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Stamatis Generic Model and Audit Quality in Nigeria

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Abstract: Due to the frequent business failure coupled with incessant malpractices and increase in fraud techniques, there is a need for auditors to improve audit quality to address these negative occurrences. This study investigated the application of Stamatis generic model as a continuous quality improvement technique to influence audit quality in Nigeria. The population consists of 916 licensed auditing firms in Nigeria and 683 was the sample size upon which questionnaire was administered. 641 copies of questionnaire were returned representing a response rate of 94%. The questionnaire was validated by certified quality management. The reliability and internal consistency of the instrument for data collection was confirmed by the Cronbach's Alpha reliability coefficients (Rc) of 82% obtained from pilot study. Pearson product moment correlation coefficient was used to confirm the research hypotheses. The result obtained showed positive correlations and statistically significant relationships among the level of Stamatis generic model awareness and degree of implementation ($r = .752$; $p = .000$) and the application of Stamatis generic model and audit quality ($r = .630$; $p = .000$). Findings show that though the model theoretically predicted audit quality but are yet to be implemented by auditors in Nigeria as a result of ignorance, inexperience and low level of firms' resources. The study concluded that Stamatis generic model will improve the quality of auditor's reports if implemented and through multiplier effect, influences the integrity of financial statements and stakeholders' decision. It was recommended that audit firms should adopt SGM to have quality output and satisfied clients.

Keywords: Audit quality, Audit practice, Stamatis generic model, Quality improvement.

1. Introduction

An organization is viewed as a network of contracts in which several groups make some kind of input to the company for a given price. In return for their contributions, the stakeholder demands accountability from management and this is fulfilled through preparation and presentation of financial statements to members of the company (Hayes *et al.*, 2005). Management may window dress the accounts to hide their lack of success. Therefore, the stakeholders need assurance from a third party that the financial statements show a true and fair view. The demand for audit services is the direct consequence of the participation of these parties in the company affairs. Recently all over the world, financial statements which play a principal role in investment and business management decisions have experienced various forms of manipulations by management and the auditor's reports have not been able to clearly resolve this disorder as in the case of Enron, WorldCom, Bradford & Bingley Washington Mutual, and various banks and finance houses in Nigeria which suddenly collapsed after the auditors clean bill health.

According to Anderson *et al.* (1998), independent auditors are charged primarily with the responsibility of reporting on the financial statements of organizations. They are to state categorically whether or not in their opinion, the statements show a true and fair view of the profit or loss and the financial position of the company. In statutory audit, the auditor who must be a professional, can neither vary nor limit his reports as it must be in compliance with the status (Uzuh, 2006). The auditor also renders other services in which reports are generated for the clients. Such other reports are expected both to be in line with the terms of reference and have a good measure of quality. The audit clients should have value for his money and be satisfied at the end of the assignment (Eduardo *et al.*, 2002). Whether the assignment is statutory or non statutory, the auditor should take necessary steps to improve the methodologies used, tools applied, work flow and the quality of his outputs (DeFond *et al.*, 2002). Okpala (2012) stated that initially, the idea of quality management upon which Stamatis generic model is based is a platform for reducing defects and errors in products through the use of measurements, well defined methodology and steps.

The outcome of the quality improvement was the achievement of superior performance and minimizing the cost of production (Nwabueze, 2001). Organizations realized that achievement of continuous improvement may be impossible without significant attention to the quality of the management practices excised on the day to day basis irrespective of caliber of staff in employment and relationship between the audit practice and her clients (Nwabueze, 2001). This was the beginning of quality improvement in service delivery as studies in the banking industry (Zeithaml and Bitner, 1996). Based on the perception of Nigerian auditors, quality management in auditing is practiced more by multinationals audit firms. These include big four audit firms in Nigeria - KPMG, Ernst &Young,

Delloitte and PwC that understood the concept, having foreign technical supports and enough resources at their disposal (Okpala, 2012).

