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**A global perspective on the changing
perceptions of the role of the external
auditor and the significance of audit
developments**

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ABSTRACT

Through a consideration of factors which have resulted in a more reduced role for the external auditor in certain jurisdictions – when compared to others, this paper will consider, as well as highlight why an enhanced awareness of the role of the external auditor in such jurisdictions will be vital in an increasingly globalised financial system.

It will do so through a consideration of the current, past and future perceptions of external auditors' roles – with particular reference to selected jurisdictions from Africa, Asia and Latin America.

Key Words: external auditor, audits, regulation, financial, bank, fraud, error, financial statements, Brazil, Malaysia, Nigeria

A GLOBAL PERSPECTIVE ON THE CHANGING PERCEPTIONS OF THE ROLE OF THE EXTERNAL AUDITOR AND THE SIGNIFICANCE OF AUDIT DEVELOPMENTS

Marianne Ojo

1.1 Introduction

The roles presently assumed by external auditors in bank regulation in Nigeria and Malaysia, as will be highlighted in this paper, are quite limited (for several reasons) - as will be demonstrated. Political, legal and state influences serving as major contributory factors in the restrictions imposed on the development of auditing in these jurisdictions. Whilst political, legal and state influences have transformed and shaped the development of auditing in both countries, the impact of the State on audit developments, as will be considered under “the Profession/ State dynamics”¹ will illustrate the level of grasp which the government has on the audit profession in Nigeria. The penultimate section of this paper will also consider the extent to which external auditors’ roles have been shaped by legal and state influences in Brazil. Given the political and legal influences that have shaped the role of external auditors in Nigeria and Malaysia, what role can be assumed by external auditors in Latin American countries such as Brazil where legal influences, in recent years, have extensively shaped the regulatory landscape?

¹ “The profession/State dynamics have helped shape the outcome of the various episodes in the history of the accounting and auditing profession in Nigeria – an important influence in this dynamics being the nature of government in place (military or civilian).” CU Uche, „Professional Accounting Development in Nigeria: Threats from the Inside and Outside“.

1.2 Development of Auditing in Malaysia

This section investigates the role and contribution of external auditing as practised in the Malaysian society during the forty year period from independence in 1957 to just before the onset of the Asian Financial Crisis in 1997.

“In a case study format where qualitative data was gathered mainly from primary and secondary source materials, the study found that the function of auditing in the Malaysian society in most cases is devoid of any essence of mission; instead it is created, shaped and changed by the pressures which give rise to its development over time.” The largely insignificant role that it serves is intertwined within the contexts in which it operates.²

“The activity of external auditing as conducted by audit firms intervenes between the preparation of financial and non-financial information relating to a particular entity by management and the (supposed) use by many different groups of users of this audited information. In Malaysia, this audit is characterised by little publicity and little public clamour for needed changes.”³ There may be a few lone voices from both the public and private sectors asking auditors and their representative bodies, the Malaysian Institute of Accountants (MIA) and the Malaysian Association of Certified Public Accountants (MACPA) to do a better job, but that appears to be where the "story" ends.⁴

² For further in depth information on this see, A Ali, T Lee, N Yusof and M Ojo, „Development of Auditing in Malaysia: Legal, Political and Historical Influences. Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1740062 and <http://mpra.ub.uni-muenchen.de/28138/>

³ *ibid*

⁴ See remarks made by the then chairman of the Securities Commission (SC) (*The Malaysian Accountant*, Oct/Dec 1993, p. 15), the Finance Minister (*Akauntan Nasional*, Sept. 1989, pp. 21-23; Aug. 1990, p. 26; Oct. 1990, pp. 20-21) and those by Tun Ismail Ali, the former Governor of Central Bank and the chairman of the Bumiputra trust agency, Permodalan Nasional Berhad (PNB), and several listed companies (*The Malaysian Accountant*, July-Sept 1988, p. 18).

What is happening in Malaysia is considerably different from that experienced by auditors in countries such as the United States, Britain, Canada and Australia. In these countries, they are often criticised for business failures and a number have had to pay large damages or settle out of court with plaintiffs accusing them of committing audit failures. Besides the court, regulatory agencies and other groups have also played their part in demanding that the profession move in an expeditious fashion to meet its responsibilities as perceived by the public (see Flint, 1983; Bruce, 1988; Humphrey *et al.*, 1992; and Jacob, 1992). In these countries, even where external economic factors force businesses into liquidation and there is little proof of auditors' failure to conduct audits properly, the auditors have nonetheless become implicated in the failure.

