

# Audit Practice in Global Perspective: Present And Future Challenges

AbdulFattah AbdulGaniyy

Department of Accountancy, The Federal Polytechnic, Kaura Namoda, Nigeria.

\* E-mail of the corresponding author: [abuaishah1425@yahoo.com](mailto:abuaishah1425@yahoo.com)

## Abstract

This paper discusses the history of audit and its development particularly Enron and Worldcom scandals as some of the audit failures that increased the challenges of auditing firms to remain unbiased and independent of their clients. Secondary data was used to review the existing literature on the subject. Descriptive method was used to present the changes that occurred in the historical development of auditing. It traces the evolution of audit into a field of fraud detection and financial accountability to the advent of Industrial Revolution of 1750 to 1850 and states that as business increased in complexity, risk-based auditing makes auditing more efficient and economical than before. It highlights the global developments in audits. The author posits that as business environment gets more globalised and complex, auditing would be more challenging and the quality of the professionals involved in audit would be very important in maintaining audit quality.

**Keywords:** Audit, Auditing, Historical Development, Audit Challenges, Accountants, Professionals.

## 1 Introduction

Audits are performed to manage and confirm the correctness of a company's accounting procedures. Auditing evolved as a business necessity once it became evident that a standardized form of accountancy must exist to avoid fraud. It has developed into a standardized yet complex field that is regarded as an important procedure in the management of business finance.

This paper discusses the history, development and future of audit. It is divided into seven sections. Section one introduces the topic by highlighting major audit failures in recent times. The historical development of audit at the global level and the Nigerian experience are discussed in section two. Sections three to five discuss the current audit practices while the major challenges of auditing were highlighted in section six. Section seven concludes the paper with an emphasis that though auditing as a profession is currently facing a lot of challenges but these are not insurmountable provided ethics of the profession is strictly adhered to and auditors are truly independent of their clients.

## 2 Historical Development of Auditing

The collapse in the US of Enron and Worldcom, together with their auditors, Arthur Andersen, has focused the public spotlight on the company audit and made it a highly controversial aspect of the accountant's work. In Britain, the recent legal action by Equitable Life against Ernst and Young is only the latest in a long line of scandals at BCCI, Maxwell, and the Barings bank, among many others. A History of Auditing for the first time lifts the lid off the work of the auditors, and details how historically they have got themselves into the present situation. The resulting history traces the evolution of the auditing process from its leisurely Victorian beginnings where armies of clerks checked and ticked everything in their client's books, to the transformation in the 1960s when, with the growing scale of clients auditing became more a matter of checking a client's systems rather than the records themselves. The changes in the 1980s are also documented when because of the growing pressure on audit fees from clients meeting the threat of global competition; auditors began to put their faith in such nebulous techniques as risk assessment. Alongside all these changes auditors also had to cope with the advent of computerization which robbed them of the audit trail. (Derek, 2006)

According to Tanko (2011), auditing has its history to a large extent determined by the history of accounting, as the latter metamorphosed and culminated with the development of the world economy. Salehi (2008) observed that although ancient cultures of Mesopotamia, Egypt, Greece and Italy show evidences of highly developed economic systems, yet the economic fact during these periods were limited to the recording of single transactions. The knowledge of support system for the maximization of profit and the exposition of bookkeeping, as a support mechanism for the determination of profit or wealth, were very unpopular. With the emergence of large merchant houses in Italy and some other places in the world, the attitude of profit maximization emerged at the end of the middle ages, thereby shifting the domain of trading from the individual commercial travellers to the stable and more comfortable house merchants, which now is coordinated centrally at the luxurious desks of the large merchant houses in most parts of the world. According to Salehi (2008), entering merely one aspect of the transaction paved the way for heavy embezzlement of cash, which was found difficult to trace in the ordinary

course of business. Therefore, the system of double entry bookkeeping was first proposed and described by an Italian as a way of correcting the anomaly. Monk Luca Pacioli in his book *Summa de Arithmetica, Geometria, Proportioni et Proportionalita*, dated 20 November 1494 first introduced the system of double entry as a way of reducing the incidence of corrupt practices that was easier with the single entry. The introduction of the double-entry, coupled with the industrial revolution in Great Britain around 1780 led to the emergence of large industrial companies with complex bureaucratic structures, in other words the development of the capitalist economic system.