1.1. Statement of the Problem

Based on the information available at the membership department of the Institute of Chartered Accountants of Nigeria, 916 audit practices were licensed to practice in Nigeria. 842 audit firms were classified as small and medium practice (SMPs) with only one or two partners. These firms lack the resource ability to implement quality improvement that leads to a notable audit quality. Inability of small audit practicing firms to implement quality audit management has generated a number of negative issues such as (i) failure to improve services quality and output that is in line with standard (ii) failure to identify client segment, based on their resources availability (iii) failure to define the process required to perform a job in order to ensure audit quality (iv) failure to establish a zero-defect process and eliminate waste (v) failure to ensure a continuous improvement by obtaining continuous feedback from the clients using appropriate methods. The implications of the above failures coupled with the fact that there is advancement in fraud techniques and financial malpractices, complexity in competition, sudden collapse of viable companies, suggest the need for further investigation on quality audit management procedure or use of model in Nigeria.

2. Extant Literature and Theoretical Premise

2.1. Conceptual Framework

According to Wallace (1980), the three hypotheses that explain the role of the audit in free and regulated markets are: (a) The monitoring hypothesis which assumes that when delegating decision-making power to one party as suggested in agency theory, the agent is motivated to agree to be monitored if the benefits from such activities exceed the related costs. This hypothesis is applicable to all co-operative associations such as principal - agent relationship (Wallace, 1987). This principle assists the users and shareholders to revolve two types of problems namely: (i) the hidden action - moral hazard and (ii) the hidden information -information asymmetry (Beaver, 1989). The audit committees are also considered to be a part of corporate governance mechanism that improves the auditor's effectiveness, increases the quality of audit output and enhances the stakeholders' confidence on the financial statement (Ng and Tan, 2003). (b) The information hypothesis is a complementary proposition to the monitoring thesis which supports the argument that the demand for audited financial statements is the basis for the provision of information that enables investors to decide where, how and when to invest (Higson, 2003; Wallace, 1987). Information hypothesis views an audit as valued by investors to be a means of improving the quality of financial information for the determination of market values of investments and a basis for useful economic decisions (Wallace, 2004). Fama and Laffer (1971) stated that the three major benefits of information include: reduction of risk, improvement of decision-making and earnings - trading profits. Audited financial statements can assist stakeholders to achieve the above. (c) The insurance hypothesis shows how the demand for audits evolves and relates to management's liability exposure (Wallace, 1980). In US under the Securities Act, the auditor and auditee are jointly and severally liable to third parties for losses emanating from defective financial statements. Krishnamurthy *et al.* (2006) Stated that the going concern audit report information is considered without negative when the environment perceives the existence of insurance. The three hypotheses discussed above can only be achieved where audit quality exists and reports are of good and acceptable standard.

2.1.1. Audit Quality

Audit quality is defined as the probability that (i) an auditor will both discover and truthfully report material errors, misrepresentation, and /or omissions in the client's financial statements (DeAngelo, 1981), (ii) an auditor will not issue an unqualified report for statements containing material errors and / or unresolved disagreements (Lee *et al.*, 2007). (iii) there is an accuracy in auditor's information reporting (Davidson and Neu, 1993), and (iv) there is considerable measure of the audit's ability to reduce noise and bias and improve meticulousness in accounting information (Wallace, 1980). The above measures moderate the audit services in the provision of independent verification for the purpose of producing credible reports to the stakeholders to enhance the integrity of financial statements. To have a sufficient audit quality, there must be adequate planning, proper recording, control and review of audit working papers (Gaynor *et al.*, 2006; Watkins *et al.*, 2004).

Audit quality is achieved through the application of quality management principles or the use of quality model on the audit process. Quality lends reliability and integrity to the audited financial statements which will boost investors confident (Okpala, 2012). Investors and shareholders would have little or no confidence in non-credible audited report. All institutions including audit firms depend on having satisfied clients to make progress (Dale, 2003). Adoption of quality principle or model such as Stamatis generic model for the implementation of clients' service is the key to a success in audit assignment. In addition to quality management approaches, the auditor should also be independent to have unbiased mental attitude in making decisions throughout the audit assignment and financial reporting (Bartlett, 1993). In the absence of independence and quality management, the value of audit services will be greatly impaired (Sweeney, 1992). This will also amplifies the likelihood that auditor would neither discover any breach or misstatements nor report them even if they are found (Lindberg and Beck, 2004). If the auditors' watch word is quality which is fundamental to credible reporting, they will use appropriate strategy in the conduct of the audit and issues requiring investigation where necessary (Ittonen, 2010).

