the articles of association, bye-laws or other corresponding documents with regard to:

- (i) Any power enabling the directors, in the absence of an independent quorum, to vote remuneration (including pension or other benefits) to themselves or any member of the body.
 - (ii) The borrowing powers exercisable by the directors and how such borrowing powers can be varied.
 - (iii) Retirement or non-retirement of directors under an age limit.
 - (iv) Issue of new and unissued shares.
 - (v) Any restriction on the transfer of fully-paid shares.
- (k) Where quotation is sought for loan capital, the date of the board resolution creating it, the rights conferred upon the holders thereof, and short particulars of the security (if any) thereof.
- (l) The date and country of incorporation and the authority under which the company was incorporated.
- (m) A statement of:
- (i) any alterations in the share capital within the two years preceding the publication of the prospectus; and
 - (ii) the names of the holders of any substantial or controlling beneficial interest in the capital of the company and the amount of their holdings together with a statement of directors beneficial holding direct or indirect as at the date of the prospectus so that where there are no such holdings the fact should be stated: where a corporation is a Director, the same statement as regard individual should be given.
- (n) The general nature of the business of the company information as to the relative importance of each activity in cases where the company carries on two or more activities which are material, having regard to profits or losses, assets employed or any other factor. The situation, area and tenure (including in the case of leaseholds, the rent and the expiry date) of the company's principal landed property distinguishing between various types of use for example, factories, offices, residential, warehouses, plantations, etc.
- (o) The name, date and country of incorporation and issued capital of any company which is or is about to become a subsidiary and whose profits or assets make or will make a material contribution to the figures to be included in the auditors' report or next published accounts, together with details of the capital held or about to be held by the company (if not wholly-owned). The general nature of the business, the situation, area and tenure (including, in the case of leaseholds the rent and unexpired term) of the factories or other, main buildings of each such subsidiary.
- (p) A statement as to the financial and trading prospects of the company, together with any material information which may be relevant thereto.
- (q) A statement by the directors that in their opinion the working capital available is sufficient, or, if not, how it is proposed to provide the additional working capital thought by the directors to be necessary.
- (r) Where the securities for which quotation is sought were issued for cash within the two years preceding the publication of the prospectus or will be issued for cash, a statement as to how such proceeds were or are to be applied.

- (s) Particulars of any capital of the company or of any of its subsidiaries which has within the two years immediately preceding the publication of the prospectus been issued or is proposed to be issued fully or partly paid up otherwise than in cash and the consideration for which the same has been or is to be issued.
- (t) Particulars of any capital of the company. Any of its subsidiaries which has within the two years immediately preceding the publication of the prospectus been issued or is proposed to be issued for cash the price and terms upon which the same has been or is to be issued and (if not already fully paid) the dates when any instalments are payable with amount of all calls or instalments in arrears.
- (u) The report by the reporting accountant should comply with the information required under paragraph 17 of these Regulations, subject to such adjustments as are in their opinion necessary for the purpose of the prospectus.

(B) CONTENTS OF ACCOUNTANTS' REPORT REQUIRED IN THE CONTEXT OF 'A' ABOVE

Accountants' reports in the prospectus or related documents should include the following historical details for each of the preceding five years:

- (a) In relation to Pprofits and losses:
 - (i) Turnover representing sales exclusively to third parties, less discounts, returns inwards and other allowances.
 - (ii) Cost of goods sold, including cost of purchases showing separately costs relating to amortization, depreciation and obsolescence of fixed assets, etc.
 - (iii) Other revenue, such as investment income, rents, profits arising from sale of assets and other unusual items, all to be listed separately.
 - (iv) Profit before taxation of the company and of the group, if the company has subsidiaries.
 - (v) Taxation figures with full disclosure of bases.
 - (vi) Minority interests.
 - (vii) Extraordinary items of profit, less taxation attributable thereto.
 - (viii) Net profit attributable to shareholders after taxation.
 - (ix) Amount of preference dividends together with the rates.
 - (x) Net profit attributable to company shareholders.
 - (xi) Amount and rates of equity dividends, distinguishing between interim and final;
 - (xii) Retained profits.
- (b) In relation to the balance sheets:
 - (i) Summary of the balance sheet of the group (or company if it has no subsidiaries) at the end of each previous accounting period reported upon.
 - (ii) Balance Sheet of the company and of the group at the end of the last accounting period reported upon.
- (c) Accounting policies followed in dealing with material items such as turnover, stock valuation, attributable profits from subsidiary or associated companies, deferred taxation, depreciation.
- (d) Particulars of any capital of the company or of its subsidiaries which is under option or agreed conditionally or unconditionally to be put under option, with the price and duration of option and consideration for which the option was granted, and the name and address of the grantee. Provided that where an option has been granted or agreed to be granted to all the members or debenture holders or to any

class thereof, it shall be sufficient, so far as the names are concerned, to record that fact without giving the names and addresses of the grantees.

- (e)
 - (i) Particulars of any preliminary expenses incurred or proposed to be incurred and by whom the same are payable.
 - (ii) The amount or estimated amount of the expenses of the issue and of the application for quotation so far as the same are not included in the statement of preliminary expenses and by whom the same are payable.
- (f) Particulars of any commissions, discounts, brokerages or other special terms granted within the five years immediately preceding the publication of the Prospectus in connection with the issue or sale of any capital of the company or any of its subsidiaries.
- (g) Full particulars of the nature and extent of the interest direct or indirect, if any, of every director in the promotion of, in any property purchased or acquired by the Company or any of its subsidiaries within the five years preceding the publication of the Prospectus, or proposed to be purchased or acquired on capital account including:
 - (i) the amount paid or payable in cash, shares or securities to the vendor and where there is more than one separate vendor or the Company or subsidiary is a purchaser, the amount so paid or payable to each vendor and the amount, if any, payable for goodwill and
 - (ii) short particulars of all transactions relating to any property which have taken place within five years immediately preceding the publication of the prospectus.
- (h)
 - (i) The name of any promoter; and (if a company) the Exchange may require a statement of the issued share capital, the amount paid up thereon, the date of its incorporation, the names of its Directors, Bankers or auditors, and such other particulars as the Exchange may think necessary in connection therewith.
 - (ii) The amount of any cash or securities paid or benefit given within the five years immediately preceding the publication of the Prospectus or proposed to be paid or given to any promoter and the consideration for such payment or benefit.
- (i) In relation to other assets:
 - (i) Land and buildings distinguishing between freeholds and leaseholds and in the latter case the terms of the leases.
 - (ii) Where a valuation or revaluation of assets took place during any of the period reported upon, full disclosure must be made of any surplus arising from such an exercise and its appropriation.
 - (iii) Quoted investments should be valued and in the case of quoted trade investments the names and holdings of the companies in which such investments are made should be stated together with aggregate dividends received in each case.
- (j) A Statement to the effect that no audited accounts have been made up to a date subsequent to that of the latest accounts on which the Reporting Accountant's report is based.
- (k) In relation to forecast profits: A published letter to the Issuing House commenting on the accounting bases and calculations for the profit forecast.
- (l) The report shall be by both the Auditors to the Company and the independent Reporting Accountants to the issue except the prior waiver had been received in accordance with paragraph II of the Regulations in which event the Auditors would be signing in dual capacities.

- (m) Any other matter which appear to be relevant for the purposes of the report. The above requirements are not exhaustive and the Stock Exchange reserves the right to delete or add.

(C) SPECIMEN ACCOUNTANTS' REPORT

(This specimen report is a joint report by the auditors (T.T.Y & Co) and the reporting accountants (AB & Co.) and it is drawn up in accordance with the form required by The Nigerian Stock Exchange).

The Directors
XY Industries Limited
S.T. & Co. Limited (Merchant Banker)

3 July, 2008.

Gentlemen,

1. XY Industries Limited ("the company") was incorporated on 1 November, 2001 and in 2002 acquired in exchange for shares in Black and White Limited, Black and White (Sales) Limited, XY Design Limited and XY Motors Limited which were controlled by the shareholders of the company. For accounting purposes these transactions were regarded as a merger and accordingly the shares issued as consideration have been recorded at nominal value. The results of these companies have been included in this report for the whole of the five year period from 1 April, 2003 to 31 March, 2008.
2. We have examined the audited accounts of the company and its subsidiary companies (together called "the Group") from 1 April, 2003 or subsequent date of incorporation, to 31 March, 2008. The subsidiary companies concerned and the commencement of the accounting periods covered by our report are set out below:

Black & White Limited	1 April, 2003
Black & White (Sales) Limited	1 April, 2003
XY Design Limited	1 January, 2003
XY Motors Limited	1 January, 2003
B & F (Engineers) Limited	1 January, 2005
XY Estates Limited	12 June, 2005

"T.T.Y. & Co have been the auditors of the company and of its subsidiaries in respect of all the above accounting periods.

3. The accounting date for all the companies in the Group is now 31 March. Prior to 2002 XY Design Limited and XY Motors Limited had accounting date of 31 December. For the purpose of this report the results of these two companies for the year to 31 December 2003 have been apportioned on a time basis to years ended 31 March.
4. We report on the information set out in Sections I, II and III below:
5. Stock and work in progress records have not been retained by the Group for the year ended 31 March, 2004. Such records were available to T.T.Y. & Co. which is satisfied that the stock and work-in-progress have been properly taken and valued on a consistent basis throughout.

AB & Co. however are unable to satisfy themselves that the stock and work-in-progress were properly taken and valued on a consistent basis at dates before 31 March, 2005 or as to the allocation of profits between the years before that date.