Auditing existed primarily as a method to maintain governmental accountancy, and record-keeping was its mainstay.

At the advent of the Industrial Revolution, from 1750 to 1850, that auditing began its evolution into a field of fraud detection and financial accountability (Gupta, 2004).

### **3.0 Professionalization of Audit Practice.**

In the early 20th century, the reporting practice of auditors, which involved submitting reports of their duties and findings, was standardized as the "Independent Auditor's Report." The increase in demand for auditors led to the development of the testing process. Auditors developed a way to strategically select key cases as representative of the company's overall performance. This was an affordable alternative to examining every case in detail, and it required less time than the standard audit (Hasyudeen, 2009).

Capitalism, as a system of economy designed to allocate resources using market mechanism has characterized modern industrial economies of today (Watts and Zimmerman 1983). It further developed the economic system to the extent that there were needs for external financing to support the unprecedented economic growth. Lee (2009) observed that the paradigm shift in the structure of business corporations over the four centuries necessitated the mobilization of financial resources from increasingly large numbers of small investors through the financial markets and credit granting by financial institutions. Therefore, the need to look for external funds in order to finance further expansion coupled with the divorce between ownership and management gained importance in such an economic system. This resulted to the growth in sophisticated securities markets and credit-granting institutions serving the financial needs of large national and increasingly international corporations. The flow of investor funds to the corporations and the whole process of allocation of financial resources through the securities markets became dependent to a very large extent on reports made by management.

The organisations' management has control over the accounting systems of the organisation and is not only responsible for the financial reports to investors, the owners of the organisations, but also has the authority to determine the precise nature of the representations that go into the reports. Chukwunedu (2009) opined that, it is the responsibility of the management of the organisation that is vested with the preparation and presentation of the financial statement of the organisation to the stakeholders, which may need such information to guide them in their decision making. To increase the confidence of investors and creditors in financial statements, they are provided with an independent and expert opinion on the fairness of the reports. This expert opinion was initially provided by one or more stockholders, who were designated by the other stockholders to perform the task as representatives of the rest of the stockholders.

This mark the beginning of the auditing profession as it quickly emerged to meet market needs for their services. It became necessary that legislation was soon required to permit persons other than stockholders to perform the audits, giving rise to the formation of auditing firms. These developments resulted in demand for the services of specialists in bookkeeping and in auditing. Thus the institutionalization of audit as a profession was then merely a matter of time. According to Rostami (2009), it is the auditor that authenticates the correctness of financial information that is passed to the end users, and he does that based on his professional code of ethics and regulation. Therefore, auditors occupy the central role in bridging the communication gap between the management of an enterprise, and the end-users of the published financial reports. In a nutshell we cannot underestimate the importance of reliable information prepared by the organizations management, certified by the external auditor that is given to the user's of the financial statement

Prior to independence in 1960, audit practice in Nigeria followed the British style; the early accountants in the country were British trained. All the pre-independence Company Ordinances in Nigeria only placed statutory demand on Companies to appoint auditors but did not provide for the qualification of auditors to relate to any professional body of accountants. This was obviously due to lack of any professional accounting body during that period. Consequently, it was not all the auditors in the country at that time that was even British qualified professional accountants. However the proportion of those that were qualified by the British standard, being chartered accountants (either of England and Wales or Scotland) was very popular

Immediately after independence, the idea of establishing a professional body of accountants for regulation of accounting and audit practices became an issue. The British trained accountants coordinated their effort together and formed The Association of Accountants in Nigeria (AAN) which was incorporated in 1960 (Ajayi, 1997).

In 1965, the Association's effort to obtain statutory recognition was achieved when the Institute of Chartered Accountants (ICAN, 1965) was established by an Act Parliament (No. 15) with 250 members. By May 2011, it has 32,722 members both within and outside Nigeria. Until 1993, only the members of the Institute were entitled to practice as accountants and statutory auditors in the country.

