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LEGAL AUDIT AS A CRUCIAL RESPONSE TO THE LEGAL AND FINANCIAL UNCERTAINTIES FACED BY ORGANISATIONS IN THE 21st CENTURY

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INTRODUCTION

"If we are left intact, we would try to fix the department to what it ought to be –effective, efficient and responsive to the public. I see myself as part of the solution. This audit is something we requested."

Helen White

The term legal audit may sound unfamiliar in the Nigerian businesses due to the fact that the common man as well as the average organization is well acquainted with the term financial audit. Financial audit can be defined as the authentication of the financial statements or records of a company with the intention of expressing an audit opinion. It also means the critical investigation of a company's financial records and documentation. Most importantly, businesses, with the exception of nonprofit organizations are run for the sole reason of maximizing profit and not for encouraging loss. Thus, financial audits are conducted with the aim of giving shareholders; board of directors and investors a clearer standpoint on the location of a company in the profit and loss margin. Presently, financial audit has become a house-hold name and a friend that helps organizations keep their businesses above sea level by giving them an accurate picture of the financial reliability of their organizations. In sum, financial audit creates awareness to organizations on their profit and loss margin while correcting errors in their financial statements.

Generally, organizations and the businesses they carry on are governed by law. Failure to comply with the specific laws governing a particular organization can attract penalties and/or legal liabilities in the form of litigation. However, the nature of law is such that it might be difficult for an in-house counsel to identify all the existing loopholes in the entire departments of an organization. Moreover, the major function of an in-house counsel is to vet legal documents or proffer solution to legal liabilities incurred by the organization. The function of the in-house counsel more often than not does not cover the following: the examination or analysis of the intricacies of the law; the interpretation of complicated sections of the law with hidden legal implications; the continuous development of the law in dynamic sectors; the systematic compliance with provisions of the law; and the numerous legal restrictions of the law which can be used as a tool to hold an organization legally responsible for an action or omission. Such risks cannot be easily foreseen or prevented by equipping an organization with the best in-house counsel or by conducting a financial audit on an organization. Legal audit on the other hand is quite different from financial audit but encompasses financial audit by ensuring that financial audits have been conducted in addition to ensuring that a company has observed the laws and policies which are applicable to that company.

Therefore, the above analysis boils down to this question: Is legal audit necessary for organizations carrying out businesses in Nigeria? This paper examines the concept of legal audit by tracing the history of audit, it thereafter examines the meaning of legal audit and how it applies to organizations carrying on business in Nigeria. It also analyses the benefits attached to conducting a legal audit as well as provides a description of the various types of legal audit. It concludes by suggesting legal audit as a means of putting an end to endless court cases, financial liabilities and avoidable legal liabilities in organizations.

THE CONCEPT OF LEGAL AUDIT

Historically, audit originated from England in 1314 when Queen Elizabeth demanded for an audit to be carried out. Subsequently, the auditors of the Imprest were established in 1559 with the formal task of auditing Exchequers payments. In 1866, the audit system in England experienced tremendous improvement when William Gladstone changed the monitoring procedure as a reform program on public finance. The monitoring procedure also included expenditure of the parliament. Thereafter, financial audits became broadly regulated by government bodies, courts, financial institutions and company investors.

In Nigeria, section 85 of the Constitution of the Federal Republic of Nigeria 1999, makes it mandatory for an Auditor General of the federation to be appointed. Further, it is obligatory for the public accounts of the federation and of all offices and courts of the federation to be audited by the Auditor General. Thus, the Auditor General shall have access to all books, records