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INTERNAL AUDITORS' INDEPENDENCE AND OBJECTIVITY: REGULATORY AND STATUTORY NEGLECT

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Abstract

This paper conceptually examines the regulatory role of professional accounting and auditing bodies in Nigeria comprising the Institute of Chartered Accountants of Nigeria (ICAN) and the Association of National Accountants of Nigeria (ANAN), and the statutory/regulatory role of government on the independence and objectivity of Internal Auditors in Nigeria. The paper is conceptual and it gains its basis from the Protection Motivation Theory. Based on this, the study proposes a relationship between professional regulation and independence and objectivity in one hand, and government statutory/regulatory role and independence and objectivity on the other hand, and suggests a framework for internal audit independence and objectivity. The paper, therefore, calls for an empirical examination of the proposed framework and the testing of the propositions. Unlike external auditing, internal auditing is given less attention by the regulatory and statutory authorities in Nigeria. This paper, therefore, provides a potential *opportunity for policy implication. The paper examines the area of auditing that is rarely being explored by the previous studies, especially in Nigeria context.*

Keywords: Internal Auditing, Independence and Objectivity, Professional bodies, Statutory regulation, Nigeria

INTRODUCTION

It is believed that independence and objectivity are the cornerstones of auditing, and without them, the concept of auditing can merely be linked to that of a giraffe without a neck, hence, Internal Auditors become a toothless bulldog that can only bark but cannot bite. In their effort to maintain independence and objectivity on task performance, internal auditors, especially in the public sector in Nigeria, have been subjected to different categories of humiliation, ridicule, and maltreatment.

The consensus in the literature (Alzeban & Gwilliam, 2014; Gustavson & Sundström, 2016; Okike, 2004; Tepalagul & Lin, 2015) is that the principle of independence and objectivity is indispensable in both internal and external auditing. Consequently, the regulators of Accounting and Auditing, through standards, lay much emphasis on the principle. Accounting and Auditing professions globally are regulated and coordinated by the professional Accounting and Auditing Bodies, and the pronouncement of Government. The global Institute of Internal Auditors (IIA), Certified Information Systems Auditor (CISA) under the umbrella of Information Systems Audit and Control Association (ISACA), and local Accounting and Auditing professional bodies have issued standards with a view to regulating the activities of internal auditing profession globally. The bodies lay much emphasis on the concept of independence and objectivity as a strong mechanism for the actualization of internal audit activities.

The IIA clearly recognizes Internal Auditing as an independent function in its definition. Hence, the Attribute Standard 1100 of the International Standards for the Professional Practice of Internal Auditing (ISPPIA) (2012), issued by IIA, and the Public Sector Internal Audit Standards of UK (2012), state that internal audit activity must be independent and that Internal Auditors (IAs) themselves must be objective in performing their job. The standards describe independence as the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner. They also look at objectivity from an individual point of view and require IAs to have an impartial, unbiased attitude and avoid conflict of interest.

In recognition of the essentiality of independence and objectivity as the cornerstone (Gustavson & Sundström, 2016; Tang, Ruan & Yang, 2017; Wines, 2011; Yu, 2011) upon which effective internal audit function lies, scholars have described it as the "hallmark of the public accounting profession" (Hill & Brooker, 2007, p.45), the "fundamental assumptions of effective internal audit" (Tušek & Pokrovac, 2012, p.141), the "key driver of the auditor role" (Alzeban & Gwilliam, 2014, p. 81; Moorthy, Seetharaman, & Saravanan, 2010), and "critical issue for the auditing profession" (Tepalagul& Lin, 2015, p. 102). Auditor's independence is a generally accepted theory that assumes that an auditor (internal or external) needs an immunity to enable him to form an independent opinion (Okike, 2004; Okoye, 1998), and it has an impact on the quality of audit work (Tepalagul & Lin, 2015). Though, it has been argued in the literature that, internal auditor, being an employee of an organization, cannot enjoy absolute independence (Mihret, James & Mula, 2010; Tušek & Pokrovac, 2012; Unegbu & Kida, 2011; Yee, Sujan & James, 2007), the consensus is the creation of appropriate conditions that will enable him to be reasonably independent.

