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ASSESSMENT OF THE EFFECT OF EXTERNAL AUDIT ON BANK FAILURE

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ABSTRACT

This study examines the effect of external audit on bank failures in Nigeria. Questionnaire method was used to collect data for the study and the results were analyzed using frequency, percentages, mean, Standard deviation and regression analysis. The data for the study were derived from the distribution of 36 structured questionnaires for the selected banks in Osun State, Nigeria. Two hypotheses were formulated and tested using regression analysis. The findings of this study showed that, there is a significant relationship between external audit and bank failure evidenced by p-value (0.001), p-value < 0.05%. It also discovered that there is a statistical significant relationship between audit failure and bank failure supported by p-value of (0.002), p-value < 0.05%. This study therefore concluded that early detection of problems that lead to bank failures by external auditors can save the bank s from distress and failure. The study recommends that banks audit system should reveal the weakness and the solutions to the bank problem. However, banks should provide all necessary information needed by the external auditor. Bank and other financial institutions should also ensure that external auditors are employed from reputable audit firms.

Keywords: Audit failure, Auditor independence, Bank Failures, External audit.

1. Introduction

External audit is an independent examination of an expression of opinion on the financial statement of an enterprise by an appointed auditor in pursuance of that appointment and in compliance with any relevant law and regulation Olowokere (2019).The Institute of Chartered Accountants of Nigeria (ICAN) defines auditing "as a systematic process of objectively

obtaining and evaluating evidence in respect of certain assertions about economic actions and events, to ascertain the degree of correspondence between those assertions and established criteria and reporting the results to concerned parties".

The preparation and presentation of the financial statement of an organization is the responsibility of the management or directors of the organization). The responsibility of the auditor is to report on the financial statements as presented by the management. The duties of the auditors of banks in Nigeria are expressly stated, it is vital that an agreement letter should be given to the auditor which shows the duties to be performed by the auditors. The auditors should be independent in their judgement. Stakeholders especially depositors in the banks still look up to the auditors' reports to assure them of the safety of their deposits and answers other going concern questions as regard the banking industry.There are other interest groups who depend on the organization to realize their own respective goal. The suppliers, government, lenders, investors, creditors and financial organisations are all part of the stakeholders, since these stakeholders are not involved in the daily operations of the business, they may be doubtful of what the management present to them as report of the organizations performance, the stakeholders therefore needs confirmation report or assurance by an independent party known as the external auditor.

However, global financial crisis has highlighted the need for credible high quality financial reporting. Achieving quality financial reporting usually depends on the role external audit plays in supporting the quality of financial reporting of quoted companies (Farouk& Hassan, 2014). The main criteria for evaluating the financial situation of an organization are its financial statements and usually comprise the statement of financial position, statement of profit or loss and other comprehensive income, Statement of cash flows, Statement of changes in equity, and notes to the accounts. It is the responsibility of the management to prepare these financial statements in line with generally international financial reporting standards. Audit failure is a global sensation which cuts across jurisdictions. Nigeria is not spared either from incidences of audit failure.

Furthermore, the interest in this study is derived from the spate of corporate collapse witnessed in the country, most especially the banking sector, such as that involving Oceanic bank, Intercontinental bank, Fin bank, and Spring bank, which resulted in the demise of these institutions (Adeyemi & Fagbemi, 2010). More so, the causes of audit failure have been ascribed to poor audit reporting resulting from crony capitalism, inadequate regulation, multiple regulations, sloppy accounting, political and economy factors inducing the incentives of managers and auditors (Dabor &Adeyemi, 2009; Sikka 2009). Also, incidence of misappropriation of funds and frauds in recent time has poses a threat to auditing as a branch of accounting profession because of its perennial nature. This has resulted to questions as to whether auditing actually play any significant role towards the attainment of accountability and prevention of fraud especially that which is currently happening in our major financial institutions. Most of our financial institutions today fail to recognize that the phenomenon "fraud" can appear to be more dangerous when compared to other forms of problem like armed robbery attack which can only affect the institution within a short period of time, such may have no long term effect on their operations. More so, any significant fraud committed in an institution will not only weaken or shakes up it's financial stability but can sternly affect

the reputation of the institution thereby resulting to investor's loss of confidence (Okeja, 2013). This study seeks to review the impact of external audit on bank failure in Nigeria.