6. With this reservation by AB & co. in our opinion, based on the audits of T.T.Y & Co. and on the examination of the audited accounts by AB & co. the information set out in this report gives a true and fair view of the results for the period stated and of the state of affairs at the dates stated, for the purposes of the offer for sale dated 3 July, 2008.
7. Audited accounts of the group have not been prepared for any period subsequent to 31 March, 2008.

Accounting Policies

The significant accounting policies adopted in arriving at the financial information set out in this report are as follows:

- (a) Turnover represents the invoiced value of goods delivered to outside customers during the year, less returns and allowances.
- (b) Stock and work in progress are valued at cost. Cost includes all direct and works overhead expenditure incurred in bringing the goods to their current state under normal operating conditions.
- (c) Depreciation is calculated on the straight-line method to write off the book value of fixed assets over their expected useful lives. The main annual rates adopted are as follows:

Freehold Buildings	2 percent
Leasehold land and Buildings	2% or by equal instalments over the lives of the lease where less than 50 years.
Plant and equipment	10%-15%
Motor vehicles	20%

- (d) Product development expenditure is written off against profits in the years in which incurred.
 - (e) Provision is made for deferred taxation, using the liability method, representing taxation on the excess of the net book value of qualifying fixed assets over their corresponding tax written down value.
8. The issued share capital of the company shown above at 31 March, 2008 is made up as follows:

Already issued:	N'000
200,000 6% Preference shares of N1 fully paid	200
1,250,000 Ordinary Shares of N1 each fully paid	1,250
Now being issued:	
1,000,000 Ordinary shares of N1 each fully paid issued as a result of this offer for sale	1,000
	2,450

The share premium account of N250,000 results from the shares now being offered.

9. At 31st March, 2008 there were outstanding, for the group, contracts placed for capital expenditure amounting to N400,000. In addition capital expenditure had been authorised by the directors for which contracts had not been placed, amounting to N750,000.
10. There were contingent liabilities of the group, amounting to N1,200,000 at 31 March, 2008 in respect of bills discounted.

Yours truly,
T.T.Y & Co. AB & Co.
Chartered Accountants

NOTES:

- (a) A summary of the balance sheets for the five earlier years is not required for an accountants' report in a Class I circular nor for an accountants' report in a prospectus, on a company which has been or is to be, acquired subsequent to the last accounting date of the company issuing the prospectus.
- (b) It has been assumed for the purposes of this specimen report that AB & Co. are unable to satisfy themselves regarding the results for the two years ended 31 March, 2009 by the adoption of alternative procedures.
- (c) The profit retained, shown in the profit and loss account (paragraph 9), should agree with the movement in retained profits shown in the shareholders' fund section of the balance sheet (in paragraph 13) as is the case in the above specimen. Where other factors affect retained profits, for example, a bonus issue, a reconciliation should be provided in the report.

(D) SPECIMEN PROFIT FORECAST LETTER

The Directors
XY Industries Limited

Gentlemen,

We have reviewed the accounting policies applied and the calculations made in preparing the profit of XY Industries Limited and its subsidiaries (together "the Group"), for which you, as directors, are solely responsible, for the period ending 31 March, 2005, set out on page X of the prospectus dated 3 July, 2004.

The principal assumptions made by you upon which the profit forecast is based are as set forth on page X of the said prospectus.

Our review indicated that the profit forecast, so far as the accounting policies and calculations are concerned, has been compiled on the basis of the assumptions made by you and referred to above and is presented on a basis consistent with the accounting policies normally adopted by the group.

Yours faithfully,

AB & Co.,
Chartered Accountants
(Reporting Accountants)

(E) SPECIMEN LETTER FROM THE AUDITORS

The Directors
XY Industries Limited
Lagos.

And
The Directors,
S.T. & Co. Ltd (Merchant Bankers)
Lagos.

Gentlemen,

We have examined the audited accounts of ABC Company Ltd, (“the company”) for the five years ended 31 March, 2004. The accounts were prepared under the historical cost convention. We have been the auditors of the company throughout this period.

The summarised profit and loss accounts, balance sheets and cash flow statements are based on the audited accounts of the company after making such adjustments as we consider appropriate. The principal adjustments are described in Note... to the financial information.

In our opinion, these summaries together with notes thereon, give, under the convention stated above, a true and fair view of the profits of the company and of the cash flows for the years stated and of the state of affairs of the company at each of the balance sheet dates.

(F) SPECIMEN LETTER OF CONSENT

The Directors,
S.T. & Co. Ltd. (Merchant Bankers)
Lagos.

Dear Sir,

XY Industries Limited
Issue of ₦1,000,000 Ordinary Shares

We hereby give our consent to the mention of our name in the prospectus dated 3 July, 1998 in connection with the above stated offer in the form and context in which it appears therein.

Yours faithfully,

TTY & Co.,
(CHARTERED ACCOUNTANTS)

APPENDIX VIII

OCTOBER, 2003

**CODE OF CORPORATE GOVERNANCE IN
NIGERIA**

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(1) PREFACE

Long before the highly publicized corporate scandals and failures worldwide, the global community has shown increasing concern on the issues of corporate governance. The reason for this trend is not far to seek. There is growing consensus that corporate governance, which has been defined as the way and manner in which the affairs of companies are conducted by those charged with the responsibility, has a positive link to national growth and development.

Little wonder therefore that several studies and initiatives have been undertaken by countries and International Institutions on the subject “Corporate Governance”. As a result of the foregoing, several Codes of Corporate Practices and Conduct have been fashioned out and are in use in various jurisdictions.

Realising the need to align with the International Best Practices, the Securities and Exchange Commission (SEC) in collaboration with the Corporate Affairs Commission inaugurated a seventeen (17) member Committee on June 15, 2000 in Nigeria. The Committee headed by Atedo Peterside, (OON) was mandated to identify weaknesses in the current corporate governance practice in Nigeria and fashion out necessary changes that will improve our corporate governance practices.

Membership of the Committee was carefully selected to cut across all sectors of the economy, including members of professional organisations, organised private sector and regulatory agencies.

The Committee submitted a draft Code, which was published in several newspapers and was further reviewed at three (3) locations across the Country, namely: Lagos, Abuja, and Port Harcourt. This extensive exposure was designed to elicit stakeholders input before the Code was finalised. Subsequently, the final report was approved by the Boards of the Securities and Exchange Commission, being the regulatory authority of the capital market and the Corporate Affairs Commission, being the regulatory authority of companies in Nigeria, as the Code of Best Practices for Corporate Governance.

The two (2) regulatory institutions are convinced that the adoption of this Code will no doubt enhance corporate discipline, transparency and accountability. Although the main target of the Code is the Board of Directors as leaders of corporate organizations, the responsibilities of other stakeholders including shareholders and professional bodies were equally given due attention. We believe that one of the ways to improve the standard of corporate governance is to ensure that all stakeholders have a clear understanding of their roles. This is aptly provided for by this Code.

Experience from other jurisdictions has shown that answers to enforcement or compliance with a Code of this nature are not easily found. While voluntary compliance is generally encouraged, appropriate sanctions are applied when it becomes necessary and applicable. We therefore like to encourage all companies to comply with the Code.

The Securities and Exchange Commission and Corporate Affairs Commission will give due consideration to the compliance or otherwise of the provisions of this Code in the treatment of issues brought before them. It is our hope that all other regulators and self-regulatory organizations should do the same by ensuring that their rules and regulations incorporate relevant aspects of the Code.

Finally, we urge all Companies, Directors, Shareholders, Auditors, Audit Committees and other Board Committees to be alive to their responsibilities and discharge their duties diligently and honestly and in accordance with this Code. The press equally has a role in ensuring that this Code serves the purpose for which it is designed by promoting and projecting the recommended practices and to bring to public notice the companies that fail to comply.

DIRECTOR GENERAL REGISTRAR GENERAL
MALLAM SULEYMAN A. NDANUSA AHMED AL MUSTAPHA
Securities & Exchange Commission Corporate Affairs Commission

(2) FOREWORD

The importance of effective corporate governance to corporate and economic performance cannot be over-emphasised in today's global market place. Companies perceived as adopting international best corporate governance practices are more likely to attract international investors than those whose practices are perceived to be below international standards.

This realisation prompted the Securities and Exchange Commission ("SEC" or "the Commission"), the apex regulatory body in the Nigerian capital market, to inaugurate the Committee on Corporate Governance of Public Companies in Nigeria ("the Committee") on 15th June 2000.

The Committee was carefully constituted to include major participants in the Nigerian capital market, representatives of public companies and other stakeholders. The Committee had the following terms of reference:

- (a) To identify weaknesses in the current corporate governance practices in Nigeria with respect to public companies.
- (b) To examine practices in other jurisdictions with a view to the adoption of international best practices in corporate governance in Nigeria.
- (c) To make recommendations on necessary changes to current practices.
- (d) To examine any other issue relating to corporate governance in Nigeria.

The Committee set about its task by establishing the corporate governance practices already prevalent in Nigeria. This we did by preparing a detailed questionnaire on company operations, and these were circulated to various publicly quoted companies throughout the length and breadth of the country. Thereafter, we proceeded to make a comparative analysis of Corporate Governance practices around other jurisdictions and markets with particular emphasis on emerging markets and countries like the U. K. which had similar statutes. With the results of our findings we set about crafting a Nigerian Code of Best Practices for Public Companies and Private companies with multiple stakeholders.

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A draft copy of our report was presented to the Director-General of the SEC on 12 July 2001 for consideration. This report was subsequently published in a number of national newspapers for review by members of the business community and other stakeholders, and was also discussed at various workshops in Lagos, Abuja and Port Harcourt wherein a number of comments and contributions were made and suggestions proffered by many eminent personalities and organisations. These comments and suggestions were summarised by the SEC in a document and sent to the Committee for its consideration.

