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Public Expectation Gap, External auditors and Financially distressed Banks in Nigeria

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ABSTRACT

One of the ongoing and long time grey areas in financial practice is the conflict between the external auditor and the public expectation gap, particularly in developing economies. This study examines the effect of external auditors and the public expectation on financially distressed banks in Nigeria. This study used a survey research design to get information from the primary source, and it used a well-structured questionnaire to do so. The study found that there is a large gap between what the general public expects and what auditors actually do to prevent and detect fraud. The results of the statistical cross-sectional chi-square test at 0.05 levels of significance and the test of one-way analysis of variance on the hypotheses served as the foundation for our conclusion in this study. It can be said that external auditors and the public expectation gap have a big impact on financially troubled institutions in Nigeria. The study suggests that a new corporate reporting model be implemented with the goal of increasing public access to non-financial information and clearly defining the function of independent audit.

Keywords: financial practice, expectation gap, information, external auditor

INTRODUCTION

The importance of the audit function is a crucial component of the regulatory framework that upholds the integrity of our markets, including the money market, capital market, and the entire economy. However, the complexity and dynamic nature of the business environment today present constant challenges, making auditors operate in an environment where economic conditions are uncertain and users of audited financial reports are increasingly demanding more relevant and useful information. Auditing greatly enhances the credibility of the financial statements and contributes significantly to the efficient operation of business organizations. However, the audit strategies that are currently being used have changed over time. These changes have not kept up with the changes in the business environment, which has sometimes made it difficult for the auditors to solve current business problems like potential fraud or irregularities in the audited financial statements.

Notably, financial scandals have occurred in a number of economic sectors in both industrialized and developing nations, including Nigeria, particularly following an audit of the finances. The scandals in Nigeria did not spare the financial industry. Between 1997 and 1999, there was crisis in the Nigerian banking industry as a result of directors' opportunistic behavior and inadequate corporate governance

(Olojede, Olaynika, Asiriuwa and Usman, 2020). Following the global credit crunch in 2009, there was yet another breakdown in the Nigerian banking sector, and the shock caused the capital market to collapse. Cadbury Nigeria Plc. overstated its profit by N13.25 billion between 2002 and 2005, but the external auditors, Akintola Williams Deloitte, were unaware of it. Additionally, Nampak Nig. Plc2007 .'s statements were exaggerated by N2.8 billion, while the Board of the now-defunct African Petroleum Plc. hid a N22.0 billion loan in its 2000 accounts (Olojede,2009).

In addition, Godsell (1992) notes that there is a shared perception among the various stakeholders that the audited accounts serve as certification of the firm's solvency, propriety, and business viability. This perception has contributed to the escalating rise in public agitation and controversies against the auditors in recent years (Maccarrone, 1993). Because of this, the general public often equates corporate failures in businesses with audit failures. There is frequently a public uproar against the auditor and his work when the audit procedure fails to uncover fraud. According to this position, it was implied that several billions of naira were lost by investors due to the accountants' and auditors' complicity in fabricating the numbers and, as a result, manipulating the earnings to show a position that was different from the actual position (Owolabi, 2012). This explains the conflict of interest that exists between auditors and users of financial statements.

Users of financial statements generally believed that the auditor's responsibilities should go beyond those prescribed by law, but they also believed that an auditor's professional skills enable him to prevent and uncover fraud, mistakes, and irregularities that could be detrimental to those who use financial statements. However, auditors contend that laws like the Nigerian Company and Allied Matters Act explicitly outline their responsibilities (2004). This only indicates that it is not an auditor's job to look for fraud or other irregularities. Contrarily, an auditor's main duty is to lend credibility to the directors' accounts and, in doing so, to do his task with the necessary care and expertise.

Therefore, the public is perplexed as to why a company should fail or why a significant fraud should afterwards be found following an independent audit. The general public anticipates that such an audit will offer a full guarantee that everything is alright. They anticipate that an audit will reveal any frauds and irregularities, as well as ensure the correctness of financial accounts, managerial effectiveness, and soundness of financial policies. These expectations should be the foundation for the public's expectations of independent financial audits, which should go much beyond their current goal and scope (Gupta, 2005).

