HOW LIMITED FINANCIAL STRUCTURE CATALYZES FRAUD AND ABUSE IN AN EMERGING NATION: NIGERIAN PERSPECTIVE

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ABSTRACT
Societies that empower their institutions with strong financial structural frameworks could be laying solid foundation for growth and development, and the system can checkmate misappropriations and frauds through adequate reporting. In emerging nations, where financial structures and enforcement mechanisms have been reported weak, there is the need to examine factors responsible. This paper takes steps towards investigating how limited commitments to financial reporting structure prompt fraud in both the public and private sectors. Based on insightful review of literature, a conceptual analysis is presented. Building upon limited enforcement capacity, limited financial reporting structure, lack of standard audit system, the study suggests a paradigm shift to dimensions of financial structures that can correct the reported anomalies. The study concludes that strong government commitments and consistency on agreed policies, regulatory capacity, compliance, training professionals, responsible and standard audit, and enforcement mechanisms can help avert endemic frauds in the Nigerian society with high potentials to grow and develop. Although several studies on frauds and financial misappropriation have been performed separately in either the public or the private sector, this paper is original in its focus on mixing both. The study idea believes both sectors mutually complement one another, hence the need to strengthen financial structural framework. The knowledge added in this concept paper will enhance the capacity of market participants, and reduce conflicts of interests of agencies responsible. The paper lays the foundation for institutions to be placed on an appropriate and efficient financial and legal standpoint, with strong institutional foundation upon which Nigerian financial system can rely in establishing effective contractual agreements so that the nation can be in its right place in the comity of nations.

Keywords: Fraud, Financial Structure, Limited Commitments, Audit Standards, Institutions.
1.0 Introduction

According to the estimates of post 2006 census, Nigeria has a population in excess of 170 million, out of which more than 70% live below poverty line. This is unacceptable in a country producing about 2.5 million barrels of crude oil per day, and with large fertile agricultural lands and several mineral resources. Most reports blame the anomaly to weak reporting, lack of continuity, consistency, responsible audit and limited commitment to agreed policies, which prompt financial fraud and abuse in the public and private sectors. In addition, due to lack of reliable and adequate financial statements, Nigerian economy shows growth and development only on paper without a concomitant improvement in the overall welfare of citizens. There is the urgent need to examine factors responsible and suggest ways to correct these flaws that result in systemic frauds and abuse. Thus, it is obvious that the current financial crisis poses many challenges to all nations, developed or emerging. The need to strengthen financial integrity, disclosure and transparency in national financial systems cannot be over emphasized. It is therefore necessary to have in place strong financial oversight mechanisms to ensure judicious utilization of resources for citizens and corporate owners of wealth.

Unfortunately, it has been the norm for leaders on oath to design avenues of stashing their national resources hitherto entrusted in their custody to safeguard, and use financial institutions in the developed countries as conduit pipes to lauder stolen funds. Using advanced technological tools, such huge syndicated financial crimes continue to evolve in different and complex modus operandi, which results in poor infrastructure and compounding multiplier effect harm on the smooth functioning of the financial stability and economic development of developing nations. To checkmate, literature bounds that throughout history there have been some form of regulations, with acceptable codes of conduct for human societies through an established system, and with enforcement structure to monitor compliance and correct deterrence. Since the creation of mankind, ancient and contemporary rules and regulations have been aimed at building discipline and enhancing stability characterized by faith, justice, accountability and transparency. However, violations of the rules were faced with applicable punishments enforced as specified either in divine scriptures, man-made laws or conventional norms to serve as corrective measures. For example, Chapra & Ahmed (2002) state that in the heydays of Muslims civilization, mutual trust and confidence were supported by high moral values and cooperative spirit that encourage self-enforcement.

Notwithstanding, it is alarming to note that even in the 21st century, developed nation such as United States of America, reports indicate that fraud is growing at an astounding rate (Zack, 2003). In its 2002 report, Association of Certified Fraud Examiners (ACFE) estimated that occupational fraud and abuse results in $600 billion per year losses, which construe into baffling $4,500 per employee lost to fraud. In a similar report, the IMF estimated more than $800 billion of money laundered each year globally. Examples of large and hitherto well-respected organizations involved in such crimes
are: Goodwill Industries, United Way, Episcopal Church, and Baptist Foundation of Arizona among several others (Zack, 2003). Other studies such as Dewing and Russell (2008) examine the Financial Services Authority (FSA) in the UK with the use of content analysis. They also interviewed high-level individuals in the financial services industry and by way of illustrations analyzed the outcome of FSA enforcement actions against individuals involved in frauds. Similarly, Stein (2008) examines the regulatory reform of US Sarbanexe-Oxley to normalize the behavior of managers and accountants. Specific and recent fraud cases in Nigeria include $6 billion fuel subsidy fraud, $12.5 million pension funds etc. According to a global audit and financial advisory firm, KPMG, Nigeria is rated as the most fraudulent in Africa with 503 cases in the first half of 2012.