The Committee had its final meeting in February 2003 for the dual purpose of reviewing the comments and contributions of the various stakeholders and deciding which comments to incorporate into its final report.

After extensive deliberations by the Committee members, a good number of the comments and contributions were considered appropriate and therefore accepted and subsequently incorporated into the Committee's final report, which is contained herein.

We would like to express our gratitude to everyone who has contributed to our work by making contributions both written and verbal, and to the press who provided a virile platform for debates on Corporate Governance issues. All these contributions were valuable in aiding the Committee's work.

The acceptance and adoption of our report and findings should mark a significant advance in the process of establishing Corporate Governance standards in Nigeria. Our recommendations will however need to be reviewed as circumstances change and as the broader debate on Corporate Governance issues develop over time.

Atedo N.A. Peterside, OON
Chairman

01 April 2003

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THE CODE OF BEST PRACTICES

A code to make provisions for the best practices to be followed by public quoted companies and for all other companies with multiple stakeholders registered in Nigeria in the exercise at power over the direction of the enterprise, the supervision of executive actions, the transparency and accountability in governance of these companies within the regulatory framework and market; and for other purposes connected therewith.

Code of Best Practices on Corporate
Governance in Nigeria.

PART A - THE BOARD OF DIRECTORS

1. RESPONSIBILITIES OF THE BOARD OF DIRECTORS

This Code may be cited as the:

- (a) The Board of Directors should be responsible for the affairs of the company in a lawful and efficient manner in such a way as to ensure that the company is constantly improving its value creation as much as possible.
- (b) The Board should ensure that the value being created is shared among the shareholders and employees with due regard to the interest of the other stakeholders of the company.

The Board's functions should include but not be limited to the following:

- (a) Strategic planning.
- (b) Selection, performance appraisal and compensation of senior executives
- (c) Succession planning.
- (d) Communication with shareholders.
- (e) Ensuring the integrity of financial controls and reports.
- (f) Ensuring that ethical standards are maintained and that the company complies with the laws of Nigeria.

PART 4

As much as possible, the Board should be composed in such a way as to ensure diversity of experience without compromising compatibility, integrity, availability, and independence.

- (a) The Board should comprise of a mix of Executive and Non-executive Directors headed by a Chairman of the Board, so however as not to exceed 15 persons or be less than 5 persons in total.
- (b) The members of the Board should be individuals with upright personal characteristics and relevant core competencies, preferably with a record of tangible achievement, knowledge on board matters, a sense of accountability, integrity, commitment to the task of corporate governance and institution building, while also having an entrepreneurial bias.
- (c) Executive directors' remuneration should be set by a Remuneration Committee made up wholly or mainly of non-executive directors.
- (d) A Board should not be dominated by an individual. Responsibilities at the top of a company should be well defined.
- (e) The position of the Chairman and Chief Executive Officer should ideally be separated and held by different persons. A combination of the two positions in an individual represents an undue concentration of power.
- (f) In exceptional circumstances where the position of the Chairman and Chief Executive Officer are combined in one individual, there should be a strong non-executive independent director as Vice Chairman of the Board.
- (g) To maintain effective control over the company and monitor the executive and management, the board should meet regularly, and not less than once in a quarter with sufficient notices, and have a formal schedule of matters specifically reserved for its decision.
- (h) Company meetings should be conducted in such a manner as to allow free-flowing discussions. There should be enough time allocated to shareholders to speak and to enable them contribute effectively at the Annual General Meeting.
- (i) The Board should have a formal schedule of matters specifically reserved for it to ensure that the direction and control of the company is firmly in its hands.

- (j) There should be an agreed procedure for directors in the furtherance of their duties to take independent professional advice if necessary, and the company should bear the expense.
- (k) All directors should have access to the advice and services of the company secretary, who is appointed by the board and who is responsible to the board for ensuring that board procedures are followed and that applicable rules and regulations are complied with. The removal of the company secretary should be a matter for the Board.

COMPOSITION OF THE BOARD OF DIRECTORS CHAIRMAN & CHIEF EXECUTIVE OFFICER POSITIONS

The Chairman's primary responsibility is to ensure effective operation of the Board and should as far as possible maintain distance from the day-to-day operations of the company, which should be the primary responsibility of the Chief Executive Officer and the management team.

PROCEEDINGS & FREQUENCY OF MEETINGS BOARD OF DIRECTORS

All directors should have access to the advice and services of other professionals in areas where such advice will improve the quality of contribution of the directors to the overall decision-making process. Non-executive directors should be of such calibre as to make constructive contributions and for their views to carry significant weight in the board's deliberations.

- (a) Non-executive directors should bring independent judgement to bear on issues of strategy, performance, resources, including key appointments, and standards of conduct.
- (b) Directors' service contracts should not exceed three years without shareholders' approval.
- (c) Non-executive directors should not be dependent on the company for their income other than their director's fees and allowances. The non-executive directors should ideally be independent and not be involved in business relationships with the company that could fetter or encumber their independent judgment.
- (d) Non-executive directors should neither participate in share option schemes with the company nor be pensionable by the company.
- (e) Non-executive directors should be appointed for a specified period. Re-appointments should be dependent on performance.
- (f) The appointment of non-executive directors should be a matter for the entire board and a defined formal selection process should be utilised.

5. NON-EXECUTIVE DIRECTORS

- (a) The newly appointed directors should undergo proper company & board orientation and where necessary be given formal training at the company's cost, aimed at making them effective in the discharge of their duties.

- (b) Skills mix of non-executive directors should reflect the range of the competency needs of the company.
- (c) There should be full and clear disclosure of directors' total emolument and those of the chairman and highest-paid director, including pension contributions and stock options where the earnings are in excess of 500,000.
- (d) Executive directors should not play an active role in the determination of their remuneration.
- (e) The remuneration of Executive Directors should be fixed by the Board and not in shareholders' meetings.
- (f) There should be remuneration committees, wholly or mainly composed of non-executive/independent directors and chaired by a non-executive director, to recommend the remuneration of executive directors.
- (g) The following disclosures should be made for directors' remuneration:
 - (i) Directors' emoluments and that of the Chairman and highest paid director.
 - (ii) Relevant information about stock options and any pension contributions.
 - (iii) Future service contracts.

6. EXECUTIVE DIRECTORS

7. COMPENSATION OF BOARD MEMBERS

8. REPORTING & CONTROL

- (a) There is an overriding need to promote transparency in financial and non-financial reporting.
- (b) It is the Board's duty to present a balanced, reasonable and transparent assessment of the company's position.
- (c) The prime responsibility for good internal control lies with the Board.
- (d) The Board should ensure that an objective and professional relationship is maintained with the auditors. External auditors should not be involved in business relationships with the company.
- (e) The Board should establish an audit committee of at least three non-executive directors with written terms of reference, which deal clearly with its authority and duties.
- (f) The directors should report on the effectiveness of the company's system of internal control in the annual report.
- (g) The directors should report that the business is a going concern, with supporting assumptions or qualifications as necessary in compliance with the Companies and Allied Matters Act.

PART B- THE SHAREHOLDERS

9. SHAREHOLDERS' RIGHTS & PRIVILEGES ACT

- (a) The company acting through the directors should ensure that shareholders' statutory and general rights are protected at all times.
- (b) Shareholders should remain responsible for electing directors and approving the terms and conditions of their directorship.
- (c) The venue of a general meeting of shareholders should be carefully chosen in such a way as to make it possible and affordable (in terms of distance and cost) for the majority of shareholders to attend and vote, and not to disenfranchise shareholders on account of choice of venue, which is unreasonable or impracticable to reach.
- (d) Notices of meeting should be sent at least 21 days before the meeting with such details (including annual reports and audited financial statements) and other information as will enable them vote properly on any issue.
- (e) The Board should propose a separate resolution at the general meeting on each substantial issue in such a way that they can be voted for in an organized manner.
- (f) The Board should ensure that decisions reached at the general meetings are implemented.
- (g) The Board should ensure that all shareholders are treated equally; and that no shareholder should be given preferential treatment or superior access to information or other materials.
- (h) Boards should use general meetings to communicate with the shareholders and encourage their participation.
- (i) Shareholders holding more than 20% of the total issued capital of a company should as far as possible have a representative on the Board unless they are in a competing business or have conflicts of interest that warrant their exclusion from the Board.
- (j) As far as possible, there should be at least one director on the Board representing minority shareholders.
- (k) The company or the board should not discourage shareholder activism whether by institutional shareholders or by organised shareholders' groups. Shareholders with larger holdings (institutional and non-institutional) should act and influence the standard of corporate governance positively and thereby optimise stakeholder value.
- (l) Information made available to institutional shareholders should also be made available to other shareholders at the same time in such a manner as to ensure that neither group enjoys preferential treatment.