2.1.2. Stamatis 1996 Generic Model and Audit Quality

Stamatis generic model of six step approach was propounded in 1996 by D.H. Stamatis for continuous quality improvement. It states that pleasing customers through understanding their present needs and future requirements is the root of quality improvement that produces satisfied clients (Dale, 2003). Audit quality is important in the face of sudden collapse of companies all over the world with auditors at the centre of the scandals. According to Dale (2003), auditors that do not produce credible report may be removed from the office would amount to lost market shares to competitors who are quality conscientious. Audit report issued to the members of a client company is the output from an audit assignment. It is the expression of the auditor's opinion on the truth and fair view of an organization's financial statements. Section 359 (1) of the Companies and Allied Matters Act (CAMA) 1990 states the statuary duty of the auditor and by virtue of Section 359(3) the auditor is responsible for expression of his opinion and the issuance of report to the members of company. Quality audit gives birth to quality output which addresses the needs of all stakeholders and result in client's satisfaction. The six-step approach stamatis 1996 generic model are as follow:

Table-1. Six-step Approach Stamatis Generic Model

STEPS	MODEL	APPLICATION TO AUDIT PRACTICE
Step 1	Identify the added value to service that is to be rendered to the customer	Statutory audit report should neither be limited nor varied as the report should be in accordance with law. Reports from other assignment must be in line with the terms of reference. The auditor should identify areas to add value to his client's business by providing extra services that makes him stand out.
Step 2	Identify the customer segment and clearly determine their expectations	The auditor should identify his client segments taken into consideration his limiting factor e.g. staff strength, technology and expertise taking into account the terms of reference as well as finance available. He should also embrace the concept of fairness to address the need of all stakeholders of financial statements. Where the audit is complex, the auditor should collaborate with bigger firm to provide quality job.
Step 3	Identify individual client's critical needs required for customer satisfaction	The critical need for all clients' satisfaction is the credible reports that address the actual financial position of the company. The auditor should also identify issues of importance that will undermine the client's business and resolve them through letter of weakness.
Step 4	Define the process required to perform the work in order to ensure quality customer service	Auditing standard and guidelines requires the auditor to effectively plan, perform, record and review to produce quality reports. This is achieved by the application of quality methodology such as SGM. In this circumstance, the auditor should design an audit program using narrative note or flow chart.
Step 5	Establish a zero-defect process and eliminate wasted efforts	Independent review process by senior partners should establish to avoid error and misstatement in the audited financial statements. The auditor should adopt a multiple or peer review to ensure an error free audited reports.
Step 6	Ensure continuous quality improvement by obtaining continuous feedback from the clients	Feedback mechanism should be established by the auditors to enable them receive the clients and the investing public opinion on the quality of their reports. This can be achieved through a structure questionnaire or interview.

Source: Okpala (2012)

The quality performance objectives (internal and external) indicated by Pycraft *et al.* (2000) are all critical to institutional success. A comprehensive plan to implement measurable quality standards must be developed in an audit firm (Selladurai, 2000).

2.1.3. Audit Size and Resource Availability

The size of the audit is determined by the resources available, technical support at its disposal, level of technology and the market share. Those are the factors which determine the process to be adopted and quality of audit output. The "Big Four" today are the four largest international professional services networks, offering audit, assurance, tax, consulting, advisory, actuarial, corporate finance, and legal services PricewaterhouseCoopers -PwC (2014). They handle the vast majority of audit accounts for publicly traded companies across the globe and had form an oligopoly in auditing large companies. This group was once known as the "Big Eight", and was reduced to the "Big Six" and then "Big Five" by a series of mergers and finally became the Big Four after the demise of Arthur Andersen in 2002, following its involvement in the Enron scandal (PricewaterhouseCoopers -PwC, 2014). The major reason for this trend is to enlarge the size the firm and increase the audit quality. Most notably, the empirical evidence strongly suggests that Big 4 auditors are of higher quality (real and/or perceived) and that they command higher audit fees (Watkins *et al.*, 2004). Table 2 shows information relating to the big four in December 31, 2014.