Malaysia's auditing experience when compared to other Asian countries such as South Korea, Hong Kong, India and Singapore, is a source of surprise. This is because unlike what has happened in Malaysia, auditors in these countries have experienced tough times with their authorities.⁵ In the case of South Korea and Singapore, the auditors concerned have also been brought to court by disgruntled investors.⁶

The passing of the Companies Act 1965 and the Accountants Act 1967 facilitated the emergence of the initial pattern of audit system, replacing a pre-existing pattern where there was no law to govern the operations of companies throughout the newly formed federation⁷ and a national accounting body to represent all qualified accountants in the country.

⁵ Deloitte Touche Tohmatsu was criticised by a Hong Kong inspector over audits it conducted for a group of companies which were under criminal investigation (*International Accounting Bulletin*, 8 Nov 1993, p. 1). The firm was alleged to have committed audit failure leading to the publication of misleading financial statements.

⁶ In respect of South Korea, in December 1991, alleged failure of the auditors to uncover significant liabilities of now bankrupt companies had led to the investors filing the first ever lawsuit against the auditors (*International Accounting Bulletin*, Feb. 1992, p. 3). In relation to Singapore, in 1988, the former shareholders of Pan-El sued its group auditor, Coopers & Lybrand, for US\$105 million.

⁷ Previously in the Federation of Malaya, company law was governed by the Companies Ordinance 1946, whilst in the State of Singapore, it was governed by the Straits Settlements Ordinance 1940. The Sarawak Companies Ordinance was similar to the North Borneo Companies Ordinance, which was based

The Companies Act 1965 drew mainly on two sources: the Victoria Companies Act of 1961 and the British Companies Act 1948 (Walton, 1986).⁸ The former in turn was based upon the UK Companies Act 1908, 1929 and 1948 while the latter on the UK Companies Act 1929. The Act placed the requirement on companies to disclose more than ever before. It also requires companies to keep accounting records so as to have true and fair statements prepared and that record keeping should be executed in such a way so as to enable the records to be conveniently and properly audited.

In matters of auditing, the Act stressed the need for the auditor to be independent. This is illustrated in cases where he or she is not allowed to be an officer or director or had share holding (either direct or indirect) with the companies audited. In addition, the auditor was given very broad powers in relation to matters of inspecting records and obtaining information for the audit and had the right to attend and address general meetings of the company. As in the earlier Companies Ordinance 1946, the academic and professional qualifications of the auditor were not specified. However, under section 8 of the Companies Act, a person had to apply to the Finance Minister in order to gain license to become a company auditor.⁹

From a practice originating as a consequence of the need perceived by the national leaders in the late 1950s and 1960s to maintain the status quo in the nation's modern economy, following the launching of the NEP in early 1970s, the function of auditing in the Malaysian society was in most cases devoid of any essence of mission; instead, it was

on Hong Kong companies legislation which in turn was modelled from the English Companies Act of 1929.

⁸ To be noted however that in the *Parliamentary Debates* (Vol. II, no. 8, Col. 1558 and dated 9 Aug. 1965), it was stated by the then Minister of Commerce and Industry, Dr. Lim Swee Aun, that the committee with the responsibility to draft the Companies Bill (whose chairman came from the ministry of commerce and industry and with the assistance of John Finemore, a Colombo Plan draftsman from Australia) had considered not only the present legislation in force in the UK, Australia, India and New Zealand but also the draft code prepared for Ghana by Professor Gower and the reports presented in the UK by the committees chaired by Lord Cohen and Lord Jenkins.

⁹ The MIA president mentioned in 1987 that the power to issue audit and liquidator licenses had been delegated in accordance with Section 8(7) of the Companies Act 1965, to a committee in the finance ministry (*The Malaysian Accountant*, Oct-Dec 1987, p. 10). He did not say however when this committee had actually started its operation.

created, shaped and changed by the pressures which gave rise to its development over time. The role that it served was intertwined in the contexts in which it operated. As has been noted by Hopper et al. (1987), accounting development has been implicated in broader ideological and political struggles in the society.

1.3 Development of Auditing in Nigeria

„Over the years several, sometimes conflicting theories attempting to explain the development of professions have emerged. The „functionalist“ and „interactionist“ theories have since lost the spotlight to a more critical approach based on the Weberian concept of closure.“¹⁰

Whilst these theories attempt to explain how professions have developed and transformed over the years, this paper aims to focus on „the profession/ State dynamics“ that have contributed to shaping the outcome and development of auditing in Nigeria.

