BANK AUDIT: A CALL FOR PARADIGM SHIFT

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Abstract

This paper demonstrates, using of empirical evidence, that shares of non-- bank companies are likely to suffer more losses than creditors of the same companies in the event of failure of such companies. On the other hand, bank's depositors are likely to suffer more losses than bank's shareholders in failure of such banks. Consequently, the paper calls for a paradigm shift in banks audits and propose that banks' auditors should report to the two groups: shareholders and depositors; and an amendment to the relevant provisions of the Companies and Allied Matters Act (1990) and the Banks and Other Financial Institutions Act (1991).

Introduction

Auditor's report comes up at the end of all statutory audit exercise and is addressed to members of a company because the audit is undertaken on their behalf. The present position appears to be derived from the origin of audit function in organizations as Okolo (1987:1) puts it,

> The need for an audit would arise where one person or group of persons handle money or money's worth on behalf of some other person or group of persons. In such a situation the beneficial owners of the fund need an audit to satisfy themselves that their funds are being honestly and prudently managed.

It needs to be stated here that the managements of such funds are normally reported in the financial statements hence, the objectives of an audit are reported on the truth and fairness of the financial position shown by the financial statements and weather such statements are prepared in accordance with appropriate legislation and statutes, generally accepted accounting principles and conventions.

According to Woolf (1979) the words *true and fair* encompass the final objective of accounting. Section 359 of the Companies and Allied Matters Act (CAMA) 1990, places- the responsibility of ensuring that financial statements give a true and fair view of the state of affairs of the company on the directors of every company. While this duty remains exclusively that of the directors, the auditor in his report to the members, is required to state whether in his opinion, the accounts do in fact meet the above requirements.

The significance of the two words *true and fair* should be soberly appreciated. The inherent subjectivity with which *fair* has to be assessed represents auditors' most sever challenge, rather than a license to authenticate any of a range of views.

The dictates of present day organization are such that stakeholders other than the shareholders are constantly increasing. Such other stakeholders include but are not limited to creditors, depositors, governments, financial experts, prospective investors and employees. The increase in the number and variety of stakeholders has called for a re-examination of the addressee of the auditors' report especially in banks where the funds of the company is mainly that of the bank depositors. This position has been foreseen by Woolf (1979:263) when he indicates that:

> In stark contrast to the narrowly defined and traditional reporting context of the auditor, i.e. the usual report addressed to the members of a company, stand the possibilities and probabilities of the next decade. It is now widely recognized that a range of interest other than shareholders both require and are entitled to information concerning companies activities and results and the only reason this has not so far led to uniform, even statutory, reporting pattern is that a good deal of research is still needed on some questions...

The objective of this paper, therefore, is to examine the need for the auditors of banks to report also to group the which will lose more money if a bank goes under; make proposition for appointing or electing a representative of that group, and suggest the modality of effecting a paradigm shift in bank audit.

Literature Review

In the world over, banking industry is undoubtedly one of the prominent industries that contribute to economic development of any country. This prominence emanates from the creation of wealth through the central role that it plays in financial intermediation between areas of deficit and surplus. In Nigeria, 1990 to 2000 without doubt could be described as a watershed in the annals of banking practice for both positive and negative developments. The introduction of economic reform measures such as the Structural Adjustment Programme in 1986 brought trade liberalization and financial deregulation which led to a phenomenal growth in the number of licensed banks to over 100 by 1990.

According to Oshio (1995:3),

> A bank may simply be defined as a corporate body licensed or otherwise authorized by the State to operate as a bank and transact business as defined by its enabling statute or regulations. Three elements in this definition need clarity. For an institution to be a bank, i. It must be a corporate body, either a registered company or an institution established as a corporate body by statute e.g. People's Bank of Nigeria, ii. It must either obtain a banking license such as UBA Pic, ACB Limited did or otherwise be authorized by statute to transact business as a bank such as the Nigerian Bank for Commerce and Industry. iii. The business transacted by the bank must be as defined either in the enabling statute or regulation.