Table-2. The Big Four Audit Firms

Firm	Revenues $b	Employees	Revenue per employee	Firms' Head Quarters
Deloitte	$34.2b	210,000	$162,857	USA
Ernst & Young	$27.4b	190,000	$144.211	UK
KPMG	$24.8b	162,000	$153.209	Netherlands
PwC	$34.0b	195,000	$174.359	UK

Source: PricewaterhouseCoopers -PwC (2014)

It is on this note the institute of chartered accountants of Nigeria have been advocating for merger of sole practitioners to pool resources that will affect audit quality in Nigeria.

2.2. Theoretical Underpinning

There are many theories which attempted to explain the reason s for the demand for audit services but the set of theories used to underpin this study according to Hayes *et al.* (2005) are: The lending credibility theory and The theory of inspired confidence. The lending credibility theory suggests that the primary function of the audit is to add credibility to the financial statements. In this view, the auditor's service selling point to the clients is credibility. Audited financial statements are seen to have elements that increase the financial statements users' confidence in the figures presented by the management. According to Limperg (1932), the theory of inspired confidence also known as theory of rational expectations addresses both the demand and the supply for audit services. The demand for audit services is direct consequence of the participation of stakeholders in the company who demands accountability from the management in return for their investments in the company. The stakeholders' and auditor relationship is based on the agency theory (Arrow, 1985) This suggests that the auditor is appointed in the interests of both the third parties and the management to resolve the problem of assurance (Watts and Zimmerman, 1979). The auditor accomplishes the professional task through his judgment in form of reports. In the past, it is claimed that the auditor is responsible for searching, discovering and preventing fraud in his client company which was an early 20th century perception. More recently, the focus of auditors has been to provide reasonable assurance and verify the truth and fairness of the financial statements, though detection of fraud as the auditor's responsibilities has not diminished.

2.3. Empirical Framework

According to Lennox (1999), the size of audit firm and reputation has a direct association with quality of report produced. The relationship between the auditor's reputation and the quality of work is provided by economic theorists such as Klein and Leffler (1981) and Shapiro (1982). The gaps identified in the study are as follows: (i) there is a dearth of research interest on audit quality models which made it impossible for conclusion to be drawn on the relationship between the audit quality and quality improvement model. Stamatis 1996 generic model initially applies only to production setting and to best of the researcher's knowledge has not been used for professional service oriented company. Therefore this research is exploratory hence empirical evidence through which the result of this study will be compared may not be available. It is on this note that this research is conducted to establish the link between quality improvement and audit quality to contribute to the body of knowledge.

2.4. Research Objective and Hypotheses Development

The key research objective of the study is to investigate Stamatis generic model and audit quality in Nigeria while secondary objectives are to examine the level of awareness and degree of implementation of SGM in Nigeria and the application of SGM and audit quality in Nigeria. Based on the research objectives and the need to validate the research question, the study hypotheses formulated are:

Hypothesis 1: There is no significant relationship between level of awareness and degree of implementation of SGM in Nigeria.

Hypothesis 2: There is no significant relationship between the applications of SGM and audit quality in Nigeria.

3. Materials and Methods

A cross-sectional research design was used due to its ability to capture research questions raised in the study (Bhattacharya and Thakor, 1993) and also deals with the complex relationship between the variables which is not subject to management (Baridam, 2001). The population of the study consists of 916 audit firms in Nigeria licensed by the Institute of Chartered Accountants of Nigeria to provide auditing services with 1,326 partners and sole practitioners' capacity. Sample frame is made up of 340 firms with between two (2) to eighteen (18) partners in Nigeria and 79 sole practitioners that meet the following criteria: Having office accommodation, having at least two employees - receptionist and a messenger and also having other facilities recommended by ICAN-membership department. The sample size of 683 principal officers from 340 firms was determined as follows in January 2014:

Table-3. The size determination

No of partners	1	2 -3	4-5	6-18	Total	Remarks
No of firms	79	229	23	9	340	The 79 sole practitioners out 655 were selected based on researcher knowledge and ICAN established criteria
Selected no of employees	1	2	4	6		
Total sample size	79	458	92	54	683	

