Determinants of Corporate Failures in Nigeria: Preparers and Users Perspective

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Abstract

This study seeks to examine the factors responsible for corporate failure in Nigeria. The study adopted a survey research design, data were drawn from primary sources. The population of the study consisted of all preparers and users of financial reports made up of external auditors, company management, tax administrators and investors in Delta and Rivers states, Nigeria. Using convenience and simple random sampling techniques, a total of 194 respondents were administered questionnaire in the area of study. The data from the instruments were analyzed using the one-way analysis of variance (ANOVA) at 0.05 level of significance. The findings revealed that most corporate failure are due to management inefficiency, weak corporate governance and auditors' negligence and incompetence. The study further revealed that most accounting reports do not show signals to corporate failure. It recommends amongst others that auditors should devote a special section of the annual reports of companies to explore the going concern position of the companies audited so as to enable stakeholders make informed decisions on audited reports.

Keywords: Corporate failure, Audit Report, Corporate Governance, Financial Scandals

Introduction

Corporate failures and business collapse are on the increase in spite of unqualified audit reports. It has become a source of concern to the stakeholders of most companies over the incidence of unqualified audit reports giving a clean bill of health to companies only for such firms to be rocked a few weeks later by serious financial scandals and crisis leading sometimes to liquidation. The failure of statutory audit to prevent and reduce fraudulent activities in corporate governance had brought a lot of public outcry (Akpan&Adebisi, 2014). The collapse of Enron, WorldCom, Tyco, Adelphia, where over $460 billion was said to have been lost in spite of unqualified audit reports was attributed to corporate fraud (Cotton, 2003). The increase in corporate collapses in recent times has led to more scrutiny of deficiencies in the financial reporting process and corporate disclosure requirements of corporate organizations.

Weak corporate governance and reduced audit quality are perhaps the most important factors blamed for corporate failures and corporate financial scandals. There is much that can be done to improve the integrity of audit reports through greater accountability, the restoration of resources devoted to audit function, and better corporate governance policies (Saudagaran, 2003). Quality audit reports are essential for ensuring the integrity and reliability of financial information. It is for this reason that the canons of many countries require the attestation of financial statements by external auditors. Sad to note that, there are a lot of criticisms of the auditor from which opinions have emerged over the years as a result of companies that have failed after being given a clean bill of health.

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Some studies such as Obiamaka, 2008; Nwete, 2006; Ossisioma and Enahoro, 2006 and Nwaogu, 2006, note that there are questions about the, competence, negligence and independence of the auditors which are lowering the quality of audits. The auditors are expected to be independent of the management of the company being audited. However, a number of factors like familiarity, threat of replacement of an auditor and the provision of management advisory services appear to impair auditor's independence. Concerns have been expressed about the conflict of interest between the statutory role of the auditor and the other services it may undertake for a client.

This study is motivated by the interest surrounding the responsibility of external auditors, company management and effectiveness of corporate governance code in Nigeria in response to the corporate failures, global best practice and their implied efficacy in the face of significant implementation and audit quality. We therefore investigate empirically the relationship between corporate failure and corporate governance and audit reporting attributes. Hence, the broad objective of this study is to examine the factors responsible for corporate failure in Nigeria. More specifically, the objectives are to:

1. determine the extent to which auditors' negligence and incompetence lead to corporate failure;
2. ascertain the relationship between weak corporate governance and corporate failure; and
3. examine the extent to which accounting reports show signals to corporate failure.

The remainder of this study is organized as: section 2 addressed empirical evidence on corporate failure. Section 3 presented methodological issues with emphasis on data and model specification and estimation techniques. Section 4 focused on presentation and analysis. Section 5 highlighted the summary, conclusion and recommendations.

Empirical Evidence on Determinants of Corporate Failure

Corporate Failure

Altman (2004), states that there is no generally accepted definition of corporate failure. He posits possible definitions to range from failure to earn an economic rate of return on invested capital, to legal bankruptcy, followed by liquidation of the firm's assets. Continuing, he opined that corporate failure refers to companies ceasing operations following its inability to make profit and 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 and marketing strategies. However, this may represent the end of a period of financial decline, characterized by a series of losses and reducing liquidity. Sheng and Bibeault (2009) further maintain that some companies never have a reason to exist in the first place. According to them, in a lot of markets, there 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.

Bibeault (1999), identifies corporate failure from four stand points namely, social, economic, legal and managerial. The social standpoint he argues is in terms of its impact. That is, the human suffering that such a phenomenon 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. In fact, 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 (Mellahi, 2005 and Juan, 1999). However, Benston (2006) and Crowther and Jatana (2005) agree that most corporate failure is synonymous with insolvency and bankruptcy. 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.