On these interests, the prevailing reported cases of unethical practices in the public sector and corporate entities, attributable to poor reporting framework and weak enforcement, call for immediate action. Hence, country regulators, multilateral organizations and professional bodies seek methods of checkmating the ugly menace of fraud and abuse to redeem back already lost public trust and image. Hence, regulations through legislations, supervisions to comply with standards are being extended to address prevailing threats. On the other hand however, due to the inconsistent approach to assessment of effectiveness and impacts of such standards, recommendations now suggest risk approach, which is the risk management process for dealing with frauds that begins with recognizing the existence of risks, undertaking an assessment of the risks, and developing strategies to manage and mitigate the identified risks. Standards on specific issues of money laundering and terrorism financing through the use financial institutions services are being reviewed in the Financial Action Task Force (FATF) 40-49 Recommendations, where among others, several policy goals and initiatives for combating corruption, and addressing proliferation financing more effectively, are being thoroughly discussed and deliberated. A major development in the review of the standards, that is relevant to the industry, is the higher emphasis that will be placed on assessing the effectiveness of measures implemented to counter the risks of money laundering and terrorist financing, rather than merely looking at technical compliance.

Therefore, it is high time to have quality financial reporting, strengthen the regulatory structure, train personnel, standard professional audit, effective monitoring and technical compliance and enhance enforcement of rules. This can be achieved by reviewing existing regulations and codes, enacting new laws and new regulations, and instituting more proactive steps to strengthening compliance with accounting and governance rules (Okereke, 2007). Though countries may differ in establishing their corporate statutory frameworks, the general pattern has been the government regulations and professional bodies’ regulations. Lack of functional framework to manage wealth continues to plague and descend emerging nations like Nigeria into degeneration of less privileged position in the comity of nations.
2.0 Fraud in Accounting and Auditing Practices in Nigeria

Financial reporting has been described by Rosenfield (2006) as a two-party transaction, in which the issuers of a financial report, who control its preparation (Directors, Management etc.), provide it to the users of the report (Investors, Regulatory bodies etc.), who use it in the hope that the financial report will help improve their financial decisions about the reporting entity as a whole. These reports or financial statements are formal records of financial activities of corporate entities showing their actual financial condition for a stipulated period of time and expected to comply with regulatory and professional requirements. The need to report information to those outside the organization is substantial in magnitude. For example, the principals (owners of resources) rely on the agents (managers of resources) to convey information on the state of affairs in the organization. A common feature of financial reports is that they must conform to certain statutory requirements and to the stipulated accounting standards. Thus, compliance with the reporting standards aids the information system to have a useful output, thereby facilitating understandable, relevant, reliable, timely and accurate financial information, which discloses the economic resources and obligations of the business organization.

Over the years, with the shift towards deregulated free market system by national governments, and with the advent of technological development, business activities became internationalized and capital became a global commodity that can be sourced and traded in coordinated, on-line, real-time, interconnected stock exchange markets across the globe, which reduces the entire world to one global financial village. Prior to these developments, Okereke (2007) stated that, what obtained all over the world were country specific versions of the Generally Accepted Accounting Principles (GAAP), which were based on cultural, legal, economic and regulatory peculiarities of the countries. In a post-Enron economy, the American people are afraid that huge corporate entities that once promised secure employment and investments are hollow at the core (Quindlen, 2002), characterized by shareholder deception and supine boards. This is accompanied by the largest bankruptcy thus far in the U.S., for example, most recently, 2008-09 financial crises, Lehman Brothers, AIA etc. According to Lynn Turner, former chief accountant for the America’s SEC and now a Professor at Colorado State University, “In the past half dozen years, investors have lost close to $200 billion in earnings restatements and lost market capitalization following audit failures. And the pace seems to be accelerating. He mentioned that between 1997 and 2000, the number of restatements jumped 100%, from 116 to 233.

Similarly, Rhody (2004) reports that, ‘As someone with over 40 years invested in laboring in corporate vineyards of American capitalism, I am disgusted. I am absolutely disgusted at the corporate spectacle of greed and irresponsibility that seems to be endemic at the most senior level of so many Americas’ major corporations: Enron, HealthSouth, WorldCom, Adelphia, Tyco …. Thirty-eight criminal indictments! Just among the five of them! And all the indictments aren’t in yet.” In this
regard, the wave of corporate scandals that have rocked the business world in the last few years, and the incredible damage scandals have inflicted upon the credibility and reputation of governments and professionals really calls for Rhody’s kind of disgust. An opinion poll was conducted in 2003 by Gallup Organization measuring the honesty and ethics of business professions - business executives scored a lowly 25 percent. Accountants fared a little better at 41 percent. The poll empirically reveals a severe damage to business by the spate of scandals which have shaken the corporate world to its very foundation, and this question of reform is on everybody’s lips. Could these be as a result of inappropriate weak financial reporting and auditing standards applicable for government and financial institutions? Could more government intervention and professional body regulations help avert these scandals?

The problem of corruption in Nigeria and its influence on accounting and auditing practices can be traced to the various changes in its socio-political and economic environment. According to Okike (1994), Nigeria’s transformation and changes include experimentation with different styles of government, different economic experiences and changing fortunes of the people. This transformation within the Nigerian economy has significantly influenced the accounting profession in many respects. However, Mauro (1995) and Kimbro (2002) provide evidence that countries that grow at a very rapid pace tend to be more corrupt than those that grow moderately. In the case of Nigeria, Okike (1994) reports that, with changed fortunes from cash crop economy to crude oil based, Nigeria became a country of rapid economic development to the extent that every sector of the economy was a possible target for growth and development. Such rapid development, observes (Kimbro, 2002) creates opportunities for excessive rents, since fast growth does not allow countries to establish control mechanisms and infrastructure to deal with changes created by wealth.

