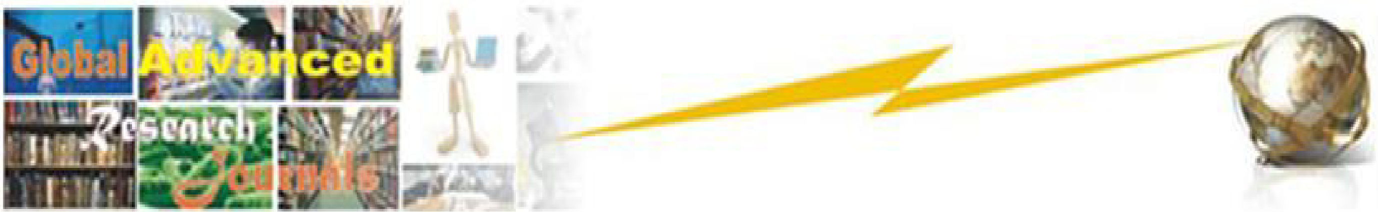

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Full Length Research Paper

Corporate Failure and The Dilemma Of Auditors

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Corporate failure has continued to dominate the entire corporate environment throughout the World, and Nigeria is not an exception. This has elicited continuous outcry about corporate survival; and the blame is always shifted to corporate management on the account of its failure to harness and use available resources effectively and efficiently for good corporate objectives. Thus, there is an increasing lack of confidence on corporate management. The negligence has led to untimely liquidation of many businesses. The main objective of the study is to examine corporate failure and the dilemma of auditors and expectation gap which has led to some pressures for increased auditor liability. It further looks at corporate failure and where the auditors share in it. The study made use of survey research design and the population for the study comprise of 200 questionnaires administered made up of shareholders, business groups and employees within Jos metropolis of Plateau State. We had 188 respondents representing 94% of the survey. Data were presented on tables of percentages and we tested the research hypotheses wit f-ratio. Findings from the study revealed that corporate failure exist despite efforts of auditors to carry out effective audit and corporate scrutiny. Proper auditing of financial records of companies has a relationship with corporate survival, and remains competitive and transparent in business environment as required by International Financial Reporting Standard (IFRS). The following recommendations were made. Corporate Auditors should perform audit with technical competence, integrity, and independence with defined objective. They should search for and detect material misstatements whether intentional or unintentional. Government and relevant stakeholders corporate owners about engaging competent hands in carrying out corporate audit in line with international best practice as these will enhance total compliance with requirements of IFRS as this will reduce incidences of corporate failure.

Keywords: Corporate failure, Corporate world, IFRS, Survival.

INTRODUCTION

Every year brings its crop of company disasters. The high degree of uncertainties in the corporate affairs with their attendance performance challenges had forced many Nigerian companies to go out of business. Nigeria's situation in late seventies and early eighties was precarious because of economic malaise fuelled by unfortunate political environment and inconsistencies in economic policies over the years. Thus, the Nigerian economy started to experience a down turn. This unpleasant situation saw companies collapsing. However, there always exist some reasons. For corporate failure, various literature have identified several

causes such as management's error, poor marketing, demand decline, increased competition, inadequate financial control and poor quality products, etc.

According to Michael (2005), a large number of people feel that business failure is an anathema. They place a premium on survival and, when falling, assert that no error has occurred, or that if it did, it was unimportant, or that if it was important, it was somebody else's fault.

According to Bibeault (199), failure in corporate entities can occur from four different stand points, namely, social, economic, legal and managerial. But, he observes that there are few instances where the phenomenal success of an entrepreneur or manager did not follow on the heals of earlier failure. This paper looks at corporate failure and where the auditor is considered to have failed.

Corporate Failure Defined

According to Altman (2004), no unique definition of corporate failure exists. Possible definitions range from failure to earn an economic rate of return on invested capital, to legal bankruptcy, followed by liquidation of the firms, assets. Continuing, he opined that corporate failure refers to companies ceasing operations following its inability to make profit bring in enough revenue to cover its expenses. This can occur as a result of poor management skills, inability to compete or even insufficient marketing. However, this may represent the end of a period of financial decline, characterized by a series of losses and reducing liquidity. Any attempt to uniquely define corporate failure is likely to prove problematic. Grisat as cited by Bibeauty (199), some companies never have a reason to exist in the first place.

According to him, in a lot of markets, this is room for two or three companies and no more. Many organizations that either refuse or lack the resources to adapt in an atmosphere of growing competition and immeasurably increasing sophistication; end up being edged out of business. In his own contribution, Afolabi (1994) argues that firms without avowed objectives and target make performance difficult to be judged.