10. INSTITUTIONAL SHAREHOLDERS**PART C - AUDIT COMMITTEE****11. THE AUDIT COMMITTEE****12. COMPOSITION OF THE AUDIT COMMITTEE**

- (a) Companies should establish Audit Committees, with the key objective of raising standards of corporate governance.
- (b) The Audit Committees should not act as a barrier between the auditors and the executive directors on the main board, or encourage the main board to abdicate its responsibilities in reviewing and approving the financial statements.
- (c) The Audit Committee should not be under the influence of any dominant personality on the main board, neither should they get in the way and obstruct executive management. Audit committees should be comprised of strong, independent persons.
- (d) Audit Committees should be established in accordance with CAMA Section 359 (3 & 4), with not more than one executive on them.
- (e) A majority of the non-executives serving on the committee should be independent of the company (i.e. independent of management and free from any business or other relationship, which could materially interfere with the exercise of their independent judgment as committee members).
- (f) The Chairman of the audit committee should be a non-executive director, to be nominated by the members of the Audit Committee.
- (g) Membership of the audit committee should be for a fixed tenure. However, any member of the committee should be eligible for re-election after his tenure.
- (h) The Secretary of the Audit Committee should be the Company Secretary, Auditor or such other person nominated by the Committee.
- (i) Members of the Committee should understand basic financial statements, and should be capable of making valuable contributions to the Committee.
- (j) Audit Committee should review not only external auditors' reports but also most importantly the report of the Internal Auditor.
- (k) Members of the Committee should possess the following qualities:
 - (i) Integrity.
 - (ii) Dedication.
 - (iii) A thorough understanding of the business, its products and services.
 - (iv) A reasonable knowledge of the risks facing the company and the essential controls the company has in place.
 - (v) Inquisitiveness and dependable judgment.
 - (vi) Ability to offer new or different perspectives and constructive suggestions.

The Committee should be given written terms of reference in line with Section 359 (6) a-e of the Companies And Allied Matters Act, 2004.

13. QUALIFICATION AND EXPERIENCE OF AUDIT COMMITTEE

14. TERMS OF REFERENCE FOR AUDIT COMMITTEE

- (a) The performance of the Committee and its members should be evaluated periodically. The form of such evaluation will be for the company to decide.
- (b) The Committee should maintain a constructive dialogue between the external auditors and the board and enhance the credibility of financial disclosures and the interest of shareholders.
- (c) The quorum for the meetings of the audit committee would depend on the number of members of the Committee and should be specified in the terms of reference of the Committee.
- (d) The Committee should meet at least three (3) times in a year.
- (e) The audit committee should have a meeting with the external auditors at least once a year, without the executive board members present.
- (f) Specimen Terms of Reference for an audit committee, compiled from the many examples that are available, are shown in the Schedule on Page 20 of this report.
- (g) The Terms of Reference are intended simply as a guide for companies who wish to adapt and build on them to suit their own peculiar circumstances.
- (h) The audit committee will assist the board in fulfilling its oversight responsibilities.
- (i) The audit committee will review the financial reporting process, the system of internal control and management of financial risks, the audit process, and the Company's process for monitoring compliance with laws and regulations.

15. MEETINGS

- (a) In performing its duties, the committee will maintain effective working relationships with the board of directors, management and both the internal and external auditors.
- (b) To perform his or her role effectively, each committee member should seek to obtain an understanding of the detailed responsibilities of committee membership. They should also seek to obtain a thorough understanding of the company's business, operations and the industry specific risks.

16. INTERPRETATION

PART D

In this Code, unless the context otherwise requires:

“Company” means a public company limited by shares registered in Nigeria.
“Law” means the applicable Laws of the Federation of Nigeria.

“Regulation” means the applicable regulation made under the Laws of the Federation of Nigeria.

“Director” means a person duly appointed by a company to direct and manage the affairs of the Company, and includes alternate directors.

“Shareholder” means a person who lawfully acquires shares in the capital of a company.

“Stakeholder” means but shall not be limited to directors, employees, creditors, customers, depositors, distributors, regulatory authorities, and the host community(s).

PART E: SCHEDULES

SCHEDULE 1 SPECIMEN TERMS OF REFERENCE FOR AN AUDIT COMMITTEE (FOR GUIDANCE ONLY)

The duties of the Audit Committee shall be:

- (a) To consider the appointment of the external auditor, set the audit fee, and handle any questions of resignation or dismissal;
- (b) To discuss with the external auditor (before the audit commences) the nature and scope of the audit, and ensure co-ordination where more than one audit firm is involved;
- (c) To review the half-year and annual financial statements before submission to the Board, focusing particularly on:
 - (i) Any change in accounting policies and practices.
 - (ii) Major judgmental areas.
 - (iii) Significant adjustments resulting from the audit.
 - (iv) The going concern assumption.
 - (v) Compliance with accounting standards.
 - (vi) Compliance with stock exchange and legal requirements.
- (d) To discuss problems and reservations arising from the interim and final audits, and any matters the auditor may wish to discuss (in the absence of management where necessary);
- (e) To review the external auditor’s management letter and management’s response;
- (f) To review the Company’s statement on internal control system prior to endorsement by the Board;
- (g) Where an internal audit function exists, to review the internal audit programme, ensure co-ordination between the internal and external auditors, and ensure that the internal audit function is adequately resourced and has appropriate standing within the Company;
- (h) To consider the major findings of internal investigations and management’s response;
- (i) To consider other topics, as defined by the board.

SCHEDULE 2 - MEMBERSHIP OF THE COMMITTEE

Mr. Atedo N. A. Peterside, OON
Princess Adenike Adeniran
Brigadier E. E. Ikwue
Sir Kingsley Ikpe
Mr. Victor Olusegun Adeniji
Mr. Bolaji Balogun
Mr. Ocholi Danjuma
Chief (Mrs.) E. O. Adegite
Chief I. Olusola Dada
Mr. Chris O. Okereke
Prince Aghatise Erediauwa
Mrs. Habiba Sani Kalgo
Chairman, Investment Banking & Trust Company Limited - Member
Dominion Trust Limited - Member
Zonal Shareholders Association - Member
Thomas Kingsley Securities Limited - Member
Denham Management Limited - - Member
FCMB Capital Markets - Member
NAL Merchant Bank Plc - Member
Institute of Chartered Accountants of Nigeria - Member
Institute of Directors - Member
Securities & Exchange Commission - Member
The Nigerian Stock Exchange - Member
Abuja Stock Exchange Plc
Mr. Femi Adewunmi
Mr. Emmanuel Ukaegbu
Mr. Udo Jimmy Udoh
Hajiya J. K. Ahmadu-Suka
Mr. Funso Akere
Fabian Ajogwu
Ogbonna Ike
Daniel Gboghwe
Damilola Oyerinde
Olusola Adun - Member
Cadbury Nigeria Plc - Member
Texaco Nigeria Plc - Member
Central Bank of Nigeria - Member
Corporate Affairs Commission - Secretary
Investment Banking & Trust Company Limited
Kenna & Associates
Lagos Business School
BP & C Associates
Lagos Business School
Ajogwu & Ogbonna (Consultants)
Kenna & Associates (Solicitors & Advocates)

SCHEDULE 3 - LIST OF PERSONS AND ORGANISATIONS WHO MADE

WRITTEN CONTRIBUTIONS TO THE FINAL DRAFT OF THE CODE

1. Price Water House Coopers
2. Akintola Williams Deloitte & Touche
3. Strategic Management Centre
4. Dangote Group of Companies
5. The Institute of Chartered Secretaries & Administration of Nigeria
6. Strategic Management Centre
7. United Bank for Africa Plc
8. Chris Ogunbanjo & Co
9. National Co-ordinating Committee of Shareholders Association
10. INMB Bank Limited
11. M. I. Iro
12. Godwin Oporum
13. BoIa Ajibola & Co.
14. Oladapo B. Ayorinde
15. Kadiri Ihesiulo (Ihesiulo & Partners)
16. Cadbury Nigeria Plc
17. Risk Management, Wema Bank Plc (Toyin Y. Lasisi)
18. Alhaji B. A. Asafa
19. Financial Institutions Training Centre

**CENTRAL BANK OF NIGERIA
CODE OF CORPORATE GOVERNANCE
FOR BANKS IN NIGERIA POST
CONSOLIDATION
(Effective Date: April 3, 2006)
MARCH 1, 2006**

PART I: NEED FOR A NEW CODE OF CORPORATE GOVERNANCE

1.0 INTRODUCTION

- 1.1 Financial scandals around the world and the recent collapse of major corporate institutions in the USA and Europe have brought to the fore, once again, the need for the practice of good corporate governance, which is a system by which corporations are governed and controlled with a view to increasing shareholder value and meeting the expectations of the other stakeholders.
- 1.2 For the financial industry, the retention of public confidence through the enthronement of good corporate governance remains of utmost importance given the role of the industry in the mobilization of funds, the allocation of credit to the needy sectors of the economy, the payment and settlement system and the implementation of monetary policy.

1.3 In Nigeria, a survey, by the Securities and Exchange Commission (SEC) reported in a publication in April 2003, showed that corporate governance was at a rudimentary stage, as only about 40% of quoted companies, including banks, had recognized codes of corporate governance in place. Specifically for the financial sector, poor corporate governance was identified as one of the major factors in virtually all known instances of a financial institution's distress in the country.

1.4 Yet, the on-going industry consolidation is likely to pose additional corporate governance challenges arising from integration of processes, IT and culture. Research had shown that two-thirds of mergers, world-wide, fail due to inability to integrate personnel and systems as well as due to irreconcilable differences in corporate culture and management, resulting in Board and Management squabbles.

In addition, the emergence of mega banks in the post consolidation era is bound to task the skills and competencies of Boards and Managements in improving shareholder values and balance same against other stakeholder interests in a competitive environment. A well-defined code of corporate governance practices should help organisations overcome such difficulties.

1.5 Since 2003 when the Nigerian Securities and Exchange Commission released a Code of Best Practices on Corporate Governance for public quoted companies, the relevant banks had been expected to comply with its provisions. This was in addition to a Code of Corporate Governance for Banks and Other Financial Institutions approved earlier in the same year by the Bankers' Committee.

1.6 The consolidation of the banking industry, however, necessitated a review of the existing code for the Nigerian Banks. This new code therefore was developed to compliment the earlier ones and enhance their effectiveness for the Nigerian banking industry.