The guidelines and the standards issued by the global IIA are not mandatory for operational use in Nigeria especially in the public sector. This is also the case in Egypt that requires the IIA provisions as normal guidance only (Ebaid, 2011). This is because its chapter in Nigeria is yet to be statutory listed as a professional auditing body in Nigeria. However, the regulatory and statutory guide of Accounting and Auditing in Nigeria are conferred on the Institute of Chartered Accountants of Nigeria (ICAN), the Association of National Accountants of Nigeria (ANAN), and different enactment, rules and regulations emanating from the Government. The Nigerian Standards on Auditing (2013) issued by ICAN and the Profession Code of Conduct and Guide for Members by ICAN (2009), and ANAN (2014) mentioned the concept of independence in several pages. However, the standards, just like it is in the other global Accounting standards, and the application of the codes are skewed towards external auditing. In the statutory angle, the Companies and Allied Matters Act (1990 as amended) is meant to guide the operations of companies in relation to accounts and auditing. Similarly, this Act relates to external auditing. Generally, therefore, the attention of the regulatory and statutory framework is normally directed to external auditing (Alzeban&Gwilliam, 2014).

Based on this, Internal Auditing aspect of the profession appears to be less regulated, less coordinated, and relatively abandoned thereby exposing IAs at the mercy of their employers and the auditees (Achua&Alabar, 2014). Despite the intellectual materials such as knowledge, experience and organization information (Osman &Ngah, 2016) possessed by Internal auditors, they lack reasonable independence, especially in the public sector, as a result of lack of support from the regulatory and statutory authorities. Consequent upon this neglect, evidences have shown that IAs have, at one time or the other, been relegated, side-lined, un-promoted and brutally murdered in the course of discharging their responsibilities independently and objectively (Auditor General Report, 2016, 2009; Premium Times, 2015; Unegbu& Kida, 2011). For instance, Adebayo (Premium Times Newspaper, 31 August, 2015) reported that the Assistant Chief Internal Auditor of the Federal Radio Corporation of Nigeria (FRCN), Kaduna Zonal Office (Mr. Ibrahim Falalu), was sacked in 2014 as a result of exposing financial misappropriation and corrupt practices of the Director General of FRCN, which led to panel investigation and indictment of the Director General. Prior to the dismissal of the IA in 2014, he was subjected to different levels of victimization, hatred, and unjust treatment through undue redeployment, denial of promotion, and non-payment of necessary allowance. In a similar case, Mr. Tunde Olawuwo, another Internal Auditor of Red Star Express, a courier company, was brutally murdered in 2014 (Daily Post, January 6, 2014). Based on these scenarios and many other related ones, IAs in Nigeria are not only subjected to professional and operational hazard but also left at the mercy of the management and the auditees generally. This is because they lack effective professional/regulatory and statutory protection while discharging their responsibility professionally, independently, objectively, and as required by the law. In order to survive in this kind of situation, IAs in Nigeria need to apply native intelligence to cope with the threat.

Studies in Nigeria have also supported the claim of internal auditors' maltreatment and exposure to hazard arising from the discharge of their duty with objectivity and independence. According to Okike (2004), auditors in Nigeria have been rendered powerless, considering the environment they found themselves. Unegbu and Kida (2011) report that IAs are exposed to many hazards. They state thus:

"Another factor, which impairs internal audit efficiency, is the hazards that stare the honest and principled internal auditor in the face, there are reported cases of assassinations, burglary, native medicine and acid attacks on the lives and properties of internal auditors" (p.307).

Consequent upon this, Akharayi (2013) posits that the level of independence of IAs in Nigeria is very low, and in most cases, they are not objective in their recommendations and conclusions simply because of the fear of losing their job. This situation is not in line with the best practice and basic principle of independence and objectivity which is the cornerstone of the auditing profession. Auditing without independence and objectivity is just like a "giraffe without a neck", hence, if the threat to the lives, properties, and job loss of IAs continues, there is a high chance of them becoming a "toothless bulldog" that can only bark but cannot bite.