This merely illustrates that the primary point of contention is the discrepancy between the auditors' legal obligations and what the general public perceives their duty to be. The public expectation gap of audit is crucial to the way audit work is done since any unmet expectations by the public would undoubtedly undermine the audit firm's credibility and financial viability, which might then harm stakeholders. The "heartbeat of any profession" is public trust. When trust is broken, credibility issues and a decline in the profession's worth follow.

Few studies have been conducted in Nigeria that deal with the situation related to the public expectation gap, external auditors, and financially troubled banks. Few of these studies also concentrate on the real sector. Additionally, a large number of the studies that are currently available in the nation were done prior to 2016/17, when the new auditor's report had not yet been adopted. Therefore, our study aims to fill these gaps in the literature and further knowledge. From the aforementioned, the researchers may wonder: What impact do external auditors and the public expectation gap have on financially challenged banks in Nigeria? The study's primary objective is to investigate how external auditors and the public expectation gap affect financially troubled banks in Nigeria.

While determining the impact of the external auditor and the public expectation gap on financially challenged banks in Nigeria is the specific goal. The findings of this study will help to further define the variables that tend to have a big impact on how much the Nigerian public relies on audited financial accounts. The other sections of the study are organized as follows: Section two reviews the pertinent literature; Section three outlines the technique; Section four deals with the presentation and evaluation of data; and Section five wraps up the study.

REVIEW OF THE RELATED LITERATURE

Conceptual framework

Auditing and Accounting

In this study, the terms “accounting” and “auditing” had both been defined in relation to the topic at hand. According to the American Accounting Association, accounting is the process of gathering, analyzing, and disseminating economic and financial data to enable consumers of the data to make wise decisions (Glautier and Underdown, 2001; Olojede, 2009). When financial statement information accurately captures the economic content of a business, its relevance, dependability, and comparability become useful. A significant portion of all company information is made up of accounting information. Due to the separation of ownership, an impartial party is hired to check the agent’s report in order to give it credibility because of the control and conflicts of interest that can exist between the main and the agent. The credibility that auditing adds improves the financial statements’ quality of information.

Auditing

This independent audit of the books and records aims to provide information on the financial statements’ fairness. An auditor provides their assessment of the accuracy and fairness of the directors’ financial accounts (Ekpenyong 2011). A more acceptable description was offered by the American Accounting Association’s Committee on Basic Auditing Concepts. According to (Arens, Peter, Gregory, & James, 1997), who cited the committee’s definition, auditing is a systematic process of impartially gathering and assessing evidence regarding claims about economic actions and events in order to determine the degree to which those claims correspond with predetermined criteria and communicating the results to interested users. This implies that an auditor must demonstrate professional prowess. He must be methodical, objective, and analytical in the conduct of his work, and be able to communicate effectively the results of his work to the stakeholders.

Public Expectation gap

It has always been challenging to give an accurate and accepted definition of the audit function; this difficulty results in a perception gap between the general public, users, and auditors. The financial crises at large corporations like Enron and WorldCom, which gave rise to the term “audit expectation gap,” appear to have made the perception gap worse. The term “audit expectation gap” refers to the discrepancy between how the general public, users, and auditors see the degree of performance displayed by auditors during the course of their work. The Cohen Commission (1998) broadened this term to include any discrepancies between what the general public anticipates and what auditors can actually accomplish.

Porter (2003) observed that Liggio (2014) and Cohen Commission (2014)’s definitions did not take into account the possibility of the auditors providing subpar service. She blamed the auditors’ incapacity to keep up with public demands for the recent rise in criticism of and litigation against auditors (also cited by Akinbuli, 2010). The audit expectation gap, according to her definition, is the discrepancy between what society expects of auditors and their actual performance. According to Salehi (2011), the audit expectation gap refers to either one or both of these two: the discrepancies between expectations and actual performance of auditors. The existence of these disagreements in opinion between auditors and users of accounts, both separately and in comparison. Public expectations include things like a safety net, a burglar alarm system, a radar system, an independent auditor, and consistent communication, which goes against the fundamental principles of auditing (Tweedie,1987) challenges facing the auditor include the expectation gap and professional misconduct. In their study, Lee *et al.* (2017) came to the conclusion that users and auditors have distinct perspectives on the nature and goals of auditing. They claim that the dispute between the two groups is what causes the audit expectation gap.