Furthermore, Oshio (2001:189) states that

> In Nigeria *Bank* means a corporate body licensed or otherwise authorized by the State to operate as a financial institution with the word 'bank' as part of the business name and transact business as defined by its enabling statute or regulation.

A bank depositor or customer, on the other hand can be defined as a person or individual that voluntarily gives out his/her funds to financial institution (bank) for the purpose of safeguarding the fund and at the same time acting as a lender to the financial institution for using the fund to transact business for a return known as interest. There are various types of depositors such as savings account, current account and time/fixed deposit.

Savings account depositors are depositors who open account with the banks with less formality and make regular payments and withdrawals without notice. Low rate of interest is usually offered to them and bank credit facilities are not available to them in most cases.

Demand / Current account depositors are depositors who open active accounts with the banks. They are usually issued with cheques. Deposits and withdrawals are made by self or through third parties. This is the most convenient type of account for individuals, businessmen and corporate bodies. Of late, some banks offer very low rate of interest on current account deposits.

Time/Fixed depositors are those depositors who open an account for the specified time for the purpose of earning high interest. Fixed deposits are grouped into two: short-term and long term deposits.

Various regulatory instruments and statutes have been put together to ensure adequate supervision and monitoring of the industry such as Companies and Allied Matter Act (CAMA) 1990 Central Bank of Nigeria (CBN) Act 1991,and Bank and Other Financial Institutions Act (MA) 1991 The activities of banks are regulated by BOFIA 1991. Banks as incorporated companies are also subjected to the provision of the Companies and Allied Matters Act 1990 and it is explicitly provided in the BOFIA 1991 that where the provisions of CAMA 1990 are in conflict with the provisions of the BOFIA 1991, the provisions of the later prevail. Consequently, a case could be made that since banks are specialized companies dealing with huge funds of their depositors as their stock-in-trade; they should also be treated as a special industry that requires special and separate audit attention. Although the rules and regulations of BOFIA 1991 and the CBN Act 1991 are enough to ensure confidence in banks by the public as well as regulate the activities of the banks, there is need now more than ever before for the government to recognize the all important interest of the depositors.

Business of banking has witnessed so much prominence over the years that virtually all other sectors of the economy rely heavily on it for survival and growth. A stable banking sector is therefore *a sine qua non* for economic growth and development. A bank is said to be stable when it is free from the dual problems of liquidity and insolvency. Both problems are not only fraught with negative consequences for the depositors but also for the economy as a whole.

Therefore, it is surprising that it is only in Section 29 (7) (c) & (d) that the interest of the depositors is protected in BOFIA 1991 when it states that

If an audit appointed under this section, in the course of his duties as an auditor of a bank is satisfied that

a. Any irregularity which jeopardizes the interest of depositors or creditors of the bank or any other irregularity has occurred, or

b. 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 bank (Central Bank of Nigeria)

Report to the Central Bank of Nigeria for what? This provision is insufficient and does not adequately cover the interest of the depositors, especially when viewed against the background that no penalty is expressly stated against such erring banks. Perhaps BOFIA 1991 relies on its provision in Section 12(d) which prescribes revocation of banking license if a bank has insufficient asset to meet its liabilities.

There will be suspicion if the reports presented in the form of financial statements by banks' directors (who prepared such statements) are not verified. The reason why such report may not be trusted stems from the fact that the report may contain errors, frauds or failure to disclose or reveal material facts. The solution to this problem of suspicion of Managers/Directors reports is the introduction of credibility by the appointment of independent persons called auditors who are expected to express independent opinion on the directors[1] reports and financial statements to the shareholders.

The primary objective of auditing is for independent auditors to express an opinion to the shareholders of a reporting entity on the 'truth and fairness' of the financial statements.

However, since the expressed opinion is about the 'truth and fairness' of the financial statements, the recipients of the report should be extended by the Banking Act to take into cognizance the interest of all stakeholders in the economy especially shareholders and depositors. This is because the financial sector is the engine room of any economy, the moment its stability is threatened or hampered in any way that economy is on its way to ruin. Banks audit reports should also be available to depositors to put them on alert of any unfavourable circumstances that may threaten their interest.