Source: Field survey, January 2014

The instrument is a 7 - term survey questionnaire with a - 7 Likert scale response options (very high, high, slightly high, no effect, slightly low, low and very low). It was structured in line with the research objectives and hypotheses of the study. Total enumeration of 683 was conducted to minimize sampling errors and have a very good result (Comfrey and Lee, 1992). Selected respondents were independent of age and sex. The questionnaire was developed from conceptual and theoretical framework. An exploratory factor analysis was conducted to confirm the instrument's reliability. Cronbach's Alpha reliability coefficients (Rc) result obtained is 82% which confirmed the reliability and internal consistency of the instrument for data collection. Pearson product moment correlation coefficient statistical instrument was used to confirm the hypotheses. The formula for PPMC (r) is stated below:

$$r = \frac{n\Sigma xy - (\Sigma x)(\Sigma y)}{\sqrt{n\,[\Sigma x^2 - (\Sigma x)^2]\,[n\Sigma y^2 - (\Sigma y^2)]}}$$

4. Data Presentation, Analysis and Interpretation

683 copies of questionnaire were administered out of which 641 were correctly filled and returned representing 4%. The response rate is considered excellent for the study. The 641 response was analysed using PPMC. The data elicited from respondents was analyzed using IBM SPSS version 21.

4.1. Interpretation and Discussion of Results

Table 4 below presents the results of the Pearson correlation between the dependent variable – implementation and independent variable – awareness. The correlation between Awareness of SGM and Implementation was (r =.752; p =.000) indicating a high, positive and significant relationship between the variables. Table 4 below indicates that the correlation between application of SGM and audit quality was (r =.630; p =.000) indicating a high, positive and significant relationship between the variables. Thus the correlation results provide evidence in opposition to hypothesis one and two in Table 3 below. Therefore, the all null hypotheses (**Ho_1,** and **Ho_2**,) which states that there is no significant relationship between level of awareness and degree of implementation of SGM in Nigeria audit firms and there no significant relationship between the applications of SGM and audit quality in Nigeria are hereby rejected and all alternate hypotheses are not rejected. Lack of awareness and application of SGM model shown in table 5 might have emanated from ignorance on the part of the auditors and also the refusal of many partners of small and medium size audit practices in Nigeria to improve quality. Question 1 in the questionnaire addressed the issue of the level awareness of SGM in Nigeria. 420 respondents representing 65.5% agreed with very low option. This was confirmed by question 3 in the questionnaire with 259 respondents representing 40.4% which have very low opinion that auditors have at least 3 years SGM implementation experience in Nigeria. This is in conformity with hypothesis 1. In hypothesis 2, the high, positive and significant relationship between the SGM application and audit quality seems to be theoretical as only few audit firms in Nigeria have implemented the model. The firms were found among the big four audit firms in Nigeria with foreign technical support representing 21 respondents (3.3%) as shown in table 2 above. Question 2 addressed the issue of adoption of SGM model. 253 respondents representing 39.5% agreed with very low opinion that their respective organization has adopted the model and applied it in every audit engagement.

5. Findings, Conclusion and Recommendations

5.1. Summary of Findings

The theoretical findings based on the literature reviewed, questionnaires administered and thesis tested shows that (a) for auditors to produce quality reports, he should: (i) be independence and embraced integrity (ii) continuously improve on the current business system by adopting one of quality improvement models such as SGM (iii) use current audit technologies such as system accounting and auditing software (b) The awareness of SGM is significant to implementation of the programme (c) Most auditing firms in Nigeria have not adopted SGM due to staff constraint, poor level of technology and financial limitation (d) Most audit staff do not improvement focus. They do not attend training even those organized by the institute of chartered accountants of Nigeria free of charge. An inquiry into members' credit hours shows that some principal partners for the past 5 years have not attended MCPE. (e) Selection of 79 sole practitioners was due to the fact that most sole practitioners in Nigeria do not have the minimum facilities prescribed by ICAN membership department. Majorities of audit firms in Nigeria are small and medium size practice (SMPs), therefore the qualities of the audit reports produced by this segment are in doubt. This is in line with the opinion of Lennox (1999).