Cause of Corporate Failure

Bibeault (1999), Identifies corporate failure from four stand points namely, social, economic, legal and managerial. They social standpoint he argues, is in terms of its impact. That is, the human suffering that such a phenomena usually brings, it affects almost everyone: the owners, employees, government, customers, investors, suppliers, creditors and the society in general. However, not everyone agrees that the longer-range social impact of corporate failure is negative.

The economic standpoint viewed failure as a situation whereby the realized rate of return on investment capital is significantly and continually lower than prevailing rates on similar investments. Infact, a company could be an economic failure for years and yet, in the absence of legally enforceable debt, be able to meet its current obligations. This view of failure is however subjective, and there are very few data available on industry or company incidence of economic failure.

Legally, a company is declared as a failure if it Is not able to meet its current obligations and settling its outstanding debts. Thus, failure is synonymous with insolvency and bankruptcy, (Benston, et al, 2006). Glaessner and Ma (2001), on the contrary, opined that insolvency is officially recognized and the organization is closed.

A business can also be a failure from a managerial standpoint before it is an economic failure and certainly long before a legal failure. Managerial failure is measure by a long period of decline and leading to large write-offs and to losses at the bottom line, which culminate into intense pressure for a change in management.

There is therefore a considerable degree of consensus that the quality of management makes the difference between sound and unsound organizations. Most of the corporate failures that result in different organizations are as a result of mismanagement of resources and virtually every aspect of mismanagement of resources comes as a result of non compliance to policies and virtually every aspect of the organization's regulations.

Failure, according to Ormerod (2005), is the most fundamental feature of both biological systems and human social and economic organizations. It is always believed in the corporate cycle that failure is proportionately skewed corporate failure and young companies.

According to Sheth and Sisodia (2005), corporate life expectancy across major European economics has declined in recent years. They believed that much of this is because of merger and acquisition, arguing that many of the acquisitions are prompted by corporate failure or distressed selling rather than strategic buying. Companies succeed because by chance to match the opportunities in the environment at that particular time. As such, they can just as easily fail if they prove unable or unwilling to change their culture, processes, system and structure.

Other reasons for failure include changes to the environment. Many organizations consider technology and globalization as key issues for changes as they affect regulations and capital market competition which have the most impact upon a company's ability to survive or fail.

Corporate failure is not about the environment or the organization per-se, but rather about a failure of alignment between the organization and its environmental realities, (Sheppard and Chowdhury,

2005).

Corporate Management and Supervision

Management it is said, involves a system of harnessing the resources of an entity to achieve set objectives. Thus, quality of management makes the difference between sound and unsound firms (Sheng and Bibeault, 2009). This singular factor bears a high share of the causes of failure in most firms. Thomas (2004) argues that faulty management rather than external circumstances is the major cause of failure in organizations. During periods of prolonged depression, weak and inefficient time, contributes heavily to failure.

Also, with poor supervision, even good managers become bad managers, engaging in speculative, excessive spending, and ultimately fraud (Juan, 1999). He is of the opinion that mismanagement and failure are more likely to occur of a firm's supervision or auditing process is poor or ineffective, stressing that, contrary to the theory that financial crises are only diet to macro-economic factors, management is a major element and is a potential originator or a multiplier of losses and economic distortions.

According to Borish et al, (2005), poor supervision emerges from insufficient training, poor information systems, lack of enforcement powers and focus on liquidity without a long-term approach to risk management and inefficient auditing system. Further to this, Graddy and Spencer (2002), believes that supervision agencies are required by law to conduct period on-site examinations of firms, and firms are also required to submit financial statements and reports of condition and income to the regulatory agencies in order to determine the quilt of their records; but most often they fail to do so or where they do, they manipulate and distort their records to conceal their ineptitude.

The basic responsibilities of directors are to maintain proper accounting records and to prepare financial statements that give a true and fair view and have been prepared in accordance with relevant legislation (Woolf, 2003). In submitting these statements, those who govern the firm give over-riding assertion as to the genuineness of the data contained in the statements which the auditor has to prove the validity by forming an opinion of the truth and fairness of the financial statements (IAS paragraph 15 and 16).

Ma and Kari (2005), argue that top management generally bears the main responsibility for corporate failure usually through ignorance of their own source of competitive advantage, gross negligence, arrogance, overconfidence and self-aggrandizement.