The main professional accounting body responsible for accounting and auditing in Nigeria is the Institute of Chartered Accountants Nigeria (ICAN). Unlike the previous section which dealt with the historical developments of auditing in Malaysia – particularly legislation which have contributed to the audit development process, this section will focus on more political and governmental issues which have shaped and transformed the audit profession in Nigeria.¹¹

¹⁰ See CU Uche, „Professional Accounting Development in Nigeria: Threats from the Inside and Outside“. See also C Ramirez, „Understanding Social Closure in its Cultural Context: Accounting Practitioners in France (1920 – 1939) Accounting, Organizations and Society (2001) and WF Chua and C Paullaos, „The Dynamics of „Closure“ Amidst the Construction of Market, Profession, Empire and Nationhood: An Historical Analysis of an Australian Accounting Association, (1998) Accounting, Organizations and Society, 23(2) at pages 155-187.

¹¹ For in depth information and analysis on theories of professional development and the history of the accounting profession in Nigeria, as well as the origins of the Institute of Chartered Accountants Nigeria, see CU Uche, „Professional Accounting Development in Nigeria: Threats from the Inside and Outside“

The most important and recent legislation in respect of the debate on the „credibility of the auditing profession“ in respect of audit matters in Nigeria is considered to be the Companies and Allied Matters Decree of 1990. As well as „providing the opportunity for the government to register its dissatisfaction with the performance of auditors in Nigeria“ this Act also embodied provisions which „challenged the credibility of the accounting profession in Nigeria – almost threatening its very existence.“¹²

Such an incidence whereby the government was able to voice its dissatisfaction, indeed may be regarded as a case of „pot calling kettle black“. This opinion being attributed to the fact that the social, cultural and political environments (and particularly the political environment) have all contributed to shaping the development of auditing in Nigeria and transforming it to its present outcome. The following section aims to elaborate on why the government should also „clean up“ and rectify its acts.

Factors Which Have Influenced the Progress of, and Shaped the Development of Auditing in Nigeria.

Major contributory factors include (but are not exclusively limited to) the following:

- Presiding government (and whether such a government is corrupt or not)
- Level of transparency
- Level of accountability

¹² See E Okike, „Management of Crisis: The Response of the Auditing Profession in Nigeria to the Challenge to its Legitimacy“ (2004) Accounting, Auditing & Accountability Journal, Volume 17 Issue 5 at pages 705-730. For events and environmental factors which resulted in the „crisis of confidence“, ways whereby the profession has attempted to re-establish public confidence in its members, as well as other developments in the regulatory framework for accounting and auditing, see also *ibid*.

The Audit Report of 2001 impliedly targets government officials as highlighted by Inyang et al¹³ who add that „the Report implies that heads should roll for the wickedness and inefficiency made potent in high places.“ Furthermore, urgent response and action was called for, in response to the Report as any form of inaction was considered to reflect „an acceptance of the obnoxious norms and values in government.“ Such „obnoxious norms and values in government“ constituting „the canker worm eating deep into the fabrics of the financial prosperity of the nation.“¹⁴ This great impediment to the progress of audit development in Nigeria, namely, corrupt government officials is an issue which is in need of urgent redress. How can auditors be held accountable when those in charge of audits are condoned by such government officials for fraudulent and corrupt acts?

Results of data analysis and the findings of a research which was conducted to „determine the behavioural constraints on practices of auditing (BCPAN),“¹⁵ revealed that auditors were found to be „conniving with corrupt officials to cover their lapses.“¹⁶ In accordance with the findings of the research, it was recommended that „as a matter of policy, auditors should anonymously assess administrators as at when due, so that those found guilty of serious (BCPAN) could be sanctioned; external auditors should not stay longer than a duration of 10 years in the firm in which they are engaged.“¹⁷ Furthermore, it was also recommended that administrators should have a „positive behaviour towards auditors in Nigeria because they are not fault finders“ – but simply engaged for the well being of Nigerian firms.

¹³ See U Inyang et al, „Auditing and the Nigerian Nemesis“ (2003)
<http://www.nigerdeltacongress.com/articles/auditing_and_the_nigerian_nemesi.htm>

¹⁴ ibid

¹⁵ See M E Akpomi and J Amesi, „Behavioural Constraints on Practices of Auditing in Nigeria“ (BCPAN) 2009 Educational Research and Review Volume 4 (10), pp 465-469, October 2009.
<<http://www.academicjournals.org/err/PDF/Pdf%202009/Oct/Akpomi%20and%20Amesi.pdf>

¹⁶ ibid

¹⁷ It was also recommended that “Internal Audit Committees (IACs) be constituted along every organization lines so as to vet all vouchers and contracts. The IAC should be provided with standardized working schemes and members of such a committee should be persons drawn from the accounting profession, with tested and proven impeccable character.”ibid; „The study also revealed that BCPAN is still very much prevalent in Nigerian public limited companies, private limited companies and tertiary institutions.“ see page 465;ibid.