Methodology

This study covers companies quoted on the first-tier of the Nigerian Stock Exchange (NSE). The methodology is to select five banks and five non banks companies from the NSE, present their financial statement for five years (1993-2003), and analyze them through the use of percentages. Only secondary data from various sources such as NSE Factbook, financial statements of the selected companies, journals and other relevant publications were used. These sources are very established and dependable for our purpose. It was, therefore, unnecessary to seek primary data.

Data Presentation, Analysis and Discussion

Table 1 shows the Financial Statements of banks from 1999-2003 and Table 2 shows the financial statements of non-bank companies for the same period.

Table 1: Banks Financials

Afribank	2003 N'M	2002 N'M	2001 N'M	2000 N'M	1999 N'M
Total Assets	98,005	83,210	78,630	68,065	45,414
Deposits Liabilities	72,493	61,195	62,041	56,398	35,279
Other Liabilities	18,179	15,404	11,711	7,873	6,922
Shareholders' funds	7,383	6,611	4,878	3,791	3,213
First Bank	2003 N'M	2002 N'M	2001 N'M	2000 N'M	1999 N'M
Total Assets	409,083	290,593	224,007	194,744	137,869

Deposit Liabilities	-264,245	178,603	155,598	138,003	89,868
Other Liabilities	116,958	91,788	49,477	40,725	33,377
Shareholders funds	27,880	20,202	18,932	16,016	12,509
Guaranty Trust	2003 N'M	2002 N'M	2001 N'M	2000 N'M	1999 N'M
Totai Assets	90,522	65,021	45,471	35,597	20,626
Deposit Liabilities	51,522	31,366	24,139	15,446	10,369
Other Liabilities	28,950	25,593	17,185	17,004	7,681
Shareholders' funds	9,773	8,062	4,147	3,147	2,576
UBA	2003 N'M	2002 N'M	2001 WM	2000 N'M	1999 N'M
Total Assets	203,871	200,196	188,032	120,834	100,647
Deposits Liabilities	142,427	131,866	133,135	82,518	73,207 .
Other Liabilities	46,543	57,703	45,830	30,980	22,039
Shareholder's funds	14,901	30,627	9,067	7,336	5,311
Universal Trust	2003 J£M	2002 N'M	2001 N'M	2000 N'M	3999 N'M
Total Assets	32,125	32,500	30,098	22,710	16,507
Deposit Liabilities	26,442	22,873	19,152	14,125	8,200
Other Liabilities	2,230	6,332	8,166	6,416	7,161
Shareholder's funds	3,453	3,295	2,780	2,169	1,145

Source: NSE Factbook 2002 and 2004

Table 2: Non-Bank Financial

Cardbury Nig. Pic	2003 N'M	2002 N'M	2001 N'M	2000 N'M	1999 N'M
Total Assets	8,838	7,370	6,138	3,052	2,809
Liabilities	595	505	2,830	430	373
Shareholders[1] funds	8,243	6,865	3,308	2,622	2,436
Union Venture & Petrol Pic	2003 N'M	2002 H'M	2001 N'M	2000 N'M	1999 N'M
Total Assets	25	24	23	22	21
Liabilities	2	3	3	3	3
Shareholders' funds	23	21	20	19	18

Incar Nig. Pic	2003 N'M	2002 ^'M	2001 N'M	2000 N'M	1999 £TM
Total Assets	141	134	125	126	132
Liabilities	52	32	20	22	25
Shareholder's funds -	89	102	105	104	107
B. O. C. Gases Nig.	2003 N'M	2002 N'M	2001 N'M	2000 * ™	1999 N'M
Total Assets	482	419	363	336	307
Liabilities	100	77	62	-	-
Shareholders' funds	382	342	303	336	307
PZ Industries	2003 N'M	2002 N'M	2001 N'M	2000 N'M	1999 N'M
Total Assets	17,475	16,416	15,218	12,433	11,845
Liabilities	2,264	2,066	1,745	1,543	1,304
Shareholders' funds	15,211	14,350	13,493	10,890	10,541