According to Sheppard and Chowdhury (2005), 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 every aspect of the organization's regulations. 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 they have a 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.

Corporate Failures and Perceived Auditors' and Management Responsibility

The deepening financial crisis brings increased awareness of corporate collapses and bailouts that plunder the taxpayers' pockets at an unprecedented scale. Innocent people are losing jobs, homes, pensions and investments. Each collapse shows that highly paid directors had little idea of the value of company assets, liabilities, income, costs, profits and financial health. This has been accompanied by one constant factor: the argument about silence of the auditors. Saudagaran (2003) complains that many of the distressed companies have been on a diet of toxic debts, off balance sheet accounting, dubious asset values and questionable business models. All these have had a negative and cumulative impact on the way informed opinion views financial reporting by corporate management and auditors' responsibility.

According to Smith (2002), there has been great apprehension regarding the fairness of the operation of a market system where investors such as shareholders, debenture holders, creditors, and other stakeholders (excluding management) have lost large sums, while managers and directors of companies (management), and seen as responsible for those losses, have enriched themselves as the businesses got liquidated.

Despite the presence of several regulatory initiatives, the challenges of ensuring credibility in financial and audit reports with regards to the going concern certainty of companies are still prevalent. It therefore becomes pertinent to investigate the factors responsible for corporate failure in order to enhance the relevance and reliability of audit reports and how corporate governance mechanism will impact on going concern challenges of the firm.

Corporate Governance and Corporate Failure

Mactosh, Francis and Ongocho (2010) state that in the past decade, the auditing profession has had to deal with a lot of challenges than it has done in its lengthy history which spans over one hundred years. Corporate failures in which lack of accurate financial reporting and corporate disclosure have figured prominently are not a new phenomenon. The past ten years has been characterized by series of company collapse, ethical negligence and accounting scandals both in developed and developing economies. Publicized cases of the recent past, such as Satyam, Enron, WorldCom, Global Crossing, Adelphia Communications, HIH, Tyco, and Vivendi, Royal Ahold and HealthSouth are evidences of corporate failure in the advanced economies of the world (Norwani, Mohamad &Chek, 2011). A host of Nigerian companies such as, Cadbury Nigeria Plc, Afribank Nigeria Plc, Intercontinental Bank Plc, and Oceanic Bank International plc etc have also experienced financial scandals bordering on corporate survival and thus drawn increasing attention to the corporate financial reporting.

In advanced economies such as the United States of America, United Kingdom and France, regulatory initiatives have been put in place to deal with the poignant erosion of ethical standards in corporate governance, financial reporting and auditing standards. For example, in the United States of America, the Sarbanes Oxley Act was passed into law in 2002. The International Federation of Accountants (IFAC) has also supported the formulation of auditing guidelines to enhance the reliability of corporate financial statements. The International Accounting Standards Board has consistently stressed the need for global adoption of the International Financial Reporting Standards (IFRS). All these are efforts geared towards maintaining credibility of the financial statement so as to make them useful for informed decision making by stakeholders.

Suffice to say that, in developing economies, including Nigeria, there have been little or no efforts in positively addressing the challenges posed by poor corporate governance principles and auditors' ethical guidelines as regards negligence and responsibility. Bakre (2007) reported that investors in Nigeria have lost several billions of naira through the collusion of accountants and external auditors with companies' management and directors to falsify and deliberately overstate companies' accounts.

Methodology

Data and Model Specification

We employed a survey research design using primary data (questionnaire designed to examine the opinion of preparers and users of companies' financial reports on matters relating to audit reports, corporate governance, auditors' negligence and competence as they relate to corporate failure and financial scandals).The respondents were 50 each from ICAN register of members, corporate offices, investors at the NSE and Tax offices of two hundred respondents in Delta and Rivers states of Nigeria, using convenient random sampling technique to ensure equal representation and to enhance a broad spectrum generalization of the study results.

For purpose of the study, the one-way analysis of variance (ANOVA) at 5% level of significance, with the aid of Statistical Package for Social Sciences (SPSS) software.

Results and Discussions

Table 1: Summary of Questionnaire Administered.

Delta	N	%	Rivers	N	%
Total Questionnaire Distributed	100	100	Total Questionnaire Distributed	100	100
Total Questionnaire Retrieved	98	98	Total Questionnaire Retrieved	100	100
Total Questionnaire Rejected	2	2	Total Questionnaire Rejected	2	2
Total Questionnaire Used	96	96	Total Questionnaire Used	98	98

Source: *Researchers Computation (2018)*

Table 1 highlights the response rate of the questionnaire distributed to Delta and Rivers states in the course of the study. As indicated above a total of one hundred (100) copies of questionnaire were distributed to Delta state out of which ninety eight copies were retrieved representing 98%. Two of the questionnaires were rejected due to the fact that large portion of the questionnaire was left unfilled hence ninety retrieved questionnaires were considered suitable for use. On the other hand, one hundred (100) questionnaires were also sent and retrieved from respondents in Rivers state. However, the researcher was able to use ninety eight copies due to mutilation and blank questionnaires not filled. The response rate for Rivers is 98%.