Despite all these problems affecting IAs, the approaches adopted by the regulatory authority (professional bodies), and statutory authority (government) appear to be theoretical and non-supervisory. This, therefore, leaves internal auditors at the mercy of the management. Unfortunately, prior literature appears to follow the same pattern (Alzeban & Gwilliam, 2014; Christopher, Sarens & Leung, 2009; Cohen & Sayag, 2010). This is because the focus of the standard and prior literature lies on the appointment procedure, reporting pattern, budget, appointment, promotion, and removal of IAs as the parameters for gauging their independence. Therefore, there seems to be a dearth of study on the protective mechanism. However, this study takes different dimension as it examines the theoretical and practical supervisory and regulatory roles of professional accounting and auditing bodies, and that of the government in ensuring a reasonable level of independence of IAs in Nigeria, especially, in the public sector context. These external factors have rarely been examined in the prior literature. This study also examines the Protection Motivation Theory as a basis for the need for the protection of IAs because the theory provides a useful account of how employees are motivated from protection in an organization.

LITERATURE REVIEW

Independence and Objectivity

Prior literature tends to focus on the provisions of the ISPPIA and that of other professional bodies as the basis for examining the level of independence of IAs in organizations. Unfortunately, most of these provisions are internal mechanism and guide, thereby underestimating other external factors such as professional and statutory protection as also strong mechanisms for ensuring effective independence.

Attribute Standard 1100 of ISPPIA, issued by IIA, and the Public Sector Internal Audit Standards of UK (2012) describe independence as the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner. The standards, on the other hand, look at objectivity from an individual point of view and require IAs to have an impartial, unbiased attitude and avoid conflict of interest. In a similar manner, the Institute of Chartered Accountants of Nigeria (ICAN, 2009, Section 13.2), and the Association of National Accountants of Nigeria (ANAN, 2014, Section 290.6), in their separate Professional Code of Conduct and Guide for Members, describe independence of mind as the state of mind that permits the expression of a conclusion without being affected by influences that impair professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional scepticism. This aligns with the provision of IFAC (2014).

There is a growing body of literature that recognizes the importance of independence and objectivity in internal auditing. Yee, Sujan, James, and Leung (2008) argued that independence is indispensable and without it, the IA simply becomes a part of the management team, losing the ability to offer a fresh perspective through an objective evaluation. According to Brinkley (2015), independence is reflected in an auditor when he is self-sufficient, self-reliant, operationally autonomous, free from undue control, and thinking or acting for oneself. Hence, the consulting activity, assurance activity, risk management process, internal control, and corporate governance function of modern internal auditing derive their base from independence and objectivity (Tušek&Pokrovac, 2012). However, independence and objectivity are tampered with, undermined and become compromised when the management mounts pressure on internal audit to change its findings (Chambers, 2015).

Factors found to be influencing independence and objectivity have been explored in several studies. Base on the global standards and the best practice, therefore, literature identifies about six factors that can enhance or mar the level of independence of IAs. This comprises the reporting pattern; conflict of interest; level of interaction of IAs with the Board and management; level of access to records, personnel, and properties; who and who are responsible for the appointment, appraisal, promotion, and removal of IAs; and performance of non-audit function (Abu-azza, 2012; Alzeban&Gwilliam, 2014; Chambers &Odar, 2015; Christopher, 2014; Cohen &Sayag, 2010; Ebaid, 2011; Mihret et al., 2010). Unfortunately, all these appear not to provide the required protection to IAs, as there have been several cases of internal auditors being denied the autonomy to operate effectively and efficiently.