1.7 Compliance with the provisions of this Code is mandatory.

2.0 WEAKNESSES IN CORPORATE GOVERNANCE OF BANKS IN NIGERIA

2.1 Disagreements between Board and Management giving rise to Board squabbles.

2.2 Ineffective Board oversight functions.

2.3 Fraudulent and self-serving practices among members of the board, management and staff.

2.4 Overbearing influence of chairman or MD/CEO, especially in family-controlled banks.

2.5 Weak internal controls.

2.6 Non-compliance with laid-down internal controls and operation procedures.

- 2.7 Ignorance of and non-compliance with rules, laws and regulations guiding banking business.
- 2.8 Passive shareholders.
- 2.9 Poor risk management practices resulting in large quantum of non-performing credits including insider-related credits.
- 2.10 Abuses in lending, including lending in excess of single obligor limit.
- 2.11 Sit-tight directors – even where such directors fail to make meaningful contributions to the growth and development of the bank.
- 2.12 Succumbing to pressure from other stakeholders, e.g. shareholder’s appetite for high dividend and depositors quest for high interest on deposits.
- 2.13 Technical incompetence, poor leadership and administrative ability.
- 2.14 Inability to plan and respond to changing business circumstances.
- 2.15 Ineffective management information system.

3.0 CHALLENGES OF CORPORATE GOVERNANCE FOR BANKS POST-CONSOLIDATION

- 3.1 **Technical Incompetence of Board and Management:** In view of the greatly enhanced resources of the consolidated entities, Board members may lack the requisite skills and competencies to effectively re-define, re-strategize, restructure, expand and/or refocus the enlarged entities in the areas of change of corporate identities, new business acquisitions, branch consolidation, expansion and product development.
- 3.2 **Relationships among Directors:** Boardroom squabbles could be an issue due to different business cultures and high ownership concentration especially in banks that were formerly family or “one-man” entities. The dominance of a “key man” could also emerge with the attendant problems.
- 3.3 **Relationship between Management and Staff:** Squabbles arising from knowledge gaps, harmonization of roles and salary structure could also manifest among staff and management of consolidating banks with the potential to create unhealthy competition and a counter-productive working environment.
- 3.4 **Increased Levels of Risks:** Currently, very few banks have a robust risk management system in place. With the huge amount of funds that will be available to them and the significantly increased legal lending limits, banks will be financing more long-term mega projects in the real sectors of the economy as opposed to the existing working capital/trade financing. Given the

expected significant increase in the level of operations, the banks will be facing various kinds of risks which, if not well managed, will result in significant losses. The management of risks in a transparent and ethical way will thus present some issues bordering on corporate governance.

- 3.5 **Ineffective Integration of Entities:** Banks that would have completed the process of merging might continue to operate independently rather than as a single entity. For example, an investment bank's merger with a retail bank in which the MD of the investment bank continues to manage his arm of the business and the MD of the retail bank does the same and the operating results of the two entities are then consolidated for reporting purposes.
- 3.6 **Poor Integration and Development of Information Technology Systems, Accounting Systems and Records:** Banks with different IT systems (banking application, database platform, operating systems, human resource applications, hardware, server configuration, and network and telecommunication infrastructure) as well as different accounting systems and records will have to fuse and this could pose problems if not well managed. There will also be increased use of technology to power the consolidated business and this too will have to be well managed to ensure efficient operations and quality service delivery.
- 3.7 **Inadequate Management Capacity:** Directors and Managers will be running a much larger organisation and controlling a significantly higher level of resources. Adequate management capacity is needed to efficiently and profitably run a larger organization.
- 3.8 **Resurgence of High Level Malpractices:** To boost income as a result of intense competition and lack of enough viable projects, malpractices may resurface post consolidation. Such sharp practices could include round-tripping of forex, excessive customer charges, falsification of records etc., and adoption of unethical methods to poach customers.
- 3.9 **Insider-Related Lending:** If consolidation should fail to achieve transparency through diversification in bank ownership, the pervasive influence of family and related party affiliations may continue, resulting in huge levels of insider abuses and connected lendings.
- 3.10 **Rendition of False Returns:** Similarly, rendition of false returns to the regulatory authorities and concealment of information from Examiners to prevent timely detection of unhealthy situations in the banks may continue as a result of lack of transparency and pressure to boost income.
- 3.11 **Continued Concealment:** Continued concealment of material issues discovered by banks during their pre-merger due diligence will also compromise good corporate governance.

- 3.12 **Ineffective Board/Statutory Audit Committee:** The audit committee, which comprises both directors and shareholders who are not board directors, may be composed of people who are not knowledgeable in accounting and financial matters thus rendering the committee less effective.
- 3.13 **Inadequate Operational and Financial Controls:** There might be absence of such controls to cater for the increased size and complexity of operations.
- 3.14 **Absence of a Robust Risk Management System:** The huge amount of funds that would be available to banks post-consolidation would significantly increase their legal lending limits and make them engage in financing long term mega projects. The management of the attendant risks in a transparent and ethical manner would require, as part of sound practices, the institutionalization of a robust risk management system.
- 3.15 **Disposal of Surplus Assets:** After consolidation, some branches of banks that are closely located may be sold to insiders at below market price. Other surplus assets may also be similarly sold. Fixed assets may also be sold indiscriminately and the profit from the sale used to boost profits with the intention of covering operational losses and inefficiencies.
- 3.16 **Transparency and Adequate Disclosure of Information:** These are key attributes of good corporate governance which the merged banks should cultivate with new zeal in order to provide stakeholders with the necessary information to judge whether their interests are being taken care of. Currently there are many deficiencies in the information disclosed, particularly in the area of risk management strategies, risk concentration, performance measures etc. These shortcomings will need to be addressed.

PART II: CODE OF BEST PRACTICES ON CORPORATE GOVERNANCE

4.0 PRINCIPLES AND PRACTICES THAT PROMOTE GOOD CORPORATE GOVERNANCE

- 4.1 The establishment of strategic objectives and a set of corporate values, clear lines of responsibility and accountability.
- 4.2 Installation of a committed and focused Board of Directors which will exercise its oversight functions with a high degree of independence from management and individual shareholders.
- 4.3 A proactive and committed management team.
- 4.4 There should be adequate procedures to reasonably manage inevitable disagreements between the Board, Management and staff of the bank.
- 4.5 The Board should meet regularly at a minimum of four (4) regular meetings in a financial year. There should also be adequate advance notice for all Board meetings as specified in the Memorandum and Articles of Association.

- 4.6 The Board should have full and effective oversight on the bank and monitor its executive management.
- 4.7 There is a well-defined and acceptable division of responsibilities among various cadres within the structure of the organisation.
- 4.8 There is balance of power and authority so that no individual or coalition of individuals has unfettered powers of decision making.
- 4.9 The Articles of Association should clearly specify those matters that are exclusively the rights of the Board to approve apart from those for notification.
- 4.10 The number of non-executive directors should exceed that of executive directors.
- 4.11 All Directors should be knowledgeable in business and financial matters and also possess the requisite experience.
- 4.12 There should be a definite management succession plan.
- 4.13 Shareholders need to be responsive, responsible and enlightened.
- 4.14 Culture of compliance with rules and regulations.
- 4.15 Effective and efficient Audit Committee of the Board.
- 4.16 External and internal auditors of high integrity, independence and competence.
- 4.17 Internal monitoring and enforcement of a well articulated code of conduct/ethics for Directors, Management and staff.
- 4.18 Regular management reporting and monitoring system.

5.0 CODE OF CORPORATE GOVERNANCE PRACTICES FOR BANKS POST-CONSOLIDATION

5.1 EQUITY OWNERSHIP

5.1.1 Preamble:

The current practice of free, non-restrictive equity holding has led to serious abuses by individuals and their family members as well as governments in the management of banks. However, to encourage a private sector-led economy, holdings by individuals and corporate bodies in banks should be more than that of governments. It is also recognised that individuals who form part of management of banks in which they also have equity ownership have a compelling business interest to run them well. Such arrangements should be encouraged.

- 5.1.2 Government direct and indirect equity holding in any bank shall be limited to 10% by end of 2007.

- 5.1.3 An equity holding of above 10% by any investor is subject to CBN's prior approval.

5.2 ORGANISATIONAL STRUCTURE

5.2.0 Executive Duality

- 5.2.1 The responsibilities of the head of the Board, that is the Chairman, should be clearly separated from that of the head of Management, i.e. MD/CEO, such that no one individual/related party has unfettered powers of decision making by occupying the two positions at the same time.

- 5.2.2 No one person should combine the post of Chairman/Chief Executive Officer of any bank. For the avoidance of doubt, also no executive vice-chairman is recognised in the structure.

- 5.2.3 No two members of the same extended family should occupy the position of Chairman and that of Chief Executive Officer or Executive Director of a bank at the same time.

5.3 QUALITY OF BOARD MEMBERSHIP

- 5.3.1 Institutions should be headed by an effective Board composed of qualified individuals that are conversant with its oversight functions.

- 5.3.2 Existing CBN guidelines on appointment to the Board of financial institutions should continue to be observed. Only people of proven integrity and who are knowledgeable in business and financial matters should be on the Board.

- 5.3.3 Regular training and education of board members on issues pertaining to their oversight functions should be institutionalized and budgeted for annually by banks.

(The term 'extended family' here refers to the members of a nuclear family comprising the husband, wife and their siblings plus (+) parents and brothers/sisters of both the husband and the wife.

- 5.3.4 The Board should have the latitude to hire independent Consultants to advise it on certain issues and the cost borne by the banks.

