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THE ETHICAL REASONING PROCESS OF AUDITORS IN A CLIENT'S CONFIDENTIAL MATTERS: A FOCUS ON NIGERIA

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Abstract

The Code of professional conduct issued by Accountancy bodies prohibits Accountants/Auditors from breaching the rule of confidentiality. Auditors who are members of the accountancy profession in Nigeria are not allowed to disclose any confidential information concerning their clients without the due permission of the client. However, there are certain exceptions to the rule. Auditors may disclose information of his client without permission in response to a legitimately issued and enforceable subpoena. This study was conducted to investigate the reasoning process of auditors in Nigeria when faced with an ethical dilemma involving sensitive client information. The survey approach, involving three scenarios was used. The findings show that auditors usually adhere to the code of professional conduct in taking decisions. The study also shows that decisions taken in line with the code are not always in accord with good ethical reasoning. It is therefore recommended that the accountancy profession needs to emphasize the greatest 'good criterion' in drawing up codes of ethics for members.

Introduction

An audit is the independent examination of, and expression of opinion on the financial statements of an enterprise by an appointed auditor in compliance with any relevant statutory obligation. Auditing is an ethically precarious profession. In other disciplines such as Medicine and Law, the major responsibility is assisting the client. But the auditors confront more complicated professional issues. Although the clients compensate them by way of fees, their primary focus is to represent the public. When conducting an audit of financial statements, the auditor has the obligation to act with due care and diligence. The reasons for this are two folds: Firstly, the conduct of the auditor will be judged by reference to the standards generally applied by the accounting profession for the proper and competent conduct of an audit. Secondly, the auditor is required to express an opinion on the financial statements he has audited. This means that the auditor is expected to provide an impartial endorsement of financial statements.

In the course of an audit engagement, some irregularities and errors, which by their nature affect either the accounting records or financial statements, could come to the notice of the auditor. The auditor's responsibilities towards such irregularities and errors is to design his work so that he has a reasonable expectation of detecting those which might impair the truth or fairness of the financial statements. Accordingly, the auditor should seek reasonable assurance that those irregularities and errors which are material and might impair the truth and fairness have not occurred, or have either been corrected or properly disclosed in the financial statements.

In doing this, conflicts usually arise as the duties toward one interest group could be inconsistent with responsibilities to another group. This creates a situation of an ethical dilemma as the auditor's duty of confidentiality prevents him from reporting any irregularities (including fraud), other illegal acts or errors to third parties, without his client's permission. Should an auditor elect to publicize a discovered impropriety, he runs the risk of violating confidentiality, facing litigation, and damaging client's trust. Alternatively, if he withholds general release of this information his actions can be considered legally negligent. He also has to fear the resultant loss of reputation from being overly lenient.

Based on this conflict situation therefore, it is the objective of this study to examine empirically the reasoning process used by auditors in Nigeria in resolving ethical dilemma involving sensitive client information

Literature Review/ Theoretical Frame Work

Auditing and Auditor

Business organizations and even government agencies engage in commercial activities irrespective of size and nature, keep one form of records or the other. They also have written and unwritten policies and regulations. These organizations are also to comply with statutory regulations guiding their domain of activities. The records and the extent of compliance with policies and relevant regulations constitute valuable information to various groups of persons. The responsibility for keeping records and complying with relevant regulations rests with management of the organization. (CAMA, 1990. Sec 331-334)

On account of the agency relationship between providers and managers of resources, it therefore becomes logical that such accounting and other records should be subjected to some form of independent verification in order to confer reasonable credibility on them. The task of this independent verification constitutes the province of auditing and the person(s) who performs it is generally referred to as an *auditor*. (Mautz and Sharaf, 1961). The credibility of the auditor is taken seriously by the public because Accounting profession has a long history of reputation, integrity and veracity which has continued to justify its social and market relevance.

In adding credibility to the information conveyed in the financial statements, the auditors stand between the statement preparer and the statement users and should have regard to the interest of both. Since the user is in the weaker position by virtue of not having access to the detailed accounting records, the natural tendency for the auditor is to represent the user. However, according to Skinner (1987) when the auditor deals with the management directly, "the possibility of pressing the user viewpoint vigorously is limited by the fact that the auditor has a practical need to retain the goodwill of the management." This situation creates an ethical dilemma for the auditor, which he must resolve, using any applicable ethical theory.

Confidential Information.