But is it the professional duty of accountants to expose corruption? Opinion is divided even amongst members of the profession. Whilst accountants have the duty to maintain the confidentiality of information relating to their clients, Gruner (1999) opines that “confidentiality is not absolute”. There are situations where legal or professional requirements could override that responsibility, in that accountants might be obliged to report findings and even suspicions to some particular regulatory bodies. But there is the issue of what kind of legal and governance frameworks exist to protect accountants. Gruner (1999) further states that, accountants who expose corruption can suffer such untoward consequences as legal problems, loss of job, loss of client, loss of reputation and perhaps, in most extreme circumstances, loss of life. There are suspicions that some professionals have been victimized, and even murdered for discharging their duties. Such environmental consequences accountants and auditors have to contend with in Nigeria. Therefore, the assertion that the inability of members of the accounting and auditing profession to tackle the problem of corruption is associated with cultural factors has been confirmed by (Wallace, 1992; Okike, 1994 and Kimbro, 2002) due to insecure environment.
Similarly, (Wallace, 1990) assert that, it would appear that internal and external auditors are powerless in dealing with the situation because internal monitoring systems are weak. He further confirmed that, some auditors have been assassinated after it had become evident that they had unearthed the ugly truth regarding massive fraud in their client companies. Although it is possible for the accounting profession in the country to equip its members to be in a better position to address this endemic problem, it would no doubt be an uphill task without the cooperation of all stakeholders particularly the regulatory authorities. Perhaps, the recommendations of the World Bank team in 2004, which suggests improving the statutory framework of accounting and auditing to protect the public interest, could serve as a benchmark towards alleviating the menace.

Supporting this assertion, the former Permanent Secretary, Federal Ministry of Commerce, Janet Ogunleye, identified the Nigerian Accounting Standard Board (NASB) as a partner in progress in the battle to rid the nation of corruption and to make the Nigerian business environment more attractive to investors. She further stated that the federal government's war against corruption will remain a pipe dream unless proper attention is paid to monitoring and enforcements of compliance with accounting standards by individuals and corporate bodies.

3.0 The state of Professional Education, Training and Ethics

In Nigeria, two professional bodies, Institute of Chartered Accountants of Nigeria ICAN and Association of National Accountants of Nigeria ANAN are conferred with the right to determine the standard of knowledge and skill to be attained by persons seeking to become members of the accountancy profession and raising those standards from time to time as circumstances may permit. A registered auditor must have acquired higher education, obtained practical experiences in an audit environment and passed either the ICAN or ANAN examinations. The main professional entry requirement of ICAN is in line with International Federation of Accountants (IFAC). The syllabus is reviewed every five years in order to ensure timely changes that reflect amendments to the International Education Standards. However, World Bank (2004) reports that the information technology content is still deficient. The report further stated that, since the late 1980s, lack of investment in education, low quality of educators, and diminution in the value system at tertiary institutions have adversely affected the quality of education. However, most educators have neither professional qualifications nor necessary practical experience. And worst still, unavailability of affordable, up-to-date learning materials further hampers education.

In pursuance of the principle of consistency in training of their members, both ICAN and ANAN have a program of Mandatory Continuing Professional Education (MCPE) to ensure that members keep abreast of the developments within the profession and in the current dynamic reporting environment in commerce, industry, public practice and government. Okike (2004) observes that, attendance at the MCPE seminars was poor due to its voluntary nature but as a result of the crisis of
confidence, it was later made mandatory. Nevertheless, a column in the July edition of ‘The Nigerian Accountant’ (2006) reports that some members of the institute do not comply with the mandatory MCPE requirements, hence ICAN members are expected to accumulate 60 credit hours of continuing professional education in two years, with at least 50 percent through structured programs. In its reforms, ICAN now updates members with international developments in accounting and auditing.

The two bodies have an established code of ethics to guide the conduct of its members. ICAN cautions that, judging from the public statements about the profession, the need for all members of the profession to be meticulous in keeping to both the letter and spirit of the code cannot be over-emphasized. Similarly, The Nigerian Accountant Journal of October, 2011 reports the President of ICAN as saying a body founded on the virtues of integrity and accuracy, it is important to have a high standard of conduct which must be adequate, comprehensive and pace-setting. Furthermore, a panel of investigations was established constituting of three members to monitor and probe any allegation against members of the profession for appropriate actions to be taken. Though the professional bodies have taken strong stance in the discipline of its erring members, there appears to be complaints of various acts of misconduct by its members. The registrar and chief executive of ICAN was quoted and as seen in (Okike, 2004) that, “Members take the implications of their non-compliance with the codes too lightly. In particular, members in public practice do not seem to take the legitimate interests of other members into consideration. Audit jobs are accepted without any recourse to the members being removed or ensuring that such removal is in accordance with provisions of the Companies and Allied Matters Act 1990.” He further stated that, “There have also been reports bordering on integrity against members in employment in both the public and private sectors.” With the investigating panel in place, proven cases of misconduct against erring members can easily be detected and punitive actions taken to serve as deterrent. Alternatively, preventive measures towards a scandal-free practice are better assured if potential members are groomed from a study that institute ethical courses in its syllabus. In this respect, World Bank (2004) reports that, educational institutions in Nigeria do not teach professional values and ethics as separate subjects in pre-qualification academic educational programs. Consequently, there is a perception in Nigeria that some professional accountants ignore ethical dimensions and conflicts and do not comply with the Code of Conduct.