Statement of the Problem

According to Olukotun, James, Olusegun and Olorunfemi (2019) banks help in mobilizing savings through a network of branches, by mobilizing savings, the bank channels the savings into investments. Other roles executed by banks includes financing trade, industry, agriculture, consumer activities and they also help in the implementation of monetary policies. Banks arrange for the sale of shares and debentures. It also acts as an adviser, counsellors and agent to business and industrial organization. Regardless of the fact that there are so many sectors in the economy that depend on banking, banks in Nigeria are yet to realize their full potentials (Olukotun, James, Olusegun & Olorunfemi, 2019). The history of bank failure in Nigeria is dated back to 1930 when majority of commercial banks failed. The major causes of the bank failure are fall in the bank assets value below the market value of bank liabilities, structural changes in the economy, social and political, inconsistencies in regulatory and macro-economic policies, bad management, lack of experience personnel, insufficient capital, excessive branch expansion, non-compliance with banking regulations, unfair competition among foreign banks, incidences of fraud and lack of proper internal control measures. Most of the bank failures were resolved mainly through self-liquidation.

However, audit quality is an essential element in preventing the failure of banks in Nigeria because an objective quality audit forms the basis for confidence on the credibility and integrity of financial reports which is extremely important for efficient-functioning of financial institution. The absent of well efficient audit quality practice can leads to bank failure such as the case of Union Bank Plc, Afribank Nigeria Plc, Intercontinental bank Plc and Oceanic Bank Plc in 2009. Several research work has been conducted in Nigeria on bank failure some of which are the study conducted by Olukotun, James, Olusegun and Olorunfemi, (2019) and Iwedi (2017) while very few has considered the effect of external audit on bank failure. Also, studies have been carried out on the general role of the external auditing in areas of fraud prevention in the banking industry but few or none has been conducted on the effects of external audit on bank failure in Nigeria with specific interest in audit failure this study seeks to bridge the gap by examining the effect of external auditing on bank failure in Nigeria.

Objectives of the study

This study intends to evaluate the effect of external audit on bank failure.
The specific objectives of this study are as follows:

i. Examine the impact of external auditing on bank failure
ii. Determine the effect of audit failure on bank failure

Research Hypotheses

H_{01}: There is no significant relationship between external auditing and bank failure
H_{02}: Audit failure has no significant effect on bank failure

Significance of the Study

The implications of this study is that it will serve as a reference material to researchers and student who might be interested in conducting further research into similar or related areas of study and the recommendations based on the findings, would help banks and other

financial institution to know how external audit can help to prevent bank failure. This study will also be of benefits to auditors and audit firms.

2. Literature Review/ Conceptual Review

External Auditing

The role of audit as control mechanisms are considered to be crucial to ensure the reliability and accuracy of the financial institutions financial reporting. Every organisation is required to set up audit committee who has responsibility towards internal audit, including reviewing the internal audit programme and ensuring the adequacy of the scope of the internal audit activities (Yasin & Nelson, 2012). Financial institutions are also mandated by BOFIA (Bank and other financial institution) Act 2020 section 28 to have an independent auditor known as external auditor who will examine the financial statements of the banks and state in his report whether the financial statements show a true and fair view. Yasin and Nelson (2012) stated in their study that it is a perquisite to establish a good relationship between internal auditors and audit committee in other to ensure the effectiveness of internal control mechanisms and improve the quality of financial reporting. External auditing function is carried out by an external auditor who is approved by the shareholders of the organization. External auditors' reports are key to measuring performance of public investments in banks as the quality assurance reports attracts deposit while a negative report could trigger off a panic withdrawal of deposits (Inyiama,2012).

Audit Failure, External Auditing and Bank Failure

Audit failure is perceived to be connected, directly or indirectly, with corporate failures. In a previous study by Fafatas (2010) audit failures have been proven to tarnish auditor reputation through loss of market share. Audit failure occurs when there is a serious distortion of the financial that not reflected in the audit reports and auditors has made a serious error in the conduct of the audit. There will be an audit failure when an auditor does not adhere to a basic principle or carry out an essential procedure in accordance with International Standards on Auditing (ISAs).On the other hand, external auditing is promoted as a technology that enables stakeholders to control, manage and prevent risks. Audit failures often result to loss of employments and loss of deposits. The incidence of the collapse of Enron, the world's largest bankruptcy, is connected with audit failures. Enron auditors, Arthur Andersen, performed consultancy services, including internal audit and just as the regulators were poised to examine the failures, the firm allegedly shredded a number of relevant electronic and paper documents (Financial Times, 11 March). Dabor and Adeyemi, 2009; Sikka (2009) revealed in their study that some of the cause of audit failures are; multiple regulations, crony capitalism, poor audit reporting resulting from inadequate regulation, sloppy accounting, multiple regulations, political and economic factors influencing the incentives of managers and auditors, other causes are; when the auditors commit fraud by issuing more favourable audit report than warranted , most especially when the auditor has collect bribes or he is being intimidated by a party in the organisation, the auditor having direct or indirect financial interest in the audit client and the auditor being duly influenced as a result of some personal relationship with the client beyond what is expected in a normal audit between independent parties.