The audit expectation gap, as defined by Ojo (2016), is the discrepancy between the users of financial statements' perceptions of an audit and the audit profession's assertion as to what is expected of them in carrying out an audit. The audit expectation gap is referred to in the context of regulation as the result of the conflict between the profession's self-regulation and the minimal government rules, notably the overprotection of self-interest, which has enlarged the expectation gap. According to Onulaka (2014), the audit expectation gap refers to the discrepancy between what the general public and other users of financial statements perceive the duties of auditors should be and what the auditors actually believe those duties are.

Causes of Audit Expectation

The complexity of audit functions, conflicting auditor roles, retrospective evaluation of auditor performance, time lag in responding to moving expectations, the auditing professional's self-regulation process, and unawareness and irrational expectations are all factors that this study identifies as contributing to the gap's existence (Lee and Azham, 2008).

There are numerous and diverse potential factors for the audit expectation gap. Humphrey, Turley, and Molzer (1992) proposed that a number of factors, including the probabilistic nature of auditing, the ignorance, naiveté, and unreasonable expectations of non-auditors, the retrospective evaluation of audit performance, the evolutionary development of audit responsibilities, which creates response time lags to changing expectations, corporate crises, which result in new expectations and accountability requirements, and periods of high stand, could be responsible for the gap.

Components of Audit Expectation Gap

The MacDonald Report, a research on the audit expectation gap funded by the Canadian Institute of Chartered Accountants, established a model that divided the audit expectation gap into three categories: unreasonable expectations, inadequate performance, and defective standards. Based on this concept, Porter (1993) divided the expectation gap into two parts in order to help close the audit expectations gap by considering the merits of each individual case. Following the survey in New Zealand, the audit expectation gap has been renamed "the audit expectation-performance gap" and structured it into reasonable gap and performance gap. The reasonable gap described the difference between what the public expects auditors to achieve and what they can reasonably be expected to accomplish. On the other hand, performance gap is the difference between what the public can reasonably expect auditors to accomplish and what auditors are perceived to achieve. She further divided performance gap into deficient standard and deficient performance.

Deficient standard is the gap between what can reasonably be expected of auditors and auditors existing duties as defined by the law and professional standards. Deficient performance is the difference between the expected standard of performance of auditors' existing duties and auditors' perceived performance, as expected and perceived by the public.

Consequences of Audit Expectation Gap

There are some negative effects of the audit expectation gap. According to Sikka et al. (2003), the auditing profession suffers as a result of the audit expectation gap. They contend that it damages the reputation, earning potential, and credibility of audit work. They went on to say that in a capitalist system, the process of wealth creation and political stability depended on how much people trust the accountability process. As a result, the audit expectation gap could harm the government, investors, regulators, and users of accounting information. The pulse of any profession is public trust. When trust is broken, credibility issues and a decline in the profession's worth follow. It is assumed that wrongdoings are equivalent to business failures. Due to the stakeholders' perspective, there are more liability concerns and audits are receiving more criticism.

Reducing the audit expectation gap

The audit expectation gap's innate characteristics make its eradication challenging (Jedidi & Richard, 2019). An auditor's perceived performance changes over time. Its measurement is challenging as a result. Therefore, it is feasible to lower it. There are several strategies to lower it, as evidenced by the literature now in print. These include extending the auditor's obligations with regard to fraud, mistakes, and unlawful activities; expanding the audit report; providing audit education; and improving the auditor's perceived independence (Commission, 2008). The audit expectation gap can also be closed by requiring audit rotation, controlling the appointment of auditors, and limiting the range of services an audit can provide (Taslima & Fengju, 2019).

Financial statements

Financial statements, according to Murphy (2018), are written documents that detail a company's operations and financial performance. Government entities, accounting companies, etc. frequently audit financial statements to guarantee accuracy and for tax, financing, or investment objectives. Financial statements essentially consist of the balance sheet, income statement, and cash flow statement.

Theoretical Review

Regarding the duties of auditors and the matter of the audit expectation gap, there are numerous theories. However, the role conflict and inspired confidence hypotheses were chosen and only briefly examined in this study. This is due to the fact that they are pertinent and hence serve as the theoretical basis for the empirical study.