3.1 Professionalism factor

It is self evident that the level of professional expertise, both within the professional accountancy body and in the wider community, is an essential factor to enable the status of the profession in the country to be of recognized standard. Taylor (1987) explicitly recognizes this point when he argues that the existence of international accounting firms has clear implications for the form and content of IFRS. This is an essential element to the success of the strong enforcement process. Therefore, while financial reporting procedures may be applied at a national level, many large
accounting firms operate on an international basis, using standard procedures and common stationery, and sharing training programs internationally. These multinational accounting firms are likely to have a comparative advantage over smaller, nationally based firms in respect of the knowledge and skills required to prepare financial data in conformity with the IFRS. This comparative advantage will be greater in countries that prepared their local accounting standards based on IAS (for example, Nigeria) and will be greatest in countries that do not have their own reporting systems, but that adopt IAS. World Bank (2004) reports that 90% of Nigerian listed companies employ the services of big four audit firms in auditing their financial statements.

3.2 Type of Auditor

The audit firm of a company can influence significantly the compliance in the annual report to reduce the agency costs borne by principals and agents (Watts and Zimmerman, 1986). This might be based on the arguments that companies audited by big 4 firms have substantial agency costs, and try to reduce them by contracting with these auditing firms. It follows that when agency costs are greater there is increased demand for higher level audit quality (Francis and Wilson, 1988). This might have implication for the enforcement of accounting standards as high level of compliance with IFRS reduces monitoring costs by the regulatory enforcement bodies, thus making enforcement mechanisms more effective. On the other hand, the choice of an external auditor can serve as a signal of firm value (Morris, 1987). Also, entrepreneurs are likely to choose a big-4 audit firm, since such an action signals to investors the expectation of high cash flow. Thus, the selection of an auditor is a signal to the market about quality of a firm’s accounting practices.

Similarly, Fama and Jensen (1983) suggest that large independent firms have a competitive advantage over small audit firms in reporting misstatement and non-compliance with mandatory reporting rules. Since large independent audit firms have many clients, their economic dependency on a particular client is minimal. Thus, large independent audit firms have greater incentives to maintain independence from their clients. Hence, they are more likely to report any misstatement and errors, and to ensure compliance by their clients with statutory and regulatory reporting rules than small independent audit firms. Consequently, large independent audit firms have greater incentives to resist client pressures for lax application of auditing and accounting standards. The rational for this, is that large audit firms have high reputation capital at stake. According to Watts and Zimmerman (1986), independence is a necessary condition for an auditor’s reputation. Consequently, by forcing their clients to apply stringent accounting standards, large audit firms prove they are independent and thus strengthen their audit reputation (Dumontier and Raffournier, 1998).

However, smaller audit firms are often sensitive to client demands because of the economic consequences associated with the loss of a client (Dumontier and Raffournier, 1998). It seems more likely that big audit firms that are less dependent on one or a few clients are more likely than small
audit firms to suggest more compliance in the annual reports of their client firms and thus more effective enforcement of the standards by the relevant regulatory bodies. In addition, audit firms are likely to accede more frequently to advice given by big audit firms than those given by small audit firms.

Empirical support for the agency theory prediction that accounting and reporting practices are related to audit firms are contradictory. Raffournier (1995) and Inchausti (1997) provide some evidence of positive relationship between sound accounting practice and the type of auditor. Al-Basteki (1995) provide evidence of significant positive relationship between being audited by a big 5 firm and compliance with IASB practices. Adversely, Wallace (1990), Naser (1998) and Owusu-Ansah (1998) provide no evidence of this association.

Currently, all the big 4 international audit firms have their presence in Nigeria. 90% of the listed companies in Nigeria are being audited by one of the big 4 audit firms (World Bank, 2004). The apparent lack of bonding with clients would enable these firms to demand greater degree of compliance with the local SAS that are based on IFRS in the annual reports of their clients probably due to superior training of their employees. In addition, due to problems associated with the education and training on SAS that are based IFRS and the local audit profession in general as reported by World Bank (2004) and Okike (2004), it might be expected that international audit firms (as a proxy of high professionalism) operating in Nigeria would be more familiar with IFRS leading to an expectation that Nigerian companies audited by one of the international firms will comply more closely with SAS and thus facilitate more effective enforcement of the standards by the relevant regulatory bodies.

3.3 Weak Governance Mechanism

Despite its huge resources being one of the 10th largest oil producers in the world, Nigeria lacks the ability to manage wealth by effectively developing and encouraging indigenous and foreign investments. This inability has a direct relationship with the need for efficient corporate governance strategy for sustainable development. Hence, the inadequacy of effective corporate governance in Nigeria has worked to the detriment of shareholders and created a class of stakeholders who have lost interest in the system (Oyejide and Soyibo, 2001). In other words, the corporate governance culture in Nigeria is not rooted enough to be responsible to contractual stakeholders, accountable to the shareholders and has no operative mechanism adequate to maintain a balance among the major market participants, such as board of directors, shareholders, and management.

The academic researches on corporate governance in Nigeria have identified institutional, legal and capacity upgrade as critical importance to the development of corporate governance. Based on the conventional Anglo-American system commonly practiced in UK, and US and adopted by
Nigeria, board members (executive and independent) are elected by the shareholders. As a fiduciary duty, the board places higher premium on the shareholders to safeguard and encourage flow of investments. In spite of that, Oyejide and Soyibo (2001) report that in Nigeria board members are not independent and not necessary legally bound to place higher values on shareholders’ interests nor protect the business interests, let alone the interests of other stakeholders. In addition, they mention that checks and balances are compromised because CEOs are usually board chairpersons.