- 5.3.5 The number of non-executive directors should be more than that of executive directors subject to a maximum board size of 20 directors.

- 5.3.6 At least two (2) non-executive board members should be independent directors (who do not represent any particular shareholder interest and hold no special business interest with the bank) appointed by the bank on merit .

- 5.3.7 A committee of non-executive directors should determine the remuneration of executive directors.

- 5.3.8 There should be strict adherence to the existing Code of Conduct for bank directors, failing which the regulatory authorities would impose appropriate sanctions including removal of the erring director from the board.
- 5.3.9 Non-executive directors' remuneration should be limited to sitting allowances, directors' fees and reimbursable travel and hotel expenses.
- 5.3.10 In order to ensure both continuity and injection of fresh ideas, non-executive directors should not remain on the board of a bank continuously for more than 3 terms of 4 years each, i.e. 12 years.
- 5.3.11 Banks should have clear succession plans for their top executives.
- 5.3.12 There should be, as a minimum, the following board committees – Risk Management Committee, Audit Committee, and the Credit Committee.
- 5.3.13 The practice of the Board Chairman serving simultaneously as chairman/member of any of the board committees is against the concept of independence and 114 sound corporate governance practice, and should be discontinued.

5.4 BOARD PERFORMANCE APPRAISAL

- 5.4.1 Preamble: While adherence to corporate governance principles is recognised as necessary for successful performance of Boards, it is often not a sufficient condition. Hence, the need for Board performance reviews or appraisals as a new concept to ensure successful or exceptional performance.
- 5.4.2 Each Board should identify and adopt, in the light of the company's future strategy, its critical success factors or key strategic objectives.
- 5.4.3 Boards should determine the skills, knowledge and experience that members require to achieve those objectives.
- 5.4.4 A Board should work effectively as a team towards those strategic objectives.
- 5.4.5 There should be annual Board and Directors' review/appraisal covering all aspects of the Board's structure and composition, responsibilities, processes and relationships, as well as individual members' competencies and respective roles in the Board's performance.
- 5.4.6 The review should be carried out by an outside consultant.
- 5.4.7 The review report is to be presented at the AGM and a copy sent to the CBN. 115

5.5 QUALITY OF MANAGEMENT

- 5.5.1 Appointments to top management positions should be based on merit rather than some other considerations.
- 5.5.2 Existing guidelines on appointments to top management of banks should continue to be observed.
- 5.5.3 Track record of appointees should be an additional eligibility Requirement. Such records should cover both integrity ('fit and proper' as revealed by the CBN 'blackbook', CRMS etc) and past performance (visible achievements in previous place(s) of work).

5.6 REPORTING RELATIONSHIP

- 5.6.1 Officers should be held accountable for duties and responsibilities attached to their respective offices.
- 5.6.2 The structure of any bank should reflect clearly defined and acceptable lines of responsibility and hierarchy.

6.0 INDUSTRY TRANSPARENCY, DUE PROCESS, DATA INTEGRITY AND DISCLOSURE REQUIREMENTS

- 6.1.1 The above are core attributes of sound corporate governance practices that are essential to installing stakeholder confidence.
- 6.1.2 Where board directors and companies/entities/persons related to them are engaged as service providers or suppliers to the bank, full disclosure of such interests should be made to the CBN.
- 6.1.3 Chief Executive Officers and Chief Finance Officers of banks should continue to certify in each statutory return submitted to the CBN that they (the signing officers) have reviewed the reports, and that based on their knowledge:
 - ◆ The report does not contain any untrue statement of a material fact.
 - ◆ The financial statements and other financial information in the report, fairly represent, in all material respects the financial condition and results of operations of the bank as of, and for the periods presented in the report.
- 6.1.4 False rendition to CBN shall attract very stiff sanction of fine plus suspension of the CEO for six months in the first instance and removal and blacklisting in the second. In addition, the erring staff would be referred to the relevant professional body for disciplinary action.
- 6.1.5 There should be due process in all the procedures of banks.

- 6.1.6 All insider credit applications pertaining to directors and top management staff (i.e. AGM and above) and parties related to them, irrespective of size, should be sent for consideration/approval to the Board Credit Committee.
- 6.1.7 The Board Credit Committee should have neither the Chairman of the Board nor the MD as its chairman.
- 6.1.8 Any director whose facility or that of his/her related interests remains non-performing for more than one year should cease to be on the board of the bank and could be blacklisted from sitting on the board of any other bank.
- 6.1.9 The Board Credit Committee should be composed of members knowledgeable in credit analysis.
- 6.1.10 The practice/use of Anticipatory Approvals by Board Committees should be limited strictly to emergency cases only and ratified within one month at the next committee meeting.
- 6.1.11 Banks' Chief Compliance Officers (CCO) should, in addition to monitoring compliance with money laundering requirements, monitor the implementation of the corporate governance code.
- 6.1.12 Banks should also establish 'whistle blowing' procedures that encourage (including by assurance of confidentiality) all stakeholders (staff, customers, suppliers, applicants etc) to report any unethical activity/breach of the corporate governance code using, among others, a special email or hotline to both the bank and the CBN.
- 6.1.13 The CCO shall make monthly returns to the CBN on all whistle blowing reports and corporate governance related breaches.
- 6.1.14 The CCO together with the CEO of each bank should certify each year to the CBN that they are not (apart from 6.1.14) aware of any other violation of the Corporate Governance Code.
- 6.1.15 The corporate governance compliance status report should be included in the audited financial statements.

7.0 RISK MANAGEMENT

- 7.1.1 The Board/Board Risk Management Committee should establish policies on risk oversight and management.
- 7.1.2 Banks should put in place a risk management framework including a risk management unit that should be headed by a Senior Executive, in line with the directive of the Board Risk Management Committee.

- 7.1.3 The internal control system should be documented and designed to achieve efficiency and effectiveness of operations; reliability of financial reporting, and compliance with applicable laws and regulations at all levels of the bank.
- 7.1.4 External auditors should render reports to the CBN on banks' risk management practices, internal controls and level of compliance with regulatory directives.

8.0 ROLE OF AUDITORS

8.1.0 Internal Auditors

- 8.1.1 Internal auditors should be largely independent, highly competent and people of integrity.
- 8.1.2 The Head of Internal Audit should not be below the rank of AGM and should be a member of a relevant professional body.
- 8.1.3 He should report directly to the Board Audit Committee but forward a copy of the report to the MD/CEO of the bank. Quarterly reports of audit must be made to the Audit Committee, and made available to examiners on field visits.
- 8.1.4 Members of the Board Audit Committee should be nonexecutive directors and ordinary shareholders appointed at AGM and some of them should be knowledgeable in internal control processes. One of such appointed ordinary shareholders should serve as the Chairman of the Committee.
- 8.1.5 The Audit Committee will be responsible for the review of the integrity of the bank's financial reporting and oversee the independence and objectivity of the external auditors.
- 8.1.6 The Committee should have access to external auditors to seek for explanations and additional information without management presence.
- 8.1.7 Internal Audit Unit should be adequately staffed.
- 8.1.8 External Auditors
- 8.1.9 External auditors should maintain arms-length relationship with the banks they audit.
- 8.2.0 Appointment of External Auditors will continue to be approved by the CBN.

- 8.2.1 The tenure of the auditors in a given bank shall be for a maximum period of ten years after which the audit firm shall not be reappointed in the bank until after a period of another ten years.
- 8.2.2 A bank's external auditors should not provide the following services to their clients:
- (a) Bookkeeping or other services related to the accounting records or financial statements of the audit client;
 - (b) Appraisal or valuation services, fairness opinion or contribution-in-kind reports;
 - (c) Actuarial services;
 - (d) Internal audit outsourcing services;
 - (e) Management or human resource functions including broker or dealer, investment banking services and legal or expert services unrelated to the audit contract.
- 8.2.5 Quality assurance auditing should be engaged whenever the CBN suspects a cover-up by auditors, and where proved, erring firms would be blacklisted from being auditors of banks and other financial institutions for a length of time to be determined by the CBN.
- 8.2.6 An audit firm would not provide audit services to a bank if one of bank's top officials (Directors, CFO, and CAO etc) was employed by the firm and worked on the bank's audit during the previous year.

APPENDIX IX

GLOSSARY OF TERMS

A Prospectus is “any prospectus, notice, circular, and advertisement, or other invitation, offering to the public for subscription or purchase any shares or debentures of a company and includes any document which save to the extent that it offers securities for a consideration other than cash, is prospectus”.

A Receiver is an individual appointed to recover sums owing to the holder of a charge, usually referred to as a debenture, over assets. The receiver may be appointed by the debenture holder under the terms of the debenture deed giving a fixed and/or floating charge over the assets or by the court.

A Reporting Accountant is a chartered accountant in public practice who is reporting under the relevant provisions of CAMA and/or the Listing Requirements of the NSE. He may be the statutory auditor of the company on which he is reporting or some other chartered accountant.

Advocacy Threat occurs when there is an apparent threat to the auditor’s objectivity, if he becomes an advocate for (or against) his client’s position in any adversarial proceedings or situations.

An Audit is the independent examination of, and expression of opinion on, the financial statements of an enterprise by an appointed auditor in pursuance of that appointment and in compliance with any relevant law and regulation.

Assets are resources controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise.

Assurance Engagement according to International Standard on Auditing (ISA) No. 100 (on Assurance Engagements) is “one in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users, other than the responsible party, about the outcome of the evaluation or measurement of a subject matter against criteria”.

Audit Risk is the term given to the risk that the auditor will draw an invalid opinion or conclusion from his audit work.