Source: NSE Factbook 2002 and 2004

Discussion

Table 3 shows the disaggregation of the funding of sampled banks' assets

Table 3: Percentage funding of banks

Afribank	2003 %	2002 %	2001 %	2000 %	1999%
Total Assets	100	100	100	100	100
Deposit Liabilities	744	74	79	83	78
Other Liabilities	18	19	15	12	15
Shareholders' funds	08	07	06	05	07
First Bank	2003 %	2002 %	2001 %	2000 %	1 999 %
Total Assets	100	100	100	100	100
Deposits Liabilities	65	60	70	70	70
Other Liabilities	29	30	20	20	20
Shareholders[1] funds	06	10	10	10	10

Guaranty Trust	2003 %	2002 %	2001 %	2000 %	1999% ;
Total Assets	100	100	100	100	100
Deposit Liabilities	60	50	50	40	50
Other Liabilities	30	40	40	50	40
Shareholders' funds	10	10	10	10	10
UBA	2003 %	2002 %	2001 %	2000 %	1999%
Total Assets	100	100	100	100	100
Deposit Liabilities	70	66	71	68	73
Other Liabilities	20	29	24	26	22
Shareholders' funds	10	05	05	06	05
Universal Trust	2003 %	2002 %	2001 %	2000 %	1999%
Total Assets	100	100	100	100	100
Deposit Liabilities	82	70	64	60	50
Other Liabilities	07	20	27	30	40
Shareholder's funds	11	10	09	10	10

As shown on table 3, disaggregating the funding of the total assets of banks indicates, that deposit liabilities contribute majority of bank funding. It would be seen that deposit liabilities of banks consistently contribute in excess of 51% when the funding of total assets is disaggregated.

Table 4 shows the disaggregation of the funding sampled non-bank companies' assets.

Table 4: Percentage funding of non-banks

Cardbury Nig. Pic	2003 %	2002 %	2001 %	2000 %	1999%
Total Assets	100	100	100	100	100
Liabilities	7	7	46	14	13
Shareholders' fund	93	93	54	84	87
Union Venture & Petrol. Pic	2003 %	2002 %	2001 %	2000 %	1999%
Total Assets	100	100	100	100	100
Liabilities	10	10	13	14	14
Shareholders' fund	90	90	87	86	86
Incar Nig. Pic	2003 %	2002 %	2001 %	2000 %	1999%
Total Assets	100	100	100	100	100
Liabilities	37	24	16	17	19
Shareholders' fund	63	76	84	83	81

B. 0. C. Gases Nig.	2003 %	2002 %	2001 %	2000 %	1999% '
Total Assets	100	100	100	100	100
Liabilities	21	18	17	-	-
Shareholders' fund	79	82	83	100	100
PZ Industries	2003 %	2002 %	2001 %	2000 %	1999%
Total Assets	100	100	100	100	100
Liabilities	13	13	11	12	11
Shareholders' fund	87	87	89	88	89

As shown on tables 4, disaggregating the fund of the total assets of non-bank companies indicates that shareholders[1] fund contributes the majority of the funding of assets. Shareholders of non-bank companies consistently contribute in excess of 51% when the funding of total assets is disaggregated.

According to Okolo (1987) the need for audit arises when one person or group of persons handle money or money's worth on behalf of another. The reason for this, according to Howard (1981:1) is to ensure that those investing in business ventures could be protected from complete ruin in the event of losses. For non-bank companies it is easy to identify shareholders as those who have given their funds to be managed by others and therefore require protection because they have invested in limited liability companies. The Companies and Allied Matters Act m(1990) ensures that they get the deserved protection. Table 4 shows that shareholders provide in excess of 51% of funding of companies[1] assets and in the event of liquidation may suffer more. To this extent, audit reports are addressed to them so that they would be aware of the status of their funds and take corrective measures to ameliorate any adverse circumstances.

Unfortunately, this straight forward scenario of non-bank companies is not replicated in banking companies. Though the depositors provide majority of funds for total assets of banks, they are not primary recipient of audit reports.