From the list of regulations stated above, only two; the ICAN Act (1965) and the ANAN Act (1993) are regulations set by the two professional auditing bodies in Nigeria. The remaining are government legislative enactments and administrative regulations. The Nigerian legislations derive their roots from the UK as an extension of the influence of the British colonial inheritance for nearly hundred years. The disappointing failure of the Nigerian Companies Act of 1968 to deal with the rapid economic and commercial developments of the country and to address the peculiar Nigerian Company Law problems led to the enactment of CAMA 1990. World Bank (2004) reports that, the Companies and Allied Matters Act (CAMA) 1990 is the main legal framework for corporate practices in Nigeria. It has voluminous provisions that include requirements for auditing, governance, disclosures, and preparation and publication of financial statements. It also provides for the Registrars of Companies at the Corporate Affairs Commission to monitor compliance with these requirements and specifies penalties (although outdated) for companies and their officers in cases of non-compliance. The auditor is liable for negligence if, because of failing to discharge the fiduciary duty properly, the company suffers loss or damage.

The Securities and Exchange Commission (SEC) regulates securities market participants under the Investments and Securities Act of 1999 and the SEC rules and regulations (2005). The Nigerian Stock Exchange, a self-regulating organization established by the NSE Act 1961, supports the SEC, supervises the securities market operations, and regulates second-tier capital market. Occasionally, there are conflicts between the SEC and the NSE with respect to the authority to discipline erring companies; there is a need therefore to review relevant legislation to clarify roles and powers. As a matter of rule, audited financial statements must be filed with the SEC, Stock Exchange,
and the Corporate Affairs Commission and be approved by the Stock Exchange before publication in newspapers within three months after the year-end. The Investments and Securities Act requires every market participants to maintain accurate and adequate records of its affairs and transactions, but it does not specify the standards to follow in preparation of financial statements, as companies have to comply with CAMA 1990 requirements and follow the local SAS set by NASB. This multiplicity of laws may sometimes create a tug of war among the regulatory agencies especially CBN and SEC.

However, World Bank (2004) reports that, despite the efforts made to minimize inconsistencies among the provisions of these laws, they have led to a situation where several bodies review and approve the audited financial statements of some companies before they are published. In some cases, the regulators have differed in their assessments of their quality of financial statements. There is the need, therefore, to harmonize regulatory arrangements, and codify them as a separate law. This task is likely to be addressed by the establishment of the financial reporting council (FRC), which has already been debated by the national assembly and the President assented. It is left to the council to establish an effective framework, with the mechanisms to improve the existing flaws in the polity.

### 3.5 Limited Enforcement Commitments

The subject of enforcement has attracted increased attention in recent years. Berglof & Claessens (2004) opine that enforcement more than regulations or voluntary codes is the key to effective corporate governance, at least in transition and developing countries. They observe that when the general enforcement environment is weak and specific enforcement mechanisms function poorly, as in many developing and transition countries, few of the traditional governance mechanisms are effective, and this can lead to fraud. Like UK and US, since Nigerian ownership structure is concentrated in the hands of few, development of governance rules can be largely affected in favor of controlling owners, thereby potentially perpetuating social costs. In this respect, effective industry and external enforcement mechanisms can mitigate the potential costs that come along with these ownership structures if the goals of the corporations are to be achieved.

The Committee of European Securities Regulators (CESR, 2003) defines enforcement as monitoring compliance of financial information with the reporting framework and taking action in the case of infringements. This means that, for any enforcement body or mechanism to function effectively, it must have a quality-reporting framework issued and developed by experts in accounting and auditing. They observed diminishing differences in accounting recognition and measurement internationally; enforcement continues to differ significantly across countries, even being non-existent in some countries (FEE, 2002).

Furthermore, Saudagar & Diga (1997) opine that in an emerging market, “Systematic inquiry needs to be made regarding the strength of the regulatory mechanisms, and factors limiting their
effectiveness”. Saudagaran and Diga (1997) further opine that, the enforcement stage in emerging capital markets should be given to the entity equipped with the power to enforce, which is the government. In their view, these governments’ agencies will perform functions similar to the SEC in the US including formulating rules for public issuance of securities, approving specific offers of securities and listings, and defining the overall direction (governance) of capital market development. On the other hand, they report that as the emerging capital market reach a particular size and attain a greater number of well trained professionals, regulators may allow the private sector, i.e. stock exchanges to play more active role in enforcing governance standards since in many developing countries enforcement is a big problem. This is because corporations, akin with human behavior are likely to take advantage if nobody takes action when rules are breached; the result is that the rules remain requirement only on paper (Hope, 2002).

In their effort to compare independent enforcement body in Australia (ASIC) and the UK’s FRRP, Brown and Tarca (2007) conducted interviews to compare these two bodies based on their respective roles, origin, structure of cases and press coverage. Their results found ASIC reported more cases than FRRP (42-25). The results show different types of enforcement bodies can achieve similar results. However, ASIC appears to be more active than the independent FRRP. Following corporate collapses in Australia (notably HIH, One.Tel and Harris Scarfe), ASIC has been provided with additional funds to expand its surveillance activities and increase its profile in the community. The FRRP on the other hand, was not able, nor was it requested by the UK government to address community concerns about the quality of financial reporting in the UK. The authors applied regulation theory to explain the rationale for government intervention.