1.4 Audit Developments in Brazil

“External audits performed in accordance with high quality globally accepted audit and ethics standards are critical to the appropriate implementation of accounting standards. They help ensure that financial statements and reports are reliable, transparent” and generate the resulting effects of enhancing “market confidence as well as improving the quality of information relied upon by bank supervisors.”¹⁸

The increased need and importance of external auditing is further highlighted by banking supervisors’ growing reliance on external auditors:¹⁹

- Auditing and ethics standards are written for a broad range of audited companies and do not always include requirements that are specific to banking. This increases reliance on auditors’ specialised expertise and emphasises the importance of the Committee’s input into the audit standard setting process.
- Implementation of principles-based accounting standards and increased complexity of rules-based accounting standards have amplified reliance on auditor expertise and judgments.

Significant developments which have occurred in Brazil’s accounting and auditing environment primarily include the central bank’s and Securities Commissions’ decisions to: ²⁰ Require entities (financial institutions and listed companies) under their supervision

¹⁸ See Basel Committee on Banking Supervision, “External Audit Quality and Banking Supervision” December 2008 <http://www.bis.org/publ/bcbs146.pdf> at page 8 of 17

¹⁹ see ibid at pages 10 and 11 of 17

²⁰ See Report on the Observance of Standards and Codes (ROSC) Brazil, Accounting and Auditing, June 20 2005 at page 4 of 50 http://www.worldbank.org/ifa/ros_c_aa_bra.pdf

to publish consolidated financial statements (in accordance with IFRSs) as from 2010, as well as the creation of an independent accounting standard setter – the Comit  de Pronunciamentos Cont beis (Accounting Standards Committee). Challenges which have previously been encountered by external auditors, and which are listed in the Report on Observance of Standards and Codes, include the following:²¹

- Many accounting standards and financial reporting rules are codified in the Corporations Law of 1976 (amended 1997 and 2001). As a result, significant changes to the accounting and reporting framework would require that the law be amended. The problem with this is that the legislative process in Brazil can be lengthy and cumbersome, particularly when controversial issues are at stake. Hence, since 2000 it has been difficult to incorporate new accounting concepts reflecting increasingly complex business transactions.²²
- Not all public interest entities are required to follow high-quality accounting standards or be subject to a statutory audit or publication requirement.
- Many institutions are mandated with the issue of accounting standards, financial reporting rules and auditing requirements – with the resulting effects of inefficiencies.
- Significant gaps between Brazil’s GAAP and IFRS
- In relation to the securities market and within the financial sector, statutory auditors are subject to relatively stringent independence rules which include compulsory audit firm rotation and the prohibition of a range of services to audit clients.
- Enforcement of accounting standards is dispersed across several institutions – resulting in inefficiencies.

²¹ see *ibid* at pages 1 and 2 of 50

²² In respect of this, it is recommended that “Corporations Law be amended to remove detailed accounting standards and financial reporting rules which should be set forth by sub-legislative Acts such as regulations and instructions.”

- Not all public interest entities are required to follow high quality accounting standards or are subject to a statutory audit or publication.”

According to the Basel Committee on Banking Supervision, audit quality specific to bank accounting is influenced by the quality and complexity of accounting standards.²³ While many areas of financial reporting require significant judgments (for instance, by management when implementing the standards and auditors when interpreting the standards during the audit process), at least four areas are identified by the Bank for International Settlements as being of “particular importance to banking supervisors.” These areas include:²⁴

- 1) loan loss provisioning and recognition of other impairments,
- 2) consolidation of and other involvements with off-balance sheet vehicles,
- 3) fair value estimates and related imprecision (eg illiquid or complex financial instruments) and
- 4) disclosures (eg valuation methodologies and exposure to risk).

Even though the audit practice in Brazil has undergone recent improvements which include “mandatory continuing professional education, quality assurance system based on peer reviews, an examination of minimum professional qualification”, the Report on the Observance of Standards and Codes highlights the fact that “these mechanisms still fall short of international good practice – particularly as a result of the self regulation arrangements under which they are implemented.”

²³ See Basel Committee on Banking Supervision, “External Audit Quality and Banking Supervision” December 2008 at page 11 of 17 <http://www.bis.org/publ/bcbs146.pdf>

²⁴ see ibid at page

1.5 Conclusion

Hence it is evident that whilst external auditors also face daunting challenges in Brazil, they also have a significant role to play in the financial sector – particularly the banking and securities sectors. Rules, Acts and regulations will also play an immensely huge role in influencing the quality of audits, as well as facilitating a harmonized system of rules – which in turn, will facilitate better interpretation of accounting standards whilst reducing confusions which could arise as a result of undue significant judgments in the decision making process and the interpretation of standards.

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