The Association of National Accountants (ANAN) was formed in 1979 and incorporated in September, 1983. By December 2010, its membership had grown to 16,207 (ANAN, 2008). These two bodies ICAN and ANAN are now charged with the regulation of audit practice in Nigeria.

### 1.1.2 Heading 3

#### 3.1 Features of Audit Practice

Auditing is a branch of financial management concerned with assessing the internal financial status of a business. Audits are evaluations of the financial capability of a company.

Companies prepare financial statements of their activities, which represent their overall performance. These financial statements are evaluated by auditors, who assess them according to the industry's generally accepted standards. They are examined for accuracy and fairness in their reporting.

Companies are expected to pass their audits, as the results are very important to the company's reputation and success. Audits are very valuable to external company affiliates, such as shareholders and investors, because they provide an extra reassurance of their choice in investments when issues arise.

Auditing standards differed between America and Britain. American audits continued to evolve away from being solely a method of detecting errors and fraud, while Britain kept this as its main function (Derek, 2006).

Testing is now the industry standard for performing audits. It is only when gross errors and fraudulent activities are discovered that detailed audits are performed.

Audits have also commanded the need to establish preventive measures of monitoring the financial activities within a business to lessen the need for frequent audits and to provide simplified follow-ups, should the need for an audit arise.

Now, both in America and Great Britain, audits are a standard way of providing a monitoring of a business's financial integrity. Fair reporting practices are used to analyze their financial statements.

Audits provide feedback on a company's financial information and reporting, as well as an analysis of any fraudulent activity, potential and actual.

External audit thus rely on internal audit if it is established that a sound internal control system is available.

As business increased in complexity, risk-based auditing arose to make auditing more efficient and economical than before. Risk-based auditing actually assesses the need for an audit, based on the information in the financial statements. If many discrepancies are discovered, then it is decided to perform an audit of its financial activities.

#### 3.2 Fundamental Principles of Independent Auditing

The Auditors' Code, published by Auditing Practice Board (APB), prescribes nine fundamental principles of independent auditing, among these are:

(a) **Accountability:** Auditors act in the interests of primary stakeholders, whilst having regard to the wider public interest.

The identity of primary stakeholders is determined by reference to the statute or agreement requiring an audit: in the case of companies, the primary stakeholders are the general body of investors.

(b) **Integrity:** Auditors should act with integrity, discharging their responsibilities with honesty, fairness and truthfulness. Integrity helps to insulate auditors from matters of conflict of interests and elevate their objectivity. Confidential information obtained in the course of the audit is disclosed only when required in the public interest, or by operation of law.

(c) **Objectivity and Independence:** Auditors should be seen to be objective in all their dealings with their clients. They express opinions independent of the entity and its directors.

Important elements in determining the performance and quality of audit services include: The auditors, the firms, the legislative framework, and standards relating to auditing.

The auditors should uphold professional values and standards, Integrity, Objectivity, Due Care, and Independence. He should possess updated knowledge regarding auditing standards, accounting standards and Industry knowledge and experience and Legislative framework.

In addition the auditor should have the necessary skills which need to be applied in performing the audit. This includes Global business environment, Web based business environment and skills to apply principle-based standards.

The firms should put in place framework, processes and procedures to comply with auditing and quality control standards as well as the applicable legislative framework, uphold professional values and standards and have the capacity to accept audit engagements before doing so.

The legislative framework includes, among others, the followings: Financial Reporting Standards Companies And Allied Matter Act (CAMA), Banks and Other Financial Institution Decree(BOFID) and Nigeria Accounting Standard Board (NASB), now Financial Reporting Council of Nigeria (FRCN).

#### **4.0 Global development**

The International Auditing and Assurance Standards Board (IAASB) is an independent standard-setting body that serves the public interest by setting high-quality international standards for auditing, quality control, review, other assurance, and related services, and by facilitating the convergence of international and national standards. In doing so, the IAASB enhances the quality and uniformity of practice throughout the world and strengthens public confidence in the global auditing and assurance profession. ([www.ifac.org/iaasb](http://www.ifac.org/iaasb), 2011). Convergence of auditing standards is part of the International Federation of Accountants (IFAC) agenda.