However, reports show that, even in the EU and other regions across the world, several countries do not have an oversight system. The several EU countries needed to set up enforcement mechanisms or extend the activities of existing enforcement bodies. A study conducted by Brown and Tarca (2005) explored matters regarding uniform enforcement in the EU. They reviewed activities in France, Germany, the Netherlands and the UK in setting up and modifying enforcement bodies before 2005. They tested current developments against the FEE (2002) recommendations and against the principles for effective enforcement proposed in CESR (2003). They conducted 23 interviews to representatives of the countries’ enforcement bodies. To complement their data, they gathered views from top four big audit firms, the IASB, FEE and EFRAG about the challenges of achieving effective uniform enforcement. They found that, since enforcement remains the responsibility of each EU member state, the goal of uniform enforcement raised a particular challenge, namely the coordination of enforcement activities and sanctions and that uniform international standards can only be maintained if interpretation advice emanates from a central source, in this case the IASB and IFRIC.

Similarly, Al-Hussaini, Al-Shammari and Al-Sultan (2008) review the activities of enforcement bodies in all the Gulf Co-operative Council member states (unlike the four selected in
EU nations above) over the period 1999-2003. After conducting interviews with the enforcement bodies’ personnel in each of the countries and other public sources, they observed an increase in the bodies’ activities following adoption of IAS, with a larger number of qualified audit reports and governance issues against company directors and officers. However, they found that despite many similarities in the member nations’ respective reporting frameworks for enforcement, there were considerable differences in the level and type of enforcement activities among the countries. This means that a high degree of commonality in the legal framework of company law, corporate governance codes and accounting standards will not necessarily lead to the same enforcement outcomes, even among countries with a formal cooperative economic relationship (as the GCC and EU). A key implication of their findings is that specific commitments to enforcement activities are necessary to ensure consistency in enforcement between countries.

Nevertheless, based on the trends of events, a country’s judicial system might be functioning well but enforcement of regulations lacking. It is difficult, however, to think of a situation in which the judicial system in general works poorly but enforcement of standards is strong. The assessment of judicial efficiency produced by the country-risk rating agency Business International Corporation “may be taken to represent investors’ assessment of conditions in the country in question” (La Porta et al., 1998). The second component of enforcement, rule of law, as seen in Hope (2002) assesses a country’s law and other tradition (La Porta et al., 1998). After all if no one cares, regulations covering the content of financial reports are not likely to be effective. Assessments of tradition for law and order are produced by the country-risk rating agency ‘International Country Risk’. Both judicial efficiency and rule of law are on a scale from 0 to 10, with lower scores for lower efficiency levels and less tradition for law and order, respectfully. On the third component, it has been seen in Hope (2002), that strong shareholder protection should attenuate management opportunism in financial reporting. Managers in weak shareholder protection environments are more likely than managers in strong shareholder protection environment to manipulate earnings. For example, mechanisms by which shareholders might sue directors for losses incurred due to manipulated financial reports are more plentiful in the US than in Germany (La Porta et al., 1998). Hence, the higher anticipated cost to managers of engaging in manipulation in the US might be expected to deter such behavior.

While academics and practitioners agree on the importance of enforcement as an essential element of the governance infrastructure, there has been little research on enforcement in an international setting. One potential explanation for this is that it is not easy to measure enforcement across countries (Brown and Tarca, 2007, 2005; and Hope, 2002). Likewise, it is also difficult to measure enforcement on firm-level components but it remains an important constituent of corporate governance especially in emerging Nigerian market.

In Nigeria, World Bank (2004) reports enforcement to be weak. The team states that powers of the regulatory enforcement bodies are important because of the relatively inefficient court system.
The perception in the market is that while the court system is actively used to resolve shareholder disputes, it takes many years to receive a judgment. Therefore, a lot depends on the powers granted to the regulatory bodies, such as the SEC, CBN, NAICOM and the NASB. As earlier stated, according to World Bank (2004) report, the SEC does not have an effective mechanism for monitoring compliance or for punishing issuers that violates the rules since no effective regulatory mechanisms exist to impose sanctions on managers and boards. The only current penalties are fines and de-listing. However, since the number of listings is seen as a measure of the success of the stock exchange, relative to its international competitors, the de-listing penalty is rarely applied. Moreover, there is the need to review the current legislation on penalty of fines in the CAC because Okike (2007) observe that if the CAC is to fulfill its role of adequately promoting good corporate governance, its monitoring role needs to be strengthened, and sanctions that are more realistic applied to erring companies. For example, the penalty for contravening section 19(3) of the Act is N25, the equivalent of $0.16 cents, which is the number of persons that can form a company, association or partnership. Also, the penalty of contravening section 348(1-3) of CAMA 1990 in relation to defective financial statements for companies is N100 ($0.66 cents) and for group financial statements, the penalty is N250 ($1.66). Obviously, companies may opt to pay this token amount and present financial statements that do not give a “true and fair view” since the punishment in the legislation will not serve as deterrence. Okike (2007) observes that, where compliance with standards is legally required, companies may not comply if it is perceived that the consequences of non-compliance are not serious.

In similar arguments, Obaze (2008) sees the need to address institutional issues, especially those relating to enforcement. He further affirms that, with the confusion created by multiplicity of laws in Nigerian regulatory bodies, enforcement should be clearly vested on one body, such as Financial Reporting Council (consistent with World Bank recommendation) in order to avoid many non-compliance issues passing unnoticed.