In order to ensure appropriate independence, the standard (ISPPIA) recommends dual reporting pattern for IAs. Internal Auditors are required to report administratively to the management and functionally to the Board or Audit Committee. The rationale behind functional reporting is to guide IAs against undue encapsulation and influence of the management on the finding and judgment of IAs. This reporting structure puts IAs as the agents of the board, and partner to the management (Lenz &Sarens, 2012). However, the concept of dual reporting has been a controversial and much-disputed issue in the literature. To some authors, the belief of the management is that IAs work for them, and reporting to the Audit Committee or the Board is just a mere protocol for satisfying corporate governance rule (Christopher, Sarens,& Leung, 2009). For instance, the pattern has been challenged by Deloitte (2010), Chambers (2008), and Anderson (2003) as they considered it as “serving two masters”, and that the relationship will not produce an optimum result. In fact, Deloitte (2010), argues that the question of “who is your boss?” (p.5) can further lead to the problem of independence, allegiances, and performance. In the same manner. Chambers and Odar, (2015) disagree with the concept of dual reporting and regard it as a flaw. They argue thus:

We take the view that to be a reliable provider of assurance to the board, internal audit needs to report for all purposes, including “pay and rations”, to the board or to a chairman of the board. “He who pays the piper calls the tune”. Internal audit should be regarded as one of the costs of running the board. …………However, it should be regarded as “internal” because it provides assurance on internal matters, not because it is part of the management team. (Chambers &Odar, 2015, p.43)

Furthermore, some scholars argued that independence is compromised when appointment, remuneration, appraisal and dismissal of the Chief Audit Executive (Head of Audit Department or Unit) is determined by the management (Christopher, 2014; Christopher, Sarens& Leung, 2009), while some are of the opinion that access to information, budgetary constraint, conflict of interest, organizational structure, among others will influence the level of independence. However, regulatory and statutory roles are not laid emphasis on.

Professional Regulation and Internal Audit Independence and Objectivity

Accounting and auditing professions are just like the two sides of a coin that cannot be separated, hence, both are regulated by the same professional body in many countries (Bertin&Jaussaud, 2003). However, this notion is often applicable to external auditing, perhaps, internal auditing is considered as a semi or emerging profession (Chambers &Odar, 2015). In many developed worlds, the operations of Accounting and Internal Auditing are separated and regulated by different professional bodies. For instance, in US, UK, and other advanced countries, the Accounting profession is regulated by Accounting professional bodies/organizations such as the Association of Chartered Certified Accountants (ACCA), American Institute of Certified Public Accountants (AICPA), and International Federation of Accountants (IFAC). The auditing aspect, especially internal auditing, on the other hand, is coordinated and regulated by bodies such as the Institute of Internal Auditors (IIA), Information Systems Audit and Control Association (ISACA), and other related ones.

However, in Nigeria, Accounting and Auditing professions are used interchangeably (Okike, 2004) because they are regulated by the Accounting professional bodies comprising ICAN and ANAN. Both bodies are members of IFAC. There is no separate Auditing professional body in Nigeria. ICAN was established by Act of Parliament No. 15 of 1965 to, among other functions, determine what standards of knowledge and skill are to be attained by persons seeking to become members of the accountancy profession and to raise those standards from time to time as circumstances may permit. The mission of the institute is to produce world-class Chartered Accountants, regulate and continually enhance their ethical standards and technical competence in the public interest. As at 2015, ICAN had 39,107 professionally qualified members, and 18,898 qualified Accounting Technicians (ICAN, 2015, p. 16). These members of the Institute work in different sectors of Nigeria as Accountants, Internal and External Auditors, Tax expert among others. ANAN, on the other hand, was established in 1979 and became chartered by the Act 76 of 1993 (now CAP A26 LFN.2004). As at 2015, the association also had a total number of 25,702 members (ANAN, 2015).

The Code of Conduct for ICAN members (ICAN, 2009, Sections 12, 18) and that of ANAN (ANAN, 2014, Sections 280 & 290) discuss the concepts of independence and objectivity, and prescribe how their members can maintain and sustain it. Unfortunate, the prescription appears to be tailored towards external auditors. As part of the monitoring mechanism, ICAN instituted a Professional Practice Monitoring Committee (PPMC), yet, the activities of the committee are just for external auditors. Okike (2004) argues that the monitoring by professional body should be all encompassing. The author stressed that:

"The accounting profession in Nigeria must continue to monitor developments in the internal and external reporting environments and respond adequately. The pace of events within the Nigerian economy over the past years suggests that the accounting profession cannot afford to remain passive" (Okike, 2004, p. 724)

It can, therefore, be argued that lack of separate Auditing professional body in Nigeria, couple with inadequate attention to internal auditing by both ICAN and ANAN, perhaps, accounts for the pathetic situation IAs in Nigeria found themselves.