Furthermore, audit failure is directly link to corporate failure and the inability of the external auditor to issue a qualified report when it's appropriate can mislead the management of the

bank and the public, this will in turn lead to audit failure which may affect the bank, bring about loss of deposit, bankruptcy and collapse of the bank. The common attributes of the five banks that failed the CBN stress test in 2009 is that they were all certified distressed by the Central Bank of Nigeria (CBN) after the external auditor had given them a clean report. If the banks external auditor had issue a qualified report the bank management might have worked on the issues stated in the qualified report before the CBN examination.

Auditors Independence

An external auditor faces many threats which may affect his independence. If the auditor independence is affected, he be unable to issue fair report showing the extent of the financial statements' justice (Musa & Mahmouda, 2015). According to, Abu Shook (2010) Independence and objectivity of the auditor are the significant factors that cause reliability and credibility of financial statement. The auditor independence increases by his experience, his specialty and the efficiency of the internal auditing (Koch, Weber, & Wüstemann, 2011). Banks should allow the external auditors to be independence in their judgements, this will enable the external auditors to reveal the real state of the banks' financial position and performance and also provide solutions on how to solve the problems and challenges facing the banks, this will in turn save the banks from future distress. The independence of the external auditors therefore minimizes the tendency for the manipulation of financial records. The threats affecting external auditors can be classified into; self-review threat which arises when the auditor accepts to audit the financial statement which he was the one who gather the basic data which was used in preparing the financial statements. Self- interest threat is the one which occurs when the auditor has non-material or material interests in the client. Advocacy threat arises when the auditor supports the client in his practices and in his views or promotes his shares or defends him in court cases. Familiarity threat occurs when the auditor has worked with client for a long time, and has led to a form of familiarity which can serve as threats to the auditors' independence. Lastly, intimidation threat occurs when the client threatens the auditor with canceling the contract between them in order to reduce his fees; this may reduce the objectivity of the auditor (Nasution, 2013). All these threats can make the auditor issue a clean healthy audit report in other to cover up for the bank which can leads to a huge problem in the future. Lack of independence by the external auditor can lead to audit failure. The more skilled the auditor is, the better the services he can offer the firm on ways to improve its financial performance. The independence of the auditor is a part component of quality audit (liemena, Racheal & Okolocha, 2019).

Bank failure in Nigeria

The history of bank failure in Nigeria dates back to 1930 when the Industrial and Commercial bank failed. Thereafter, the Nigerian Mercantile bank failed in 1936 while the Nigerian Penny bank failed in 1946 (Olukotun, Ademola, James, Olusegun & Olorunfemi, 2019). It is expedient to note that 21 out of the 25 indigenous banks that were established collapsed in quick succession due to inadequate capital, bad management, inexperienced employees, lack of banking regulation, excessive branch expansion, and unfair competition from foreign banks (Olukotun, Ademola, James, Olusegun & Olorunfemi, 2019). Others included nonexistence of acceptable prudential policy, lack of right banking positioning among the operators and outright fraud,most of the bank failures were resolved mainly through self-liquidation**.** The case of fivebanks that failed the Central bank of Nigeria (CBN) stress test in 2009, Afri-bank, Fin bank, Union bank, Intercontinental bank and Oceanic bank are relevant as their external

auditors had given them clean reports just before the CBN examination. The banks had many things in common. Initially, they were certified distressed by CBN barely few months after their auditors had given them a clean bill of health. Also, the banks were encumbered with non-performing loans which were completely understated in their financial statements. In a related development, it has been observed that there were red flags in the financial statements of some of the banks including Union bank plc which consistently posted losses in the previous years just before CBN interference. The going concern status of the banks was in qualm. Again the banks escaped going concern qualifications by their auditors (Ande, 2011). Bank failures have also been associated with lack of knowledge and information, endogenous forces, poor judgment, speculation, lack of scruple and greed.

3. Methodology

The research design that was adopted in this research is survey design methods which comprise the use of questionnaire. The total population of the study comprises the staffs of First bank in Osogbo, Osun State. In carrying out this research study, population was drawn from professional accountant, auditors, and both the senior management and junior level staff of the bank. However, the population was restricted to the selected bank in Osogbo metropolis. 40 staffs of the selected bank will form the study population. The sample technique that was adopted for the study was random sampling techniques on the staff of the selected bank. The sample size of this study was 90% of the total population of 40 staffs which is 36 staffs of First bank in Osogbo metropolis. In order to minimize response bias and to reinforce the questionnaire's content validity, most of the items were reverse-coded and then pre-tested on staffs of First bank in Osogbo. STATA 14 was used to run the analysis of this study, Regression analysis was used to test the hypotheses of this study.