From the afore-mentioned, it can be rightly argued that the reported weak enforcement of reporting standard affect corporate governance as well, because the Nigerian Accounting Standards Board is also responsible for preparing governance standards and all corporations and enforcement agencies are guided by the same legislation, which has direct effects on Nigerian listed firms. For example, financial statements that lack the required qualities can be considered inaccurate and misleading, which perhaps are prepared with the intention to deceive or conceal some ulterior motives by officers responsible for their preparation. Such deceptions could be, among others, lead to concealment and distortion of accounting records, falsification and/or omission of transactions, deliberate misapplication of governance rules to perpetrate frauds etc (consequences of weak enforcement) that discourage existing and potential investments.

Akin with other developed nations with emerged capital markets, there have been so many reported cases of financial scandals in Nigeria. This makes it imperative to overhaul the present
reporting framework in Nigeria as recommended by local and international researchers. The Nigerian government has started responding to some of the recommendations by debating the establishment of a financial reporting council (yet to be legislated in the proposed Financial Reporting Act), which will be in place of the current Nigerian Accounting Standards Board. This is an important policy decision because the establishment of an oversight body such as the FRC is one of the requirements of the European Union to allow financial audit in its jurisdiction. So far, only two African countries meet the requirement, South Africa and Mauritius. New FRC in Nigeria will be responsible for issuing accounting, auditing and governance standards for both private and public sectors. It will be the only body responsible for licensing, regulating, and ensuring compliance and enforcement of standards. As an oversight body, it will provide a barrier against undue influence by bodies (seven directorates) to constitute its establishment ICAN (2004).

Even though the CAMA 1990 empowers the Registrar of Companies at the Corporate Affairs Commission (CAC) to regulate compliance with its financial reporting presentation requirements, there is however no capacity at the commission to effectively fulfill this function. In this regard, Okike (2007) reports that it is a legal requirement to file a copy of the audited financial statements and directors’ report with the Commission, there is however no rigorous enforcement of timely filing. Financial statements of non-listed public and private companies are not readily available. World Bank (2004) reports that, it seems most companies simply do not comply with the filing requirements, and sanctions are not applied. There are significant weaknesses in the enforcement mechanism, which is accentuated by a degree of corruption and poor record-keeping by the Corporate Affairs Commission. CAMA 1990 requires that the audit committee review audited financial statements and report to the shareholders. However, authorities have not assessed the effectiveness of audit committees, making their capacity to monitor unknown in practice.

Also, on behalf of SEC, the Nigerian Stock Exchange monitors compliance with financial reporting requirements of companies, whose equity or debt securities are publicly traded. Evidence reports the incapacity of SEC to monitor compliance with accounting standards effectively. There have been instances where companies have been suspended from the NSE for breach of financial reporting requirements. However, SEC enforcement is weak, and administrative sanctions (e.g. restatement at the cost of the company) and civil penalties are not adequate to deter non-compliance (World Bank, 2004).

According to OECD (2004), to ensure an efficient corporate governance structure, it is essential that an appropriate and efficient legal, regulatory and institutional foundation be established upon which all market participants can rely in establishing their private contractual relations. The OECD (2004) principles of corporate governance further state that a corporate governance framework will typically comprise elements such as legislation, regulation, voluntary commitments, and business practices that are based on a country’s specific circumstances such as history and tradition. On the
wave of this interest, new experiences are being witnessed even in Africa, judging from the worldwide trend of recognizing other significant stakeholders in governance structures for sustainability, and the changed business circumstances of achieving wider objective functions (King Committee, I; II & III). Therefore, an adjustment in the content and structure of the governance framework in Nigeria may be required.

In this respect, it has been mentioned earlier that CAMA (1990) is one of the major corporate laws regulating business operations in Nigeria, which provides for the protection of shareholders, functions of directors and audit committee. However, weak regulatory framework, slow legal processes, and high-level corruption have been reported as factors hindering effective corporate governance in Nigeria (World Bank, 2004; Okike, 2004; 2007; and Okpara, 2009). Therefore, stakeholder theory view the corporation as an enduring social institution, with personality, character and aspirations of its own, with proper interests of a wide range of stakeholder groups, and with public responsibilities, such as government regulatory and enforcement agencies.

However, the OECD principles assume that all countries have efficient legal system and the means and capabilities to enforce it as obtained in the developed member-nations the organization’s principles represent. Stein (2008) examines the impact of government, governmental techniques, and regulatory reform to normalize the behavior of managers and accountants. The regulations examined are the US SOX, characterizing the power relationships of government, and the social construction of corporate governance and reforms through autonomous agents, including managers and accountants.

In contrast, in developing countries, practices of self-dealing and insider trading are widespread. Such offences are usually unpunished because in Nigeria, the penalties are minor (Okike, 2007) and even if there are stiff penalties in theory, enforcement is lax (World Bank, 2004; and Okpara, 2009). Even the professional auditing associations in Nigeria lack the capacity to impose effective sanctions on their erring members (World Bank, 2004; and Okike, 2004). Government departments and independent regulators responsible for monitoring and enforcement are generally weak, and subject to external influence by politicians (Okpara, 2009). Unlike in the UK, community whistle-blowing watchdog organizations such as consumer bodies are not well developed in Africa (Botha, 2001).

5.0 Conclusion

This study shows the powers of the regulatory bodies are important because of the relatively inefficient court system. The perception in the market is that while the court system is actively used to resolve shareholder disputes, it takes many years to receive a judgment. Therefore, a lot depends on the powers granted to the regulatory bodies, such as the SEC, CBN, and the NASB. This is in conformity with World Bank (2004) report that, the SEC does not have an effective mechanism for monitoring compliance or for punishing issuers that violates the rules since no effective regulatory
mechanisms exist to imposing sanctions on accountants and auditors. The only current penalties are fines and de-listing. However, since the number of listings is seen as a measure of the success of the exchange, relative to its international competitors, the de-listing penalty is rarely applied.