Bankruptcy can be defined as a legal proceeding by which an insolvent debtor is declared bankrupt.

Board of Inquiry is the body convened when there is a loss of government fund, for the purpose of carrying out investigation into the circumstances of the loss of the funds as well as the causes and perpetrators of such loss or fraud.

Control Risk is the risk that the internal control system may not prevent or detect the material misstatements or errors.

Corporate Governance is the system by which the affairs of companies are directed and controlled by those charged with the responsibility for so doing. It provides the structure through which the company objectives are set and the means of attaining those objectives and monitoring performance.

Cost of Conversion consists of direct labour and attributable production overhead costs incurred in bringing an item of stock to its present condition and location.

Cost of Purchase comprises the initial cash outlay or consideration given to acquire an item of stock and payments of duties, taxes, freight inwards and other costs necessary to bring the item to its location. This should exclude trade discounts and rebates.

Cost of Stock consists of the cost of purchase and other incidental costs incurred in order to bring the items of stocks to their present condition and location. In the case of manufacturing entities, such other costs would include the cost of conversion.

Detection Risk is the risk that the auditors substantive audit tests and procedures and his review of the financial statements will not detect material misstatements or errors.

Due Process Review involves ensuring strict compliance with laid-down rules and procedures guiding the process of contract invitation, contract award and project implementation. This is with a view to ensuring that government's resources are managed in such a way that they are not wasted.

Economic and Financial Crimes, according to the EFCC Act, is the non-violent criminal and illicit activity committed with the objective of earning wealth illegally either individually or in a group or organized manner thereby violating existing legislation governing economic activities of Government and its administration and includes any form of fraud, narcotic drug trafficking, money laundering, embezzlement, bribery, looting and any form of corrupt malpractices, illegal arms deal, smuggling, human trafficking and child labour, illegal oil bunkering and illegal mining, tax evasion, foreign exchange malpractice including counterfeiting currency, theft of intellectual property and piracy, open market abuse, dumping of toxic waste and prohibited goods.

Economy Audit is aimed at examining whether the organisation has acquired the resources required for its activities and programmes at the lowest cost, and to highlight examples of wasteful or extravagant expenditure.

Effectiveness Audit is aimed at examining the extent to which a programme or project or activity undertaken for the purpose of meeting established policy goals has met the desired result.

Efficiency Audit is aimed at confirming that there is a positive relationship between the level of services provided and the resources used to achieve that level, highlighting examples of unrewarding expenditure.

Errors are unintentional mistakes in financial statements resulting in material misstatement. The mistake may be committed at any stage in the accounting cycle and may be mathematical, clerical, or simply be in the application of accounting policies.

Ethics as a branch of philosophy, is concerned with the study of what is good and right for human beings. The essence of ethics is to ascertain and continuously review how human beings should behave in order to lead a fulfilling life.

Expectation Gap is the difference between what people generally expect from an auditor and what he/she is actually statutorily required to do.

Financial Audit is the type of audit that is conducted in order to ensure that the accounting and financial control systems are efficient and operating properly; and that financial transactions have been correctly authorised and accounted for.

Financial Statements are the accounting reports in respect of the economic activities of an enterprise, prepared periodically and usually at the end of every financial year. These statements form an integral part of the company's annual report and accounts while their components are specified in both CAMA and the Statement of Accounting Standard (SAS) No. 2.

Forensic Accounting is the integration of accounting, auditing and investigative skills that provide an accounting analysis that is suitable to the court and which will form the basis for discussion, debate and ultimately dispute resolution. It encompasses both Litigation Support and Investigative Accounting.

Forensic Audit is an examination of evidence regarding an assertion to determine its correspondence to established criteria carried out in a manner suitable to the court.

Forensic Investigation is the utilization of specialized investigative skills in carrying out an inquiry conducted in such a manner that the outcome will have application to a court of law.

Fraud consists of both the use of deception to obtain an unjust or illegal financial advantage and intentional misrepresentations affecting the financial statements by one or more individuals among management, employees or third parties.

Fundamental Principles of the Ethical Standards as contained in the ICAN Code constitute basic advice on professional behaviour. They are framed in broad and general terms and are drawn from the duties owed by all members of the profession, whether in practice or not.

Government Parastatals or public sector enterprises are governmental units or public agencies “created to perform a single function or a restricted group of related activities. They are organisations set up by government for different reasons, most importantly to perform social tasks.

Impairment is defined as a fall in the value of an asset, so that its recoverable amount is now less than its carrying amount in the balance sheet.

Incoming Auditors are the auditors who are auditing and reporting on the current period’s financial statements not having audited and reported on those for the preceding period.

Independence refers to the state of not being controlled by other people or things. Objectivity and independence often go together and chartered accountants and especially auditors should not only be objective but also act independently of the entity they are working for.

Inherent Risk derives from the characteristics of the client and of its environment prior to the determination of the internal controls in operation. It derives from the type of industry in which the client operates and will vary according to the accounts item being examined.

Insolvency is the inability of a particular person (either corporate or not) to pay debts when due.

Integrity is the quality of being honest and having strong moral principles for example, personal or professional integrity. In addition to honesty, other synonyms for integrity include probity, uprightness and incorruptibility.

Intimidation Threat is the possibility that the auditor may become intimidated by a dominating personality, or by other pressures, actual or feared, by a director or manager of the client or by some other party.

Investigation is “an act of examining, searching and inquiring into a matter with adequate care and accuracy; usually undertaken to obtain information of particular or special nature”. It is not statutorily required of an auditor.

Investigative Accounting is often associated with investigations of criminal matters. Examples of investigative accounting assignments would be an investigation of employee theft, insurance fraud, securities fraud, kickbacks and proceeds of crime investigation.

Joint Audit is an audit assignment that is carried out by more than one audit firm at the same time and for the same financial statements.

Liabilities are present obligations of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

Liquidation is the process of dismantling a business, paying off its debts in order of priority, and distributing the remaining assets in cash to the owners.

Misconduct is breach of the Oath of Allegiance or Oath of Office of a member or breach of the provisions of the Constitution or a misconduct of such nature as amounts to bribery or corruption or false declaration of assets and liabilities.

Multinational Company (or Corporation) is a business entity, which operates or conducts business in many countries. In some cases foreign operations constitute a significant portion of the company's total operations. Foreign operations may be conducted through a branch, an associate, a subsidiary or a joint venture.

Negligence is a legal concept that seeks to provide compensation to a person who has suffered loss due to another person's wrongful neglect. In the case of auditors, a negligent misstatement would constitute negligence.

Negotiation is simply a discussion entered into with a view to reaching an agreement. It is the process in which two or more parties exchange goods or services and attempt to agree upon the exchange rate for them. It may as well just be a case of services being exchanged for a consideration.

Net Realisable Value is the estimated proceeds from sale less all additional costs incurred to the point of completion, marketing, selling and distribution of an item of stock.

Non-Self Accounting Units are Ministries or Extra-Ministerial departments, which are required to maintain complete records of Below-the-line payments and receipts, for example, Salary Advance Accounts but incomplete records of the Above-the-line (Budgetary Account) payments and receipts.

Objectivity is the state of mind that has regard to all considerations relevant to the task in hand but no other. It is sometimes described as "independence of mind" (ICAN).

Obligation means a law or a promise, or an influence that forces one to do something. It also means a duty, for example, fulfilling one's professional obligations. In relation to ethical requirements, obligation can also be seen as a responsibility or a compulsion.

Off Balance Sheet Items are items usually of finance nature contracted by an entity to fund or refinance its operations such that under existing legal requirements and accounting conventions, some or all of them may not be shown on the entity's balance sheet. Through this means enterprises have kept items off their balance sheet by ignoring their real substance.

Other Auditors are auditors, other than the principal auditors, with responsibility for reporting on the financial information of a component, which is included in the financial statements audited by the principal auditors. Other auditors include affiliated firms, whether using the same name or not, and correspondent firms, as well as unrelated auditors.

Predecessor Auditors are the auditors who previously audited and reported on the financial statements of an entity and who have been replaced by the incoming auditors.

Primary Mortgage Institutions (PMIs) are organisations engaged in originating, marketing and serving real estate mortgage loans either as principals or agents.

Principal Auditors are the auditors with responsibility for reporting on the audit of financial statements of an entity when those financial statements include financial information of one or more components audited by other auditors.

Professional Indemnity Insurance is insurance against civil claims made by clients and third parties arising from work undertaken by the firm. It is in the interest of chartered accountants to have this insurance policy so as to be in a position to compensate clients for any error made by the accountant and also to prevent the burden of such compensation leading to their own bankruptcy.

Property, Plant and Equipment are defined in SAS No. 3 as “ tangible assets that:

- (a) have been acquired or constructed and held for use in the production or supply of goods and services and may include those held for maintenance or repair of such assets; and
- (b) are not intended for sale in the ordinary course of business.”

Public Accounts Committee (PAC) is a committee of the House responsible for public accounts in accordance with Section 85 (5) of the 1999 Constitution. The PAC is required to deliberate on the Auditor-General’s report, consider all the queries raised by him in his report, compile a comprehensive report and recommendations for submission to the whole House.

Receivership is the process by which there is appointed someone (referred to as a receiver or receiver/manager) in whom is vested the legal right to “receive” property belonging to a company.

Recognition is the process of incorporating in the balance sheet or income statement an item that meets the definition of an element and satisfies the criteria for recognition. It involves the depiction of the item in words and by a monetary amount and the inclusion of that amount in the balance sheet or income statement.

Regulatory Audit is the type of audit (otherwise referred to as Compliance Audit) that is conducted with a view to ensuring that expenditure has been incurred on approved services and in accordance with the enabling statutory provisions and regulations governing the particular expenditure.