There was a proposed revision of standards on Review Engagements. This is to provide alternative in jurisdiction where audit for small companies are not mandatory. In response to the call for a separate auditing standards for Small and Medium Enterprises (SMEs), the IAASB recently issued an Audit Practice Alert regarding the audit of fair value accounting estimates under the current situation in the market where the level of uncertainty is very high.

International Forum of Independent Audit Regulators (IFIAR) serves the protection of public interest through enhancement of audit quality. The body shares knowledge of audit market environment and practical experience of independent audit regulatory activity. It provides the contact point for other international bodies which have interest on audit quality ([www.ifiar.org](http://www.ifiar.org),2011).

It is now a global expectation that auditors of public interest entities are regulated by a body which is independent from the accounting profession. The acceptance of International Financial Reporting Standard ( IFRS ) in Nigeria is expected to enhance not only the quality of financial statements but also the audit such statements.

#### **4.1 The Enron Scandal**

The case of Enron Scandal was revealed in October 2001.It led to the bankruptcy of Enron Corporation an American energy Company based in Houston, Texas which was formed in 1985.This scandal also led to the dissolution of Arthur Andersen, one of the five largest audit and accountancy partnerships in the world. It is attributed as the biggest audit failure. Shareholders lost nearly \$11 billion (share price fell from \$90 to \$1). (Wikipedia, 2011) Arthur Andersen was found guilty by a US District court. Although the US Supreme court overturned the ruling, the firms had already lost most of its clients.Consequent upon this case, the United States promulgated the Sarbanes- Oxley Act which increased the accountability of auditing firms to remain unbiased and independent of their clients.

WorldCom is another case of failed corporate governance, accounting abuses and outright greed. The company was created in 1983 by Bernie Ebbers. By 1999 WorldCom's share traded at \$64 and competed with AT &T. By 2002 the WorldCom was declared the largest American's bankruptcy.(Wikipedia,2011)

In Nigeria, Cadbury Nigeria Plc represents Nigeria's Enron (Cadbury,2006). Messrs Bunmi Oni and Ayo Akadiriri ended their long years of service at Cadbury in disgrace. The duo were involved in overstatement of accounts and deliberate manipulation of finances.

#### **5.0 Audit Challenges**

In this new millennium Audit Professionals face both opportunities and challenges that will keep auditing a challenging career and an excellent training ground for corporate executives.

Welch(2011) summarized the challenges and opportunities in the following:

Doing More with Less

Effective Usage of Both Internal and External Resources

Creating the Integrated Auditor

Adapting to New Organizational Environments

"Tuning In" on an Organization's Strategic Relationships

Auditing in a Highly Automated Environment

Effectively Usage of Automation to Audit

Addressing Management Concerns with the Cost and Other Effects of Fraud

## Finding New Tools to Meet the Audit Challenge Meeting the Challenges Created by the New Economy

Beasley, Carcello and Hermanson (2001) also discussed some challenges of auditors. Among these include:

1. Gathering sufficient audit evidence.
2. Exercising due professional care.
3. Demonstrating appropriate level of professional skepticism.
4. Interpreting or applying requirements of Generally Accepted Audit Practice (GAAP).
5. Designing audit programs and planning engagement (inherent risk issues, non-routine transactions).

Everywhere users of audit reports are asking the question ‘**Are good accountants bad auditors?**’ (Onwukwe,2012). The challenge is for auditors to be independent of their clients and imbibe the letter and spirit of independent auditors earlier enumerated i.e. integrity, accountability and objectivity.

Auditors in the 21<sup>st</sup> century will also face challenges in terms of professional training and development. There is inadequate infrastructural facilities to produce the required quality and number of accountants and auditors that meet today’s industrial and government needs. Ethical standard and professional competence are required for the auditors to gain the confidence of the public.

### 6.0 Conclusion

The expectation on the quality of audit would remain high in view of the interest of the investors on the audited financial statement. Audit quality goes beyond the competency of individual auditor but depends on the capacity and professional values adopted by the auditing firms

As the business environment gets more globalised and complex, auditing would be more challenging and the quality of the people involved in audit would be very important to maintain audit quality

External agencies outside the accounting profession would be more involved in the audit quality issues.

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