The nature of accounting/auditing services makes it necessary for the accountant to have access to the most confidential information about a client's activities. Confidential information is information that should not be disclosed to outside parties unless demanded by a court or an administrative body having subpoena or power of summons. (Timothy and Robert, 2005). The client could be financially injured or embarrassed if the accountant were to leak such confidential information. A safe and proper approach for professional accountants to adopt is to assume that all unpublished information about a client's affairs, however gained, is confidential.

Since the principle of confidentiality is not only to keep information confidential but also to take all reasonable steps to preserve confidentiality, the auditor needs to employ ethical reasoning process in dealing with client confidential information.

Ethics

Ethics involves issues fundamental to practical decision-making. According to Woodrow (2003), ethics is "the systematic study of conduct based on moral principles, reflective choices and standards of right and wrong conduct." In the same vein, Omoregbe (1993) defines ethics as "the branch of Philosophy which deals with the morality of human actions"

According to Mautz and Sharaf, (1961) " Ethical conduct in auditing draws its justification and basic nature from the general theory of ethics. Hence ethical behaviour in auditing or in any other activity is no more than a special application of the general notion of ethical conduct devised for men generally."

It can therefore be seen that ethics is basically concerned with values—what human conduct should be rather than what actually is the case. The question is, is this the case in the accountancy/ auditing profession? Preston and Babara (1995) illustrate how the accountancy profession 'uses' its formal code of ethics, as a means of legitimizing its professional claims. Based on an historical comparison of the United States of America's (USA) code of ethics, they *rightly* conclude that "personal characteristics or virtues that lead to an 'ethical state of mind' have been replaced by techniques, specifically rules and rule following." This practice conflicts with the opinion of Jeffrey (1996) who opines that "ethical reasoning is a function of developing personal values." Also, Owolabi (2002) opines that "assimilation of the rules and standards of a profession affect ethical reasoning"

The implication of the above assertions is that the auditor as a person has been separated from the responsibility of moral behaviour. If a logical process, which adheres to the prevailing rules, is followed in making a decision, the individual is deemed to be acting ethically. This confirms the view of woodrow (2003) that prior research on ethical issues in auditing has generally avoided philosophical discussions about 'right' or 'wrong' or 'bad' or 'good' choices. Instead the focus has been on the ethical or unethical behaviour of accountants/auditors based on whether they conform to rule-oriented code of professional conduct. Based on the above, we present theories to explain the reasoning process of accountants when faced with ethical dilemma.

Theories of Ethical Reasoning.

The applied Psychology literature suggests that it may be impossible to at all times maintain a truly objective point of view by members of a profession who face social and economic pressure. (Appelbaum, 1987; Greenberg and Wursten, 1988; Howel, 1990 and Otto 1989). Therefore, the Psychology of ethical reasoning provides theories that explain the decision making process individuals adopt to resolve ethical conflicts such as those created in Accountant/client relationship.

Kohlberg's Stage Sequence Model

This area of Psychology is based on Kohlberg's (1969) stage sequence model that defined a series of cognitive levels of development. He described these levels as "pre-conventional morality" "conventional morality" and post conventional morality." These three levels can be understood as three different types of relationships between the self and society's rules and expectation. To a pre-conventional person, rules and social expectations are something external to the self; a conventional person identifies self in relation to others, a post conventional person differentiates the self from rules and expectation of others and defines his or her own values in terms of self chosen principles.

To the pre-conventional person, resolution of an ethical dilemma is simply based upon the immediate cost and/ benefits of an ethical action. To the conventional person, resolution is based upon the avoidance of harm to others belonging to one's social institution. The post conventional person frames an ethical judgement based upon an internalized, self-chosen set of principles.

Since its inception, much research has been conducted to validate the stage-process model of ethical development (Ponemon and Gabhart, 1994) but in the area of Accountant litigation support situations. This is because the accountant under the litigation support situation is not influenced by any written code of behaviour, as does the accountant in an auditing situation. This has made the application of the stage sequence model un-popular in an auditing situation. Consequently, auditors, in resolving ethical dilemmas over the years have used the Utilitarianism and Rule De-ontology theories of ethics (Barbara and Fannie, 1994)

Utilitarianism and Rule Deontology.

Utilitarian Principle: According to this principle, when faced with ethical dilemma, the consequences of the action are evaluated in terms of what produces the greatest amount of good for the greatest number of people. The emphasis here is on the consequences of the action rather than on the following of rules. The principle is therefor based on the 'greatest good criterion'. Matters, which should be taken into account when considering whether or not disclosure of confidential information would give rise to-the greatest good for the greatest number of people include-

- The extent to which members of the public are or are likely to be affected
- The gravity of the matter
- The relative size of the amount involved and the extent of the likely financial damage
- The reason for the client's unwillingness to disclose the matters to the proper authority
- The likelihood of repetition.