4.0 Results and Discussions

Table 1: Demographic Information

Gender	**Frequency**	**Percent**
Male	17	47
Female	19	53
Total	36	100
Age	**Frequency**	**Percent**
24-34 years	15	41.67
35-45 years	10	27.78
46 years & above	11	30.56
Total	36	100
Educational qualification	**Frequency**	**Percent**
HND/B.Sc.	25	69.44
MBA/M.Sc.	5	13.89
Others	6	16.67
Total	36	100
Working Experience	**Frequency**	**Percent**
less than 1yr	10	27.78
1 – 5yrs	14	38.89
6 – 10yrs	5	13.89

above 10	7	19.44
Total	36	100

Source: Author's Computations (2019)

Table 1 above categorizes the responses of the respondent by gender. The analysis above shows that that 53% of the respondent are female whereas 47% of the respondent are male. This result indicated that the female respondents are more than the male respondent. Also, the table reveals that 41.67% respondents were within the age of 24-34 years, 27.78% respondents were within the age of 35-45 years and 30.56% were within the age of 46 years and above.

In respect to the distribution of respondents by the level of education, 69.44% were HND/B.Sc. holders, 13.89% were MBA/M.Sc. holders whereby 16.67% belong to other levels of education. With regard to the distribution of respondents by years of experience, the table reveals that 27.78% had less than one year of working experience, 38.89% had within 1-5 years of working experience, 13.89% had within 6-10 years of working experience whereby 19.44% had above 10 years of working experience

RESULTS 2

Table 2: Mean and standard deviation of responses on the impact of external audit on bank failure

External Audit	**X**	**SD**	**REMARKS**
There is a significant relationship between inefficient audit and bank failure	3.63	0.816	Agreed
Appropriate or quality external audit helps to prevent bank failure	3.09	0.657	Agreed
Audit of banks always disclose appropriate information needed by the auditor to make appropriate decision.	3.39	0.709	Agreed
Bank Failure			
Inappropriate external audit will bring about bank failure	3.38	0.706	Agreed
Non-disclosure of important transactions in the bank financial statement can result into bank failure	3.06	0.622	Agreed
Inability of the auditor to disclose incidences of fraud can leads to bank failure	3.54	0.762	Agreed
Average	3.35	0.712	Agreed

Source: Author's Computations (2019)

Table 2 reveals that respondents agreed to all the items on the table. This is obvious as all the mean scores are above the fixed decision value of 2.50. The standard deviation on the Table ranged from 0.622 to 0.762, this indicates that there is low variability in the respondents' responses. The aggregate mean and standard deviation of 3.35 and 0.712respectively are pointers to this fact. The indication of this is that there is a significant relationship between auditing and bank failure.

Table 3: Mean and standard deviation of responses on the effect of audit failureand bank failure

Audit failure	**X**	**SD**	**REMARKS**
There is a significant relationship between audit failure and bank failure	3.56	0.722	Agreed
Quality external audit helps to reduce fraud incidence which will in turn prevent bank failure	3.38	0.706	Agreed
Poor audit reporting resulting from inadequate regulation, crony capitalism, sloppy accounting, multiple regulations, economic and political factors influencing the incentives of managers and auditors are some of the causes of audit failure.	3.10	0.664	Agreed
Bank Failure			
Non-disclosure of vital information such as incidences of fraud, mismanagement of resources, non-compliance with regulations can leads to bank failure	3.63	0.816	Agreed
More than 85% cases of banks failures are caused by fraudulent activities and inability of the external auditor to disclose the incidences of fraud	3.25	0.687	Agreed
Most fraudulent activities that lead to bank failures are done by insiders who usually get the support of the external auditors.	3.59	0.752	Agreed
Average	3.42	0.72	Agreed

Source: Author's Computations (2019)

Table 3 reveals that respondents agreed to all the items on the table. This is obvious as all the mean scores are above the fixed decision value of 2.50. The standard deviation on the Table ranged from 0.664 to 0.816 this indicates that there is high variability in the respondents' responses. The aggregate mean and standard deviation of 3.42and 0.72 respectively are pointers to this fact. The indication of this is that audit failure can lead to bank failure.