Self Accounting Units are ministries or extra-ministerial departments where the accounting functions are delegated to the Accounting Officer.

Self-interest Threat is a threat to the auditor's objectivity stemming from a self-interest conflict. This could arise from a direct or indirect interest in a client or from a fear of losing a client.

Self-review Threat is the apparent difficulty of maintaining objectivity and conducting what is effectively a self-review if any product or judgement of a previous audit assignment or a non-audit assignment needs to be challenged or re-evaluated in reaching audit conclusions.

Settlement Date is the date at which a receivable is collected or a payable is paid.

Statements of the Ethical Standards provide more elaboration on what is expected of members in certain circumstances. They are for the most part in the form of principles followed by discussion and illustrations.

Statutory Audit is "an assurance engagement in which an auditor expresses a truth and fairness opinion designed to enhance the degree of confidence of the shareholders, other than the management, about the outcome of the evaluation or measurement of the financial statements against accounting standards/law".

Sub-Accounting Units are ministries and extra-ministerial departments where the accounting functions are delegated to the accounting officer but the officer is required to render monthly accounts to the Accountant-General not in details but in Sub-head aggregate form, accompanied by the original vouchers.

Value-For-Money (VFM) Audit is carried out with a view to ascertaining whether the establishment pursues optimal values with adequate consideration for economy, efficiency and effectiveness in its quest for resource management. It is related to the extent to which funds are spent economically, efficiently and effectively. It is also referred to as Comprehensive Audit or Efficiency Audit.

Value-For-Money is the concept that seeks the maximisation of the use of scarce resources for the welfare of the public by ensuring that activities and programmes are carried out at low cost and to high standard. In order to achieve this phenomenon, three elements are usually covered and these are: economy, efficiency and effectiveness.

Winding-up of a Company involves the realisation of its assets and distribution with a view to terminating (or liquidating) the affairs of the company, in cooperation with its creditors, and bringing its existence to an end.

APPENDIX X

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APPENDIX XI

STUDY AND EXAMINATION TECHNIQUES

This appendix contains notes on:

- (a) Using the questions and answers provided in the manual.
- (b) Effective study.
- (c) Examination technique

11.1 Questions and answers

Introduction

1. Two types of question are provided in this manual:
 - (a) Questions set at the ends of chapters *with answers* provided in Appendix I.
 - (b) Questions *with answers* set in Appendix II.

Questions with answers

2. These questions are either
 - (a) questions intended to test the understanding of the points arising out of the particular chapter; or
 - (b) examination questions inserted at a stage where it is considered the student will be best able to give a reasonable answer.
3. Most answers are given in outline but some examination answers go a little further in order to provide greater guidance and equip students with the basis for study.
4. When answers are *comprehensive* you could not be expected to write them in the time allowed. *Do not* worry if you feel you could not write such answers; you are not expected to. But you *should* grasp the main points or principles involved which will form the basis for good marks in an examination.
5. Do not worry if your answer differs; there is often more than one approach. You should satisfy yourself however, that it is *only* the approach that differs, and that you have not missed the fundamental principles.
6. Authors' Comments. These have been included to give *additional* points or elaborate on matters arising out of the subject covered by the question to which it is felt you should give some thought.

Using the answers

7. Have a shot at each question yourself *before* consulting the answer, you will achieve nothing if you do not do this. Write your answer out in full or jot down the main points. *Do not* hurry to the answer.
8. Look at the answer. (See para 5 in the case of examination answers). Study the particular area *thoroughly*, now making sure of your understanding. *Repeat* the process outlined in para 7 and this paragraph after a suitable interval. You *should* do this to get any benefit at all. Make sure the main points *stick*.
9. Just browsing through the answers will really get you *nowhere*. You *should* test yourself by *writing* down your version of the answer.

11.2 Effective Study

Introduction

1. These notes are intended for those who are new to studying for examination subjects, although those who are not may also benefit. They have been written in relation to study involving the reading of *textbooks*, and they apply to *all* subjects. It is often very difficult to pick out the important principles from such books. Careful reading of these notes will be of benefit even in studying the manual.

General

2. Study means more than *just reading* a piece of literature. It means *close concentrated reading* with a *notebook* at your side. Unless you are one of a *few* people do not kid yourself you can absorb material by *just one* general read through it, you cannot!
3. Read a small area, *making notes* as you go along. Then ask yourself – what have I just learnt? *Write* down what you think it was all about. Then look again and you may be surprised to find you have missed a *key* point or points – they *should* be down in your notebook and eventually in your head.

Compilation of notebook

4. A *well-compiled* NOTEBOOK is a must. Use block capitals or different colour inks to *headline* the main areas and sub-divisions of those areas. Notes made during lectures or private study should *not* go straight into your NOTEBOOK. Take them down on a “rough” paper and write them in your NOTEBOOK *as soon as possible* after the lecture or study period, thinking about what you are writing.

Memory aids

5. **Mnemonics** are very useful – if the sequence of points in the textbook *is not* significant, *change it* if it makes for a better mnemonic.
6. **Association** of the points with familiar objects which will serve to recall them is also useful.
7. Some people memorise things by *saying* them over and over *out loud*, others have to *write* them down *time after time*.
8. Many students have *small blank cards* and using one side of each card for each study area, put down the main points. They carry the cards everywhere with them and use every opportunity to study them. As they are small they are easily carried. It is surprising how much of your day can be utilized this way.

Programme

9. Map out a programme for yourself; set targets and *achieve* them. One thing is certain: studying is not easy but it is *not* too difficult if you go about it in an orderly purposeful way. Many students fail their examinations through *bad preparation*. Tackle your studies as you would a project at work, *systematically*. Allocate a number of hours each week to each subject. Try fixing *specific times* for each subject, then *keep to them* by refusing to let *anything* keep you from your planned task.

Revision

10. Revise periodically. The nearer the examination gets, the more you should concentrate on the major headlines in your notebook and less with the supporting details.

11.3 Examination technique**First impressions**

1. However well prepared you may be, you are still likely to look at the paper on the day and say to yourself, after a quick look at the questions, “There’s not much *there* I can do”.
2. The atmosphere of the exam room has something to do with this. Try to blot everything from your mind other than the job in hand. *Concentrate* hard. If you feel a bit panicky (most people do – despite the apparent looks of serenity around you) grip the table, take a deep breath, and *get on with it*. Remember things are *never* as bad as they seem!

Time allocation

3. *Allocate* each question *time* appropriate to the number of marks. At the end of the allotted time for a question *go on to the next* – remember, the *first* 5 or 10 marks on the *new* question are more readily picked up than the *last* 1 or 2 on the *previous* question.
4. The *temptation* will be to say “I’ll write just *one* more sentence”, but before you know where you are you would have written *several* more and probably just managed to scrape another mark, whereas the same time on the next question could have earned 5 or 6 marks. TIME ALLOCATION IS IMPORTANT.
5. If you *are* running out of time write down the *main headings first*, leaving a few lines between each – at least the examiner will see that you had the overall picture. *Then* go back putting in as much supporting detail as you can.

General approach

6. Read the *instructions* at the top of the paper
7. Read the question paper once through. Make your choice of questions quickly. Pick the easiest (if one appears so) and *get on with it*.

Individual question

8. Read the question again carefully. The question will involve a key principle or set of principle. What are they? It is so easy to make the wrong decision at this stage, so read the question, underlining what appear to be the *key words*. This should help you. Irrelevancy has been heavily criticised by examiners.
9. Do not rush into action with your pen *yet*. Jot down on a piece of scrap paper the *main headings* you will use in your answer. All this will take time – about 5 minutes or more, but the *careful thought* and outline answer represents *marks* already earned.
10. If the question is *set out* in a particular sequence, that is:
 - a.
 - b.
 - c. etc.
 then answer it *in that sequence* or you’ll have a *hostile examiner* to cope with.
11. Use the particular terminology *used in the question*, the examiner can then *link the points* in your answer to the relevant parts of the question.
12. Assumptions are sometimes required (for example because of the lack of standardisation of terminology in this subject). Having stated your assumptions, make sure that what you write is *consistent* with them. Do ensure, however, that your assumptions *are valid* and are *not* just a device for changing the *meaning* of the question to suit your knowledge!

Layout of answer

13. Tabulate where appropriate, using block capitals for your main headings and underline subheadings. Underline *words* or phrases which require emphasis. *Use a ruler*.
14. Leave a line *between* your paragraphs and sub-paragraphs. This makes for a *good* layout. However, do *not* write one very long line within paragraphs, or on one side of the paper only – examiners are waste conscious!
15. The use of different colour pens, where appropriate, is useful but do not overdo it. In fact one black and red felt-tip pen would be sufficient (use the felt-tip pens which have a *fine point*).

Charts and diagrams

16. A descriptive heading or title should be given to each diagram (using the one in the question if indicated).

17. Do not squeeze a diagram into a corner – *spread it out*.
18. Do not clutter your diagram up with too much detail – this defeats the object, which should be clarity.
19. Give a *key* to the symbols and the different lines you've used, and again – use a ruler.

End of examination procedure

20. Have a quick look at each answer, checking for grammatical errors and badly formed letters.
21. Ensure each answer sheet has your *number* on it and *do not* leave any lying on the table.

Conclusion

22. Good technique plays a *large* part in examination success; this is a *fact*. *Refuse* to be panicked, keep your head, and with reasonable preparation you *should* make it.
23. Remember – you do not have to score *100%* to pass.
24. A final point; once you're in the examination room *stay there* and make use of every minute at your disposal.
25. Practise your technique when answering the questions set in the manual.

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