Table 2. Management inefficiency largely responsible for corporate failure

Stakeholder opinion	SA	A	UD	D	SD	MIS
Ext. Auditor	23	12	0	10	5	3.76
Management	14	11	6	9	9	3.25
Tax Admin	29	14	2	1	1	4.47
Investors	26	8	0	10	4	3.87
Total	92	45	8	30	19	

Source: *Researchers Computation (2018)*

From the table, it is observed that most of the respondents believe that management inefficiency is largely responsible for corporate failure with 137 respondents affirming the statement while 49 disagree with mean item score of above 2.5 for all stakeholders.

Table 3: Most corporate failures are due to weak corporate governance

Stakeholder opinion	SA	A	UD	D	SD	MIS
Ext. Auditor	18	28	0	2	2	4.16
Management	5	19	2	23	0	3.03
Tax Admin	20	21	0	4	2	4.12
Investors	32	14	1	1	0	4.60
Total	75	82	3	30	4	

Source: *Researchers Computation (2018)*

The above table shows the response of stakeholders about the statement that most corporate failures are due to weak corporate governance. It can be observed that most of the respondents agree to the statement with 157 affirming while 34 disagree. The MIS of the stakeholders responses are well above 2.5.

Table 4. Accounting reports show signals to corporate failure in organization

Stakeholder opinion	SA	A	UD	D	SD	MIS
Ext. Auditor	8	9	5	24	4	2.86
Management	5	6	0	21	17	2.20
Tax Admin	6	7	1	30	3	2.63
Investors	2	8	2	27	9	2.31
Total	21	30	8	102	33	

Source: *Researchers Computation (2018)*

Table 4 shows the responses of stakeholders on the statement that accounting reports show signals to corporate failure. It is evident from the table that most respondents disagree to the statement with 135 giving a disagreed opinion while 51 respondents agree. The mean item score for management and investors are 2.2 and 2.31 respectively showing their disagreement with the statement. However, external auditors and tax administrators with mean item scores of 2.86 and 2.63 which are more than 2.5, shows that they have a contrary opinion even though they have a weak opinion about the statement.

Table 5: Auditors negligence and incompetence are largely responsible for corporate failures

Stakeholder opinion	SA	A	UD	D	SD	MIS
Ext. Auditor	0	15	0	23	12	2.56
Management	9	13	5	21	1	3.16
Tax Admin	7	11	1	18	10	2.72
Investors	18	9	1	20	0	3.52
Total	34	48	7	82	23	

Source: *Researchers Computation (2018)*

Table 5 indicates the opinion of respondents about the statement that auditors' negligence and incompetence are largely responsible for corporate failure. 82 of the respondents agree while 105 disagree. The agreement in opinion is further buttressed by mean item score of more than 2.5 for all the stakeholders.

Test of Hypotheses

The hypotheses will be restated before presenting the result analyses. The decision rule is to reject the null hypothesis and accept the alternative if P<0.05 otherwise accept the null hypothesis if p>0.05.

Hypothesis One: *There is no significant difference in the opinion of audit stakeholders on the extent to which auditors' negligence and incompetence lead to corporate failure*.

Table 6: ANOVA Statistics for Question 17: Auditors' negligence and incompetence are largely responsible for corporate failure in Nigeria.

	SS	DF	MS	F	Sig.
Between Groups	13.301	3	4.434	5.660	.201
Within Groups	148.828190	.783			
Total	162.129193				

Source: *Researchers Computation (2018) Using SPSS 20*

To test this hypothesis, we subjected statement 17 on the questionnaire to empirical test. The result of the hypothesis is presented in table 4.6. There are indications from this table that the statement used (Statement 17) is not significant with p-value greater than 0.05. In essence, there is no significant difference in the opinion of auditors, management, tax administrators and investors on the extent to which auditors' negligence and incompetence lead to corporate failure.(F 5.660 (3, 190) = p=.201, p-value > 0.05).

Hypothesis Two*: There is no significant difference between the opinions of audit stakeholders on weak corporate governance as a factor responsible for corporate failure.*

Table 7: ANOVA Statistics for Question 6: Most corporate failures are due to weak corporate governance.

	SS	DF	MS	F	Sig.
Between Groups	7.299	3	2.433	2.956	.341
Within Groups	156.371190	.823			
Total	163.670193				

Source: *Researchers Computation (2018) Using SPSS 20*

Item 6 on questionnaire was used in testing this hypothesis. Results as shown in table 7 shows F 2.956 (3, 190) p= 0.341, p>0.05. We therefore accept the null hypothesis that there is no significant difference between the opinion of auditors, management, tax officials and investors on weak corporate governance as a factor responsible for corporate failure.

Hypothesis Three: *There is no significant difference between the opinions of audit stakeholders on the extent to which accounting reports show signals to corporate failure.*

Table 8: ANOVA Statistics for Question 10: Accounting reports do not show signals to corporate failure in organization

	SS	DF	MS	F	Sig.
Between Groups	11.018	3	3.673	4.653	.004
Within Groups	149.976190	.789			
Total	160.995193				

Source: *Researchers Computation (2018) Using SPSS 20*

To test hypothesis three, item 10 on the research instrument was subjected to empirical test. Asindicated from table 8, F 4.673 (3,190), p=0.004, p<0.05. Consistent with our decision rule, we therefore reject the null hypothesis and accept the alternative hypothesis. This implies that there is a significant difference in the opinion of auditors, management, tax administrator and investors on the extent to which accounting reports show signals to corporate failure.

Discussion of Findings

The findings of the study revealed that most corporate failure are due to management inefficiency and weak corporate governance. It was discovered that there is no significant difference in agreement of opinions from respondents about the statements credited to management inefficiency and lack of proper corporate governance in firms. Sequel to this, the study found that stakeholders believe that management should not be free from any indictment when corporate failure occurs. Stakeholders such as the investors believe that financial and corporate scandals have overtime highlighted the problems of weak corporate governance in Nigeria. On the issue of going concern reporting, the study discovered that attention should be paid to it since it is a framework that can promote corporate stability. In line with going concern reporting, the stakeholders also through their opinion agree that the time period to assess whether an entity will continue as a going concern should be more than twelve months from date of financial statement.

The study further revealed that accounting reports do not show signals to corporate failure. However, this is a significant difference in opinion of stakeholders with regards to this, it is observed that stakeholders such as tax administrators and investors do not support the statement that audit reports show signals to corporate failure. In line with this, the study also found out that contemporary audit reports do not provide sufficient information about going concern of companies. As a result of this, the study finds that stakeholders want the auditor to have an additional responsibility for communicating whether a company is likely to go bankrupt/insolvent in the near future. However, based on survey responses, the study findings do not support the statement that auditors' negligence and incompetence are largely responsible for corporate failures. The study also did not find any significant difference in opinion among the stakeholders with regards to this statement. The study also observed that disclosure of going concern concept is critical to investors and tax administrators' decision making.

Summary of Findings, Conclusion and Recommendations

Summary of Findings

We made the following findings:

1. There is no significant difference in the opinion of audit stakeholders on the extent to which auditors' negligence and incompetence lead to corporate failure (F 5.660 (3, 190) = p=.201, p-value > 0.05).

2. There is no significant difference between the opinion of audit stakeholders on weak corporate governance as a factor responsible for corporate failure (F 2.956 (3, 190) p= 0.341, p>0.05).

3. There is a significant difference between the opinions of audit stakeholders on the extent to which accounting reports show signals to corporate failure (F 4.673 (3,190), p=0.004, p<0.05).

Conclusion

The aim of this research was to empirically examine the factors responsible for corporate failures in Nigeria. In achieving this aim, the study obtained data through survey on variables which were believed to have relationship with corporate failures. The factors this study focused on are responsibility of company management, external auditors, going concern certainty of companies as highlighted by audit reports and reliability on audited accounts for tax and investments decisions. The study found that management inefficiency; weak corporate governance and auditors' incompetence and negligence are major causes responsible for corporate failure in Nigeria and conclude that contemporary accounting reports do not provide information that will give signals to failure of corporate organization.

Recommendations

In line with the findings of this study, the following recommendations have been drawn:

1. Since management inefficiency largely contributes to corporate failure, it is expedient for management to put in place adequate accounting and internal control measures to check accounting frauds and unprofitable business decisions
2. Companies need to adopt and implement the corporate governance mechanism to the letter so as to be able to check fraudulent corporate accounting practices that are inimical to corporate growth. This can be done through audit committees, separation of chairman from the chief executive officer and getting members with financial literacy in the board of directors.
3. Government authorities should be able to impose stiffer sanctions on both management of companies and their external auditors who collude to window dress accounts with a bid to misleading audit stakeholders.

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