Prior literature emphasized that regulation has an impact on the activities of people or entity. Regulation refers to a sustainable and focussed control by a recognised entity or public agency over the engagement and activities that are valued by the society (Ambituuni, Amezaga,&Emeseh, 2014). Al-Twaijry, Brierley, and Gwilliam (2003) argued that internal audit independence is enhanced when the organization concurs with the provisions of the ISPPIA. The finding of their study reveals that lack of awareness of the existence of the IIA by most of the corporate sector internal auditors in the Saudi Arabia, and lack of compliance with the provisions of the standards contained in the ISPPIA issued by the institute is one of the problems militating against independence. Invariably, therefore, any effort by the professional accounting and auditing bodies in the monitoring of internal audit activities can go a long way in improving the actualization of internal audit independence.

Furthermore, Chambers and Odar (2015) posit that the global IIA always promotes its standards as being mandatory for application. Unfortunately, internal auditing is not made to be compulsory in many countries, hence, lacks independence or monopoly enjoyed by its external auditing counterpart. The authors then recommend that the IIA build momentum in order to strengthen the performance of its members.

Based on this line of argument, this study proposes that there is a relationship between professional regulation and internal audit independence and objectivity.

Government Regulation and Internal Audit Independence and Objectivity

Isolating the operation of internal auditors without government support in terms of statutory/regulatory framework or enactment can make the function to be less value adding. According to Okike (2004), government enactments on auditing refer to the mechanisms put in place by the government to represent and, at least to some extent, define the role of auditing in the society. Government regulation, therefore, has an impact on the independence and objectivity of auditor (Tang, Ruan, & Yang, 2017). Efforts have been made by the government to regulate audit activities in Nigeria. However, most of the strong efforts lie on the external auditing. For instance, the Constitution of the Federal Republic of Nigeria (1999 as amended), in sections 85 to 87, make provision for the appointment, functions, independence, reporting, and removal of the Auditor-General for the Federation. However, the fact still remains that the Auditor-General for the Federation is an external auditor to the government, and will act in an external manner like the external auditor counterpart.

Another legislative enactment that has to do with auditing is the Companies and Allied Matters Act (CAMA) (1990). Sections 357 to 369 of the Act discuss the appointment, remuneration, functions, and removal of the external auditors in relation to company audit matters. However, the identifiable area where internal audit is being mentioned is the Federal Government Financial Regulation (FGFR) issued by the Federal Republic of Nigeria (2009). Sections 1708 to 1715 of the regulation provide for the internal audit, and for internal auditors to perform their duties, to some extent, independently and objectively. Also, section 1715 of the regulation empowers IAs to have unrestricted access, at all reasonable time, to records, information, store, and personnel

The regulatory provisions of the government in relation to internal auditing appear to be theoretical and do not translate into protecting IAs like their external auditor counterparts. The trend of victimization may continue if there is no strong government rule and regulation that provide some level of protection to IAs.

Regulators of accounting and auditing in every country stipulate that auditors should be independent (Tang, Ruan,& Yang, 2017). Findings emanating from the previous literature indicate that independence of an auditor improves when the audit activities are backed up by regulation. For instance, the experimental study of Tang, Ruan, and Yang (2017) conducted on 81auditors reveals that government regulation positively influences the independence of auditors. Based on this, this study hypothesizes that there is a relationship between government regulation and internal audit independence and objectivity

PROTECTION MOTIVATION THEORY

Protection Motivation Theory (PMT) lays emphasis that fear is a catalyst for behavioural change, and it outlines the protective mechanism against the threat emanating from fear (Ashida et al., 2011; Solansky, 2014). In other words, the theory states that an individual confronted with threat will be motivated to protect oneself through the cognitive process of threat appraisal and coping appraisal (Prentice-Dunn, Mcmath& Cramer, 2009). The motivation to protect, according to the theory, is based on three fundamental factors comprising the perceived severity of the threat, the assumed probability of the occurrence of the event and, the efficacy of the perceived preventive measure (Rogers, 1975).