5.2. Concluding Remarks

From the findings in the preceding section of this study, the following conclusions were drawn: (i) for appropriate economic informed decision to be made by the investing public, auditor's report must be credible to give strength to the financial statements of organizations. (ii) No matter the incentive, the auditor's independence must not be compromised (iii) Auditors should adopt one or more of quality management approaches or models to improve his output.

5.3. Recommendations

The study based on the above conclusion therefore recommend that: (i) where there are human resources and technologies constraint, small and medium size practice (SMPs) should merge in line with the ICAN guidelines on practice merger (ii) adequate training of staff should be embarked upon by firms in Nigeria to increase professional competence and achieve quality reports (iii) that ICAN committees responsible for education and training should reduce the cost MCPE to enable principal officer of sole practitioners to attend and should carry out more research to improve the profession (iv) practice monitoring committee should wake up to their responsibility by making sure that firm must have minimum requirement to enable them practice. Implementing this recommendation will enable the auditors to achieve monitoring and reduce the problem e.g. moral hazard and information asymmetry, provide information necessary to assist stakeholders in making informed economic decision and also provide the needed insurance (Wallace, 1980).

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Appendix 1
Test of Statistical Hypothesis
Restatement of Research Hypothesis
Hypothesis 1

H0: There is no significant relationship between degree of awareness and implementation of SGM in Nigeria.
H1: There is a significant relationship between degree of awareness and implementation of SGM in Nigeria.

Hypothesis 2

H0: there is no significant relationship between the applications of SGM and audit quality in Nigeria.
H1: There is a significant relationship between the applications of SGM and audit quality in Nigeria.

Table-4. Correlations

		Y	**x_1**	**x_2**
x_1	Pearson Correlation	.752	1	
	Sig. (2-tailed)	.000		
	N	641	641	
x_2	Pearson Correlation	.630**	.521**	1
	Sig. (2-tailed)	.000	.000	
	N	641	641	641

** Correlation is significant at the 0.01 level (2-tailed).
 * Correlation is significant at the 0.05 level (2-tailed).

Source: Field Survey, 2014

Table-5. Analysis of Respondents' information on application of SGM and audit quality. (Question 1 – 7 in Questionnaire)

No	**Question**	**SS**	**Respondent's Opinion**						
			VH	**H**	**SLH**	**U**	**SLL**	**L**	**VL**
1	The level awareness of SGM in Nigeria is high	**641**	**6**	**10**	**9**	**14**	**74**	**108**	**420**
	Percentage (%)	100%	0.9%	1.6%	1.4%	2.2%	11.5%	16.8%	65.5%
2	My organization has adopted SGM and applied it in every audit engagement	**641**	**9**	**12**	**24**	**6**	**123**	**214**	**253**
	Percentage (%)	100%	1.4%	1.9%	3.7%	0.9%	19.2%	33.4%	39.5%
3	I have at least 3 years SGM implementation experience in audit firm	**641**	**9**	**12**	**24**	**6**	**120**	**211**	**259**
	Percentage (%)	100%	1.4%	1.9%	3.7%	0.9%	18.7%	32.9%	40.4%
4	SGM has positively influenced the credibility of audit report in my firm	**641**	**0**	**0**	**0**	**0**	**0**	**223**	**418**
	Percentage (%)	100%	0.0%	0.0%	0.0%	0.0%	0.0%	34.8%	65.2%
5	Audit Practices in Nigeria have enough resources to implement SGM	**641**	**4**	**5**	**3**	**7**	**25**	**174**	**423**
	Percentage (%)	100%	0.6%	0.8%	0.5%	1.1%	3.9%	27.1%	66.0%
6	The application of SGM has improves the auditor's reports in Nigeria	**641**	**12**	**13**	**14**	**3**	**21**	**180**	**398**
	Percentage (%)	100%	1.9%	2.0%	2.2%	0.5%	3.3%	28.1%	62.1%
7	Audit firms in Nigeria indicated interest in the adoption SGM	**641**	**11**	**13**	**8**	**0**	**34**	**156**	**419**
	Percentage (%)	100%	1.7%	2.0%	1.2%	0.0%	5.3%	24.3%	65.4%

Source: Author's Computation, (2015) Key: SS = Sample size.