Hence, the need to address institutional issues especially those relating to enforcement, if the systemic issues of curbing frauds are to be addressed. The full benefits of effective checks on the excesses of government officials and top managers can be realized only when policies are respected and implemented, and violations of standards are consistently enforced. With the confusion created by multiplicity of laws in Nigerian regulatory bodies, enforcement should be clearly vested on the Financial Reporting Council (consistent with World Bank recommendation) in order to avoid many non-compliance issues passing unnoticed. It should be recalled that, the current state of financial reporting in Nigeria has earlier been blamed on institutional weakness in accounting regulations, compliance and enforcement of standards. There is the need to discuss reports with stakeholders in Nigeria and an action plan to be agreed upon.

Financial statements that lack the required qualities can be considered inaccurate and misleading, which perhaps are prepared with the intention to deceive or conceal some ulterior motives by officers responsible for their preparation. Such deceptions could be, among others, distortions of accounting records, falsification and/or omission of transactions, deliberate misapplication of accounting rules to perpetrate frauds etc (consequences of weak enforcement mechanisms), which discourages existing and potential investor confidence. This makes it imperative to overhaul the present reporting framework in Nigeria as recommended by previous local and international researchers. The Nigerian government has started responding to some of the recommendations with the establishment of a Financial Reporting Act. This is an important policy decision because the establishment of an oversight body such as the FRC is one of the requirements of the European Union to allow financial audit in its jurisdiction. So far only two African countries meet the requirement, South Africa and Mauritius. The Financial Reporting Council of Nigeria is responsible for issuing accounting and auditing standards for both private and public sectors. It is also the only body responsible for licensing, regulating, and ensuring compliance and enforcement of accounting and auditing standards. As an oversight body, it provides a barrier against undue influence by bodies (seven directorates) constituting its establishment ICAN (2009).

Even though the CAMA 1990 empowers the Registrar of Companies at the Corporate Affairs Commission (CAC) to regulate compliance with its financial reporting presentation requirements, there is however no capacity at the CAC to effectively fulfill this function. It is a legal requirement to file a copy of the audited financial statements and directors’ report with the Commission. There is however no rigorous enforcement of timely filing. Financial statements of non listed public and private companies are not readily available. This confirms World Bank (2004) reports that, it seems most companies simply do not comply with the filing requirements, and sanctions are not applied.
There are significant weaknesses in the enforcement mechanism, which is accentuated by a degree of corruption and poor record-keeping by the CAC. CAMA requires that the audit committee review audited financial statements and report to the shareholders. However, authorities have not assessed the effectiveness of audit committees, making their capacity to monitor unknown.

Also, on behalf of the SEC, the Nigerian Stock Exchange monitors compliance with financial reporting requirements of companies, whose equity or debt securities are publicly traded. The capacity of SEC to effectively monitor compliance with accounting standards is inadequate. There have been instances where companies have been suspended from the NSE for breach of financial reporting requirements. However, SEC enforcement is weak, and administrative sanctions (e.g. restatement at the cost of the company) and civil penalties are not adequate to deter non-compliance, and thus an inducement for frauds and abuse.

Though Banks are the most regulated organization in Nigeria, but outdated sanctions and reduced capacity diminishes the effectiveness of monitoring and enforcement with financial reporting requirements. The Central Bank of Nigeria regulates accounting requirements for prudential regulatory reporting and general purpose external reporting of banks, as well as non-banking financial institutions. Although capacity exists in the Directorate of Banking Supervision and Inspection to monitor and enforce bank-related accounting and auditing requirements, the capacity did not quite keep up with the rapid growth of the banking sector. Occasionally, NSE and CBN have divergent views on the approval of financial statements of listed banks. In such cases, the statements are not published until they receive the approval of both NSE and CBN. Sanctions available under Banks and Other Financial Institutions Act (BOFIA) include fines, imprisonment, and suspension or revocation of license but since the CBN is not a law enforcement agent, cases reported for prosecution stay long without judgment. Hence, violators escape the shallow Eagle eye of the Law.

The biggest disturbing issue has been the penalties. Where compliance with standards is legally required, companies may not comply if it is perceived that the consequences of non-compliance are not serious. It is therefore recommended that stiff and harsh penalties be imposed on offenders if the confidence of the investor community is to be raised. Again, when we consider the long-term effects of frauds and abuses, the development and sustenance of fair and efficient markets is thwarted by rampant corrupt practices in Nigerian socio-economic environment. For instance, fraud and abuse create unlevel play ground for competition and breeds inefficiency leading to low quality services at higher prices. This in turn denies the establishment of infrastructure for development, and discourages further investments for the development of the economies of Nigeria as a nation. Consequently, fraud and abuse of office result into lower standard of living, increased poverty and underdevelopment in such country, no wonder the reports that 70% of its population live below the poverty line of $2 daily. How can such a society survive? From the perspective of sustainability, the success of a business must be judged not only against the financial bottom line of profitability, but
also against the ecological and social bottoms lines of sustainability. Based on the above analysis, this paper concludes that with the huge wealth at its disposal, Nigeria requires total overhaul of its financial structure if it wants to maintain any rightful place in the comity of nations.

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