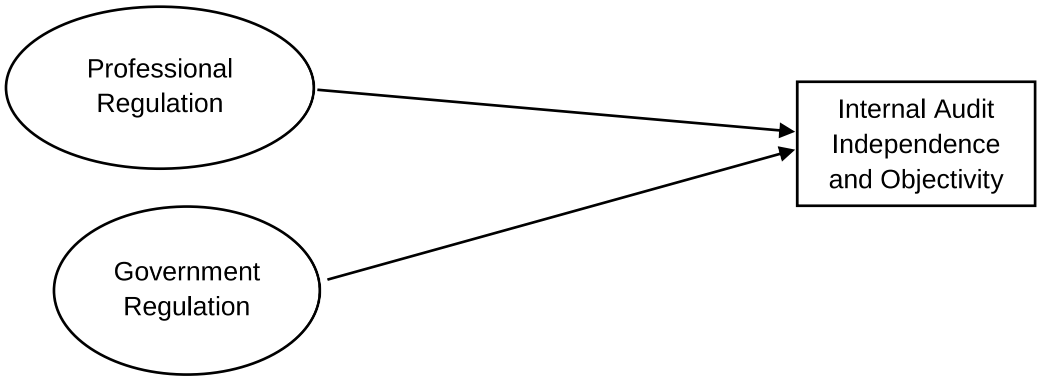
Though the application of PMT was initially tailored towards health and safety-related intentions and behaviours, and many researchers (Plotnikoff, Rhodes,& Trinh, 2009; Prentice-Dunn, Mcmath,& Cramer, 2009) have used in the medical line, it has now been widely used in literature in different fields. Scholars have used it in business (Bolkan, 2015), governance (Solansky, 2014), Information Technology (Crossler et al., 2014), and agriculture (Ashida et al., 2011)

This study, therefore, applies PMT in developing a theoretical basis for the protection of IAs by the professional bodies and government through supervision and laws. Based on the literature, and applying the principles in PMT, the major threat to objectivity and independence of IAs in Nigeria context is the fear of job loss, stagnation, assassination, different forms of attack, and operational and professional hazards. Consequent upon this fear, IAs usually result in an inappropriate decision of compromising their objectivity and independence, notwithstanding the consequential litigation that may arise. The efficacy of the protective mechanism of IAs is weak and cannot override the strong influence of the management and the auditees.

Based on this, this study, therefore, considers practical regulatory and statutory framework as the yardsticks of not only reducing the fear of IAs, but also serve as a strong protective mechanism for them in discharging their responsibility objectively and independently. This linkage of independence and objectivity to PMT is justifiable and appears to be logical because the central theme of the theory includes threat, fear, and coping strategies (Rogers, 1975).

Arising from this theory, coupled with the link between professional regulation, statutory regulation, and the internal audit independence and objectivity, this study proposes a research framework in Figure 1. The framework can be subjected to further empirical study

Figure 1. Proposed Research Framework



CONCLUSION

This study conceptually examines the independence and objectivity of Internal Auditors from the perspective of the professional and government protection. Based on the literature, documentary evidence, and media reports, the study indicates that IAs, especially in the public sector, in Nigeria face challenges of victimization and ridicule from the management and the auditees in the course of discharging their responsibility independently and objectively. The study also shows that the professional accounting bodies in Nigeria, comprising ICAN and ANAN, pay less attention to the coordination of internal auditing aspect of the profession, and invariably give no protection against the oppression of IAs. The study further indicates that the government of Nigeria is also not helping the matter as there is no any strong statutory enactment that provides a protection against the oppressors of IAs. Arising from these professional and governmental lapses, and based on PMT, the study proposes a framework showing the influence of professional regulation and government enactment on the independence and objectivity of IAs and makes propositions for the variables. The study, therefore, calls for the empirical examination of the proposed framework and the research propositions.

The study has policy implications. In the first instance, it calls the attention of the professional bodies to the area of neglect, hence, can assist them in re-prioritizing their operational coverage. Secondly, it calls on the government to be awake to its responsibility, hence, can assist the government to make policy that will entrench its zero tolerance for corruption at all levels.

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