Rule deontology: This theory is based on a duty to a moral law. Thus, the auditor's actions rather than their consequences become the focus of the ethical reasoning process. Under this principle, an auditor is morally [and professionally] bound to act according to the requirement of a rule of conduct of the code without regard to a concern for the effect of that action. However, the auditor's duty of confidentiality to his client will not prevent him in certain circumstances from making a report to the appropriate regulatory body, no matter the content of the code of professional conduct. Examples of matters which it may be appropriate to bring to the attention of the regulatory authorities, the presence of a code notwithstanding, include-

- The occurrence of a significant failure or weakness in the system of internal control or accounting records
- The provision by management of materially misleading information (or the failure to provide material information) to the regulatory body/authorities
- The commission of a serious fraud or other misappropriations by senior management.

Except where it is inappropriate for the matter to be drawn to the attention of the directors (for example, if they are suspected of involvement in serious fraud), the auditor should normally request the management to make the relevant disclosure to the appropriate regulatory authorities and should only use his right to report the matter to such regulatory authorities where this request is not complied with.

From the above theories, it is clear that if utilitarianism were applied, each situation involving confidential client's information would have to be evaluated to determine if it would be morally right to disclose the information. The confidentiality rule would be followed only if that course of action would produce the greatest good to the greatest number of people.

If rule deontology is applied however, subject to the situations stated above, the professional code of conduct would be followed in all circumstances involving client's confidential information, regardless of the consequences.

Based on the utilitarian and rule de-ontology theories, the following hypotheses have been developed.

Hypotheses

1. H_o: Auditors in Nigeria do not adhere to the Code of rules of Professional ethics when resolving ethical dilemma involving sensitive client's information.

   H_i: Auditors in Nigeria adhere to the code of Professional ethics when resolving ethical dilemma involving sensitive client's information.

2. H_o: Adherence to rule of professional ethics is always in accord with good ethical reasoning in resolving ethical dilemma.

   H_i: Adherence to rule of professional ethics is not always in accord with good ethical reasoning.

3. H_o: Adherence to rule of professional ethics is not always influenced by career choice

   H_I: Adherence to rule of professional ethics is always influenced by career choice.

Methodology

The methodology of this research is mainly based on the survey method. The survey method is chosen because, according to Soyombo (2002), survey method of data collection is especially useful for the study of issues and events, such as opinions, attitude, preferences or disposition. From that standpoint, it is suitable for the study of this nature, which examines the reasoning process of auditors in dealing with clients' sensitive information.

To determine which reasoning process governs the behaviour of Auditors in resolving ethical dilemma involving confidential client's information, a survey consisting of three scenarios (with close ended questions) was distributed to one hundred (100) Auditors randomly selected during a Mandatory Continuous Professional Education (MCPE) session in Lagos. A response rate of 85% was achieved but 10% thereof was not usable. The distribution of the respondents shows the following career choice position: Public Accounting Practice 32, Industry 18, Public sector (Govt) 9, Academics 6 and self employed 10.

Each scenario required two responses (1) To inform or not to inform a third party of confidential client's information (2) to indicate which response given in (1) was considered "good ethical behaviour" if the Code was disregarded. Respondents were also asked to provide justification for their responses.

Scenario 1 relates to the preparation of a tax return whereas scenarios 2 and 3 involve information relating to an audit. The three scenarios are presented in the appendix.

The Chi square test was used to test the hypotheses formulated. The Chi square X^2 is a measure of the extent to which, in a given situation, pairs of observed and expected frequencies agree.

Data Analysis and Presentation.

The data presented was analyzed using the Chi square test statistic on Excel

Spreadsheet

The test statistic for the Chi-square tests is given as:

$$\chi^2 = \Sigma\left[\frac{(Oi - Ei)^2}{Ei}\right]$$

Where:

Oi = Observed frequencies

Ei = Expected frequencies.

Table 1 (Response and result of chi-square test)

Scenario	1	2	3	
Adherence to code	50	55	45	150
Non-adherence	15	18	20	53
Undecided	10	2	10	22
Total	75	75	75	225
Scenario				
Adherence to code	50.0	50.0	50.0	150.0
Non-adherence	17.7	17.7	17.7	53.0
Undecided	7.3	7.3	7.3	22.0
	75.0	75.0	75.0	225.0
			$\chi2$ (cal)	7.53516
			$\chi2$ (tab.)	0.110169

(Field survey, 2006)

The above table shows the sample results for adherence or non-adherence to code of professional ethics by respondents for each of the three scenarios as well as the result of the chi-square test.