In case of liquidation, depositors suffer more. Nigeria Deposit Insurance Corporation (2003) indicates that out of 22,172,774 (N million) deposit liabilities of 36 liquidated banks, only 5,247,695 (N million or 23.7% were total insured deposits. This statistics shows that 77% of deposit liabilities might not be recovered. Only 3,294,842 (N million) total insured deposits of closed banks have been paid up to December 31[SI], 2003 (NDIC, 2003).

In the light of the above, since depositors of banks bear the brunt of liquidation, it would only be reasonable to ensure that they are also as protected as shareholders because they stand to lose much more. Though, in the strict sense, depositors are not investors in banks, they have nevertheless given their funds out to other persons (the banks) to manage. Therefore they need to know how well their funds are being managed so that they could ameliorate any 'unfavourable circumstances. This knowledge is derived from auditors[1] reports.

It is therefore our proposition that if depositors would derive the knowledge they require to monitor their funds, they need to have primary access to auditors' reports. This is a call for paradigm shift in banks' audit. Bank auditor should also report to depositors. This will also be consistent with the view that those who provide funds to others to manage should receive an accounting of such management. Since non-bank companies' audit comply with this principle; bank audits should also comply for consistency.

The above proposition raises some pertinent questions. First, how would the representatives of depositors be selected? Second, how would the auditors be appointed? Third, should auditors report to shareholders and depositors groups separately or jointly?

The compositions of depositors of banks are not as stable as that of the shareholders. In fact they are very volatile. This poses a problem in the selection of the group to represent depositors. However, in the recent past banks have tended to organize customers' forum for the purpose of encouraging bank-customer interface and soliciting depositors for banks. The process of identifying which depositors to invite could be fine tuned in getting a group to represent the interest customers. This select group should be approved by the regulatory authorities otherwise it could be abused.

The second problem is the appointment of auditors for banks. At the moment shareholders appoint the auditors as provided by Companies and Allied Matters Act (1990). Consequently, auditors report to them. This has led to some abuse in the audit process of banks. It is our considered opinion that banks' auditors should be appointed by the regulatory authorities. This would assist in sanitizing the banking sector. 'He that pays the piper dictates the tune' says a popular adage. If the regulatory authorities appoint and pay banks' auditors, they would specify and require what is in the best interest of the economy. This will of course not be free. It would be charged like deposit insurance is being charged but not in the same magnitude.

The third problem is whether banks' auditors should report jointly or separately to shareholders and depositors. Since audit reports are presented to shareholders at annual general meeting and there are so many other issues .slated for discussion on that which do not concern non members, auditors should report separately to the two bodies. Furthermore, the interest and questions of the two groups to auditors would be different.

The adoption of this proposal has a wide variety of implications for banks in particular and the economy in general. First, banks' depositors would be as informed as banks' shareholders about the fate of their funds and would be in a better position to make superior decisions with respect to their funds. Second, the managements and boards of various banks would, as a result of the improved knowledge of the depositors, formulate and implement policies and strategies that are both adequate in principles and effective in operation that would lead to superior organizational effectiveness. If this is not satisfactory, the operators of banks would constantly be under the healthy fear or impression that depositors would leave to banks they perceive as better managed and that would protect their funds. Third, this healthy fear of bank operators would elicit more care and diligence in the management of banks, which would lead to some stability in the banking sector and invariably affect the entire economy since banks are the engine room of the economy.

Conclusion

The banking sector is the engine room of any economy hence it is more regulated and attracts special treatment from governments of all nations. The moment it is destabilized other sectors of the economy will be affected. The main losers in the liquidation of any bank are not the shareholders but the depositors and ultimately the entire economy.

In the light of this, we have proposed that the government through the regulatory authorities, should ensure the stability of the banking industry by taking steps to guarantee that adequate audit information is available to both banks' shareholders and depositors.

Thus, we call for a paradigm shift in the audit of banks. We propose that regulatory authorities should appoint bank auditors, determine what should be reported on in the interest of the economy, and make the auditors' report available to both shareholders and depositors. To this end, we propose an amendment of the relevant provisions of the Companies and Allied Matters Act (1990) and the banks and Other Financial Institutions Act (1991) to reflect the interest of banks' depositors in banks' audit.

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