Mellahi (2005), while contributing to this, opines that the focus of responsibility for failing organizations lie with top management, and he developed a four-stage model of corporate failure based around the behavior of company boards. The stages, according to him, pass from conception, when the seeds of the crisis are sown, through early strategic errors, through warning signals stage, where the initial mistakes were compounded with other failed strategies, through the rebellion stage, where there is response to sharp decreases in the company's share price. The final stage is the collapse where performance deteriorates markedly and ultimately leads to bankruptcy.

Model Approaches to Corporate failure

This model, by Mellahi (2005), illustrates two key approaches to corporate failure. These are:
Prospect theory: This theory believes that managers become more prone to taking risk, in the face of a threatened failure, like the gamblers. The more they loose, the wilder their betting behavior becomes, so that disaster is often reinforced and commitment to a failing course of action is escalated.
Threat – Rigidity effect Theory: This second theoretical perspective holds that in a threatening situation, managers become paralyzed and cling to the status quo or outmoded "rules of thumb". In both cases, the role of a board of directors is to act with vigilance to prevent either excessively risky behavior on the one hand or the challenge of corporate inertia on the other hand. Therefore, both the directors and the managers should always be vigilant in looking for early warning signals rather than waiting for them for them to spring up to their notice.

Risk Factors behind Corporate Failure

Here some risk factors which characterized corporate failure are enumerated:

Lack of Board Effectiveness, which is as a result of limitations on skills and competence.

Board's risk Blindness, which is characterized by a board's failure to engage with important risks such as risks to reputation and license to operate, to the same degree that they engage with rewards and opportunity.

Poor leadership on ethos and culture, defective communication, excessive communication, inappropriate incentives, information glass ceiling which is characterized by inability of internal audit or risk management teams to report on risks originating from higher levels in their organization's hierarchy.

The Role of Auditors

Auditors are appointed by the shareholders at the Annual General Meeting, although the board of the directors has a voice on the choice of the audit firm. The main objective

Table 1a. users Conviction about Independence of Auditors.

Scale	Shareholders (SH)	Business contact Group (BG)	Employees	Other parties	Total
1	18	11	25	10	65
2	09	10	14	10	43
3	08	06	22	03	39
4	13	10	13	06	42
10	**48**	**37**	**74**	**29**	**188**

To find the average for this question.

£fx = $\frac{435}{188}$ = 2.31

X	X^2	F	Fx	Fx^2
1	1	64	64	64
2	4	43	86	172
3	9	39	117	351
4	16	42	168	672
10	30	188	435	1259

Table 1b. Users conviction about auditors work.

Scale	Shareholders	BG	Emp	Other parties	total
1	27	14	28	11	80
2	12	11	17	6	46
3	7	4	12	2	25
4	2	8	17	10	37
Total 10	48	37	74	26	188

To find the average for this question, I apply:

X	X^2	F	Fx	Fx^2
1	1	80	80	80
2	4	4	92	184
3	9	25	75	225
4	16			
10	30	188	395	1081

= $\frac{395}{188}$ = 2.1

Table 1c. Users conviction about auditors and management contribution to corporate failure.

Scale	Shareholders	BG	Emp.	Other parties	Total
1	3	4	15	5	27
2	16	14	18	5	53
3	21	11	23	12	67
4	8	8	18	7	41
Total 10	48	37	74	29	188

To determine the average for the responses we apply,

X	X^2	F	Fx	Fx^2
1	1	27	27	27
2	4	53	106	212
3	9	69	201	603
4	16	188	498	1498

= $\frac{498}{188}$ = 2.6

To what extent are you convinced that accounting reports show signals to corporate failure in organizations?

X	Shareholders	BG	Emp.	other	Total
1	19	12	17	1	57
2	12	10	34	5	61
3	9	5	10	8	32
4	8	10	13	7	38
10	48	37	74	29	188

We therefore apply fx in order
Zf

To determine the average opinion on this question.

X	X^2	F	Fx^2	Fx^2
1	1	5757	57	57
2	4	61	122	244
3	9	32	96	288
4	16	38	152	608
10	30	188	427	1196

How convinced are you that auditors and accountants are free from ay indictment when there is corporate failure in organization.

Scale	Shareholders	BG	Emp.	Other parties	Total
1	22	12	36	10	80
2	14	12	17	11	54
3	6	3	14	6	29
4	6	10	7	2	25
Total 10	48	37	74	29	188

To determine the average response by the above respondents, fx was applied

X	X^2	F	Fx	Fx^2
1	1	80	80	80
2	4	54	108	216
3	9	29	87	261
4	16	25	100	400
Z 10	30	188	375	957

Therefore $= \frac{375}{100} =$ 1.9 approx. 2.00

Using estimation statistical technique, the researcher now wish to ascertain the mean population opinion i.e. The mean opinion of the population.