Hypotheses Testing

Hypotheses testing provide the relevant data for validating or rejecting the null hypothesis

Hypothesis One

H_{01}: There is no significant relationship between external audit and bank failure

Table 4: Model Summary of the relationship between auditing and bank failure				
Model	**R**	**R Square**	**Adjusted R Square**	**Std. Error of the Estimate**
1.	.8090[a]	.9139	.8852	.1794

Table 5: ANOVA[a\] Summary of Regression Analysis of the relationship between external audit and bank failure					
Model	**Sum of Squares**	**D f**	**Mean Square**	**F**	**p-value**

1	**Regression**	1925	4	481.3	31.85	.001[b]
	Residual	0	0			
	Total	4258	5			

Predictors: (Constant)

a. Dependent Variable: Bank failure

The model summary in table 4 and 5 above shows that there is a significant relationship between external audit and bank failure, it shows that bank failure has 91.39% ($R^2 = 0.9139$) of being prevented if there is quality or appropriate external audit. In the table above, the significance level of the model is shown which is equal to (0.01) and the F statistic value is 43.33. Hence, it's an indication that this model is highly significant as the criteria for the significance level is 0.05. Therefore, this study reveals that there is functional relationship between the external audit and bank failure. Since the alpha value is greater than the P-value, we reject the null hypothesis.

Hypothesis Two

H_{02}: Audit failure has no significant effect on bank failure

Table 6: Model Summary of significant effect of audit failure on bank failure

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1.	.9174[a]	.8471	.8021	.1765

Table 7: ANOVA[a\] Summary of Regression Analysis of the significant effect audit failure on bank failure

Model		Sum of Squares	D f	Mean Square	F	p-value
1	**Regression**	3529	3	117.333	38.35	.002[b]
	Residual	61	2	30.5		
	Total	3590	5			

Predictors: (Constant)

a. Dependent Variable: Bank failure

The model summary in table 6 and 7 above shows that audit failure has a significant effect on bank failure, the calculated R square equals 0.8417 reveals that 84% of cases of bank failure is as a result of audit failure. The p-value equals .002, which, obviously lies below α (alpha) values i.e. 0.05 the F statistic value is 38.35. Hence, it's an indication that this model is highly significant as the criteria for the significance level is 0.05. Therefore, this study reveals thataudit failure has a significant effect on bank failure. Since the alpha value is greater than the P-value, we reject the null hypothesis. Dabor and Adeyemi, 2009; Sikka 2009 also attest to this that the causes of bank failure have been attributed to poor audit reporting resulting from inadequate regulation, crony capitalism, sloppy accounting, multiple regulations, economic and political factors influencing the incentives of managers and auditors.

Discussion of Findings

The result of the hypothesis testing for the first hypothesis shows that there is a significant relationship between external audit and bank failure. The independence of external auditor is very crucial, the independence of the external auditor is part element of quality audit (Iliemena, Racheal & Okolocha, 2019). If the external auditor is able to disclose or alert the bank on all the misstatements or incidences of fraud in the financial statements of the banks that can leads to failure, the bank will be able to adjust and improved. Quality external audit will help to prevent bank failure. According to Ojo, (2009) the participation of external auditors could contribute to corporate governance and address the inherent agency problem, because the auditor either forensic or external auditor can expedite a situation where by managers are encouraged or compelled to be held accountable. The second hypothesis testing shows that there is a significant relationship between audit failure and bank failure. This result is consistent with the study of Fafatas (2010), where he revealed that audit failure is directly or indirectly linked with corporate failures. The audit of a firm's accounts is a control apparatus that minimizes information asymmetry and guards the interests of the principal (Okolie, 2014). Availability of proper audit system will help to boost the confidence of the investors in the bank and also reduce fraud incidence.

5. Conclusion and Recommendations

The following conclusion could be drawn from responses obtain from respondents as well as records and confirmation made available to the researcher: Fraud gave birth to auditing and the incessant occurrence of fraud in banking sector has become the major motives behind bank failures in the country and the effects of the fraud cuts across every sector of the economy, because the banking sector is the custodian and engine house of every nation's economy. The study conclusively stated that independence external auditor and quality audit will help to reveal any form of discrepancy or inadequacy that can leads to bank failure.

However, the study recommends that banks and other financial organisations should ensure that proper audit of their account is being conducted to prevent bank failure. The banks should make available all information needed by the external auditor to give a true and fair view on the financial statement of the banks. The banks should also ensure that external auditor from reputable audit firms are being hired to audit their accounts. Finally, the auditor's report should reveal the current weaknesses and solutions to bank problems. External auditors are also advised to exercise more diligence in the accomplishment of their duties.

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