Also, the table below shows the number of respondents who consider the responses made in table 1 above as either good ethical behaviour or not or undecided as well as the result of the Chi square test.

Table 2 (Response by respondents and results of chi-square test)

Scenario	1	2	3	
Adherence to code	50	45	40	135
Non-adherence	20	27	30	77
Undecided	5	3	5	13
Total	75	75	75	225
Scenario				
Adherence to code	45.0	45.0	45.0	135.0
Non-adrence	25.7	25.7	25.7	77.0
Undecided	4.3	4.3	4.3	13.0
Total	75.0	75.0	75.0	225.0
			$\chi 2$ (cal.)	3.778444
			χ^2 (tab.)	0.43682

(Source: field survey, 2006)

Discussion and Conclusion.

Scenario 1: Given a code, 50 (66.7%) of the respondents (see table 1) would adhere to the code and not inform the Internal Revenue Service. This is consistent with the justification that Auditors see themselves to be advocates of the client in tax matters. The same number of respondents also see this as a good ethical behaviour (see table 2)

Scenario 2 Most auditors 55 (73.3%) would adhere to the code and not inform any third party. However, 45 (60%) of the respondents consider not informing any third party as not a good ethical behaviour as the non- disclosure could have adverse consequences on the lives of the people. There appears to be a conflict here in adhering to the code.(see tables 1&2).

Scenario 3. *Given a code.45 (60%) of the respondents would adhere to the code and not inform any third party. However, only 40 (53.3%) feel this is the best ethical behaviour.*

4.1 Test Of Hypotheses

To test the hypotheses formulated for this study the Chi-square technique was used.

Hypothesis 1. Using the data in table 1 above, our calculated X^2 = 7.53516. This is greater than the critical value of $X^2_{0.05}$ == 0.110169 at 2 degrees of freedom (df). The (df) is given as n-1. Thus, we reject the null hypothesis, which states that: Auditors in Nigeria do not adhere to the code of rule of professional ethics when resolving dilemma involving sensitive client's information. The alternative hypothesis is therefore accepted.

Hypothesis 2. We used the data in table 2 to test hypothesis 2. Our calculated X^2 = 3.77944. This is greater than the critical value of X^2 = 0.43682 at 2 df. Thus we reject the null hypothesis which states that adherence to rule of professional code of ethics is always in accord with good ethical behaviour. Therefore we accept the alternative hypothesis.

Hypothesis 3. Using the data in table 1, our calculated X^2 = 3.69. This is < the critical value of $X^2_{0.05}$ = 15.5 at 8 degrees of freedom (df). The (df) is given as df = (r-1)(c-1). Thus, we accept the null hypothesis that adherence to rules of professional ethics is not always influenced by career choice. That is, the choice as to whether or not to follow rules of ethical conduct is not career dependent.

The overall findings of this survey are consistent with earlier studies (Barbara and Fannie, 1994) on the reasoning process of auditors in resolving issues involving ethical dilemma. Thus: (i) most accountants prefer to adhere to professional code of conduct in resolving ethical dilemmas (ii) the decision to adhere to rules of professional conduct is not career dependent and (iii) following the rules of ethical conduct is not always in accord with good ethical reasoning.

A major issue related to these findings is this: The ethical sensitivity as well as improved problem solving of the accountant is crippled by always following the rules of professional ethics in resolving ethical dilemma. Consequently, accountants are not likely to be able to reach maximum capacity to handle principled ethical judgement.

However, the following limitations should be considered carefully before seeking to generalize the findings of this survey. First, the sample size is small relative to the number of accountants in Nigeria and hence very significant generalizations cannot be reached. Secondly, the respondents were drawn from only one of the duly recognized accountancy bodies in Nigeria. Further studies on this topic should therefore consider a much larger sample encompassing all the duly recognized accountancy bodies in Nigeria.

Conclusions and Implications

The findings of this study indicate that auditors in Nigeria usually adhere to the Code of professional ethics (rule de ontology) in resolving issues involving client's confidential information. It was found however that such decisions are not always in accord with what they perceive as 'good ethical behaviour'. This suggests that ethical conduct mean much more than abiding by a letter of a rule. It means accepting a responsibility to do what is right and honourable at all time to promote the greatest good of the greatest number of people even if some inconveniences have to be suffered in the process. We therefore recommend that the accountancy profession needs to emphasize the 'greatest good criterion' in drawing up a code of ethics for members.

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