X	X^2	F	Fx	Fx^2
1	1	308	308	308
2	4	257	514	1028
3	9	192	576	1728
4	16	183	732	2928
10	30	940	2130	5992

The mean opinion of the respondents is shown hereunder
Also, apply the standard deviation

$$\sqrt{FX2 \quad - \quad 9}$$

$$\sqrt{\frac{5993}{940} \quad - \quad (2130)^2}$$

SD = 1.10

Thus, estimating the population means, using 95% confidence level.
Formula = /\/\ = x +Z € / Z SD √

N = sample size

Zx/2 = standard normal deviate

Therefore, = x+Zx/2 SD

= 2.3 ± 1.96

= 2.3 ± 1.96 1.10

= 2.3 ± 1.96 (0.04)

= 2.3 ± 0.08

= 2.3 = 2.38

Placing the general opinion of this population along the Likert scale, it stands within partly convinced i.e 2.

according to companies and Allied Matters Act, 1990 as amended, is to enable the auditor's report to the shareholders the position of the financial statements and activities of the firm, on whose behalf, and for whose benefit, the directors carry on the business.

In making his report, the auditor must specifically and expressly states that he has examined the financial records of the company, obtain explanations necessary for his audit and that the company has complied with the best practice according to the relevant statues, and with the highest standards of corporate practice.

Izedonmi (2000), recommends more improvement in corporate governance especially in the areas of internal control systems, potential areas for efficiency and cost savings which are identified during the course of his audit work.

The auditors work therefore, in all, requires checking the accounts prepared by the directors and to report whether they give a true and fair view (Nwoha, 2010). Basically, in planning the audit, auditors obtain and document an understanding of the accounting system and control environment sufficient to determine their audit approach.

The auditor's report shows the going concern trait of the firm or otherwise because he is expected to see the signals of survival or failure from what he has done or observed in the firm.

METHODOLOGY

In this paper, we use an empirical survey approach involving questionnaire and interviews which were most appropriate to obtain data. Both percentage variables and estimation statistical techniques were applied in the analysis.

The scope was Jos Metropolis where the opinions of most users of financial reports were taken. They were categorized as shareholders, business group, employees and other parties. A sample of 200 was adopted for the study.

Data Presentations were served with questionnaire. 188 responded representing 94%. All the respondents were concerned with the financial reports of the firms.

Research Question One

How convinced are you that auditors are really independent from the clients.

1 2
3 4

Not convinced partly convinced
Convinced Strongly Convinced

The responses obtained are stated hereunder.

Research Question Two

How convinced are you that auditors do what they are expected to do.

Research Question three
To what extend are you convinced that management and auditors to corporate failure.
Research Question Four
Research question Five

CONCLUSION

Auditors play a crucial role in ensuring that financial reports can be relied upon by users. They have a responsibility to determine if substantial doubt exists at the data of the auditor's report about whether the audit client can continue as a going concern for the next year. The auditor therefore bases this evaluation on the evidence obtained in performing the audit and considers the entity's financial position as of the balance sheet date.

Presently, auditors are expected to ensure compliance with general policies and guidelines of the company by the directors in the day to day operations of the company and also try to bench mark the company's performance with similar organization within the industry.

Thus, the users of audited financial statements expect auditors to:

a) Perform the audit with technical competence, integrity, independence and objectivity.

b) Search for and detect material misstatements, whether intentional or unintentional.

c) Prevent the issuance of misleading accounts.

They believe that no independent professional understands the entity's business circumstances better than the auditor. Therefore, the general opinion from the study reveals that auditors have a share in corporate failure because they are the watch-dogs and supervisors of the shareholders and other stakeholders on what management does to enhance the corporate existence of the company.

When an illegal act having a material effect on the affairs of the entity is not properly disclosed, this may infringe on the success of the company because its failure to disclose it properly may induce fraudulent behavior on the part of the management and others in the firm.

Finally, it is hoped that the recently introduced International Financial Reporting Standard will promote audit quality and increase carefulness by auditors land encourage technical cooperation and peer review which translate into reduction of liability which will help to strengthen accountability in corporate management. IFRS emphasizes that auditor's report should reflect detailed management information and internal control systems which are sufficiently relevant and reliable to enable directors to prepare financial statements and provide assurance that the opportunities for fraud and other illegal activities are minimized.

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