The role conflict theory

According to the notion, the auditor has a duty to review the books of accounts and support the board of directors' financial statements. Additionally, it states that the stakeholders should anticipate the auditor to complete this task honestly (Koo& Sim, 1999). According to the theory, an auditor should be treated as a professional in a society. As a result, the auditor must adhere to the role requirements that the society has given him. Compliance can be enforced when there is a breach through social action, which may even involve sanctions when necessary (Davidson, 1975; Biddle & Thomas, 1979).

Management, institutional investors, financial analysts, tax authorities, and creditors are among the stakeholders, claims Davidson (1975). Due to the need to redefine their roles and interact with other societal elements, these groups' expectations vary and, in many cases, alter throughout time. The causes of role conflict are the multifaceted expectations (Olojede *et al.*, 2020).

Theory of Inspired Confidence

This theory concentrates on the supply and demand for audit services (Hayes *et al.*, 1999). The involvement of outside stakeholders in the organization has a direct impact on the need for audit services. In exchange for their contributions to the organization, these stakeholders demand accountability from the management. An audit of this information is necessary because management-provided information may be prejudiced and there may be a conflict between management's interests and those of external stakeholders. Limperg employs a normative approach when discussing the level of audit confidence that an auditor should offer (the supply side). The auditor's duties should be carried out in a way that does not confound the expectations of a reasonable outsider. In light of these possibilities, the auditor should take all necessary measures to live up to the fair expectations of the public.

Empirical review

Olojede *et al.(*2020) did an empirical analysis of the scope and nature of audit expectation gap in Nigeria. The authors used a descriptive and survey research design to achieve the objective of the study. They collected data through primary source, using structured questionnaire. The study employed Mann–Whitney *U* test and Kolmogorov–Smirnov *Z* test for the analysis of data and test of normality of distribution, respectively. The results show that audit expectation gap exists in Nigeria, and the new auditor's report did not have any serious impact in reducing the gap. The audit expectation gap was found to have primarily arisen from the unreasonable expectation of the users due to their lack of understanding of the roles of auditors. Onulaka and Samy (2017) investigated the effect of audit expectation gap in the Nigerian capital market.They confirm the wide gap in the areas of auditor's responsibility for fraud detection and prevention.

Appolos, Onuoha and Aguguom (2016), mostly employed survey questionnaire to identify the inherent characteristics of the gap, its effects, and how to narrow it. The outcomes of maqny of the studies largely showed the presence of users' misunderstanding with regard to auditor's duties and responsibilities. Audit environment, however, influenced the divergent views among the various groups.

Adeyemi and Uadiale (2011) reviewed audit expectation gap in Nigeria. They used survey research method and structured questionnaire in collecting data. With purposive sampling technique, they sampled two hundred (200) respondents. descriptive and inferential statistics were used for the analysis of data. The testing of the hypotheses was done using analysis of variance (ANOVA).Findings show that audit expectation gap existed in Nigeria, and there was significant difference in the beliefs of the groups with regard to the responsibilities of auditors.

Oseni and Ehimi (2010) sought to find out the nature and degree of audit expectation gap in Nigeria. The data were obtained through questionnaire, and 160 respondents were sampled. The authors used Chi-square for data analysis, and their results show that there was an outstanding contrast in the auditor's duties for preventing and detecting fraud.

Concerning the difference in belief of auditor's report, Tanko(2011) confirmed a wide audit expectation gap on the quality of audit report in the public sector in Nigeria, while Adeyemi and Uadiale (2011) observed wide expectation gap on decision usefulness of audit report in the private sector.

METHODOLOGY

This study applied the survey research design and collected data from the primary source. The data were acquired using well-structured questionnaire as was adopted by Oseni and Ehimi (2010) and Adeyemi and Uadiale (2011) to measure the opinions of the respondents concerning the duties and responsibilities of auditors. The cardinal aim was to help provide an authentic assessment of public expectation gap, external auditors and financially distressed banks in Nigeria and also provide the basis for comparison with previous works. The data obtained from the questionnaires distributed to two hundred and fifty respondents as presented in this section. Two hundred questionnaires were retrieved.

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However, twenty five of the retrieved questionnaires were either incomplete or too mutilated to be analyzed. Therefore, the researchers were left with one hundred and seventy five questionnaires which we deemed sufficient to make a comprehensive analysis and valid conclusion. The bases of our conclusion in this study are the result of the statistical cross-sectional chi-square test at 0.05 levels of significance and test of one-way analysis of variance on the hypotheses. The responses are classified according to their academic qualification, professional qualification in accounting, experience and occupation.

EMPIRICAL ANALYSIS

Data Presentation

Table 1.1 Highest Academic Qualifications of Respondents

Highest Academic Qualification	Bankers	Auditors	Investors	Accountants	Total
WAEC			35		35
B.sc	26	35	20	15	
MBA	4	5	9	7	
Msc		5	3	6	
PhD			3	2	
Total	30	45	70	30	175

Source: authors, 2022.

Table 1.2 Professional Qualification in Accounting and Banking

Professional Qualifications	Bankers	Auditors	Investors	Accountants	Total
ACA	20	25	5	5	55
CIBN	25	5	5	15	50
ANAN	5	5	15	7	32
CPA	5	5	–	6	16
NONE	10	5	5	2	22
Total	65	45	30	35	175

Source: authors, 2022.

Hypotheses Testing

Public expectation gap and external auditor have no significant effect on financially distressed banks in Nigeria

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Table 1.3 Expectation gap and external auditor have no significant effect on financially distressed banks

Options	O	E	O-E	$(O-E)^2$	(O-E)2/E
Strongly Disagree	0	54.8	-54.8	3003	54.8
Disagree	18	54.8	-36.8	1354	24.7
Agree	84	54.8	29.2	853	15.60
Strongly Agree	0	54.8	-54.8	3003	54.8
					150

Source: authors, 2022.

$X^2 = \sum(O-E)^2/E$

E= 219/4 = 54.8

$X^2 = 149.9$

Degree of Freedom = (r – 1)

= (4 – 1) = 3

As was stated earlier, the choice of 95% level of confidence was selected for testing the entire hypothesis. This implies that the critical level will be 5% (0.05) level of significant.

Decision rule

Degree of freedom 3 at 0.05 level of significant = 7.49, from the analysis, the X2 value = 149.9 is greater than the critical value = 9.49. This will mean that the alternate hypothesis is accepted, implying that the public expectation gap and external auditor have significant effect on financially distressed banks in Nigeria.

CONCLUSION

Recently, the world is experiencing diverse sudden financial failures making the public who are at the receiving end to believe that the auditors either fail in their role or wilfully collude with the management and board. The study noted that wide public expectation gap exists in the areas of auditors' responsibility for fraud prevention and detection. However, it must be noted that this public expectation gap arises from a combination of excessive expectations and insufficient performance. The audit expectation gap is detrimental to the auditing profession as it has negative influences on the value of auditing and the regulation of auditors in the modern society leading to the significant effect on the distressed banks in the economy.

It was also established that if auditors are to retain the public confidence and perception of them as providing a valuable service in society, the gap between the capital public expectations of auditors' performance must be narrowed. The study provides evidence of the existence of expectation gap between auditors and the financially distressed banks in Nigeria. The propositions made in the study were evaluated using selected items or statements of hypotheses. It can be concluded that the public expectation gap and external auditor have significant effect on financially distressed banks in Nigeria. It therefore means that the quantity of frauds detected by auditors has a significant effect on the public reliance on audited financial statements of the distressed banks in Nigeria.

The study recommends that a new business-reporting model be put in place aimed at releasing more non-financial information to the public and providing clear description of the role of independent audit. The auditors should improve the communication level in order to address the users' misconception of audit services and function. The Acts i.e Companies and Allied Matters Act (CAMA) should be reviewed with a view to expanding the existing duties and responsibilities of the auditors particularly, accommodating the demand of the public in terms of the prevention and the detection of errors and fraud.

More so, the rotation of external auditors provided for in the Nigerian Code of Corporate Governance is principle-based, and we suggest that it should be made compulsory for all companies by including this provision in Companies and Allied Matters Act with stiff penalty for non-compliance. An audit firm should not be allowed to carry out both audit and non-audit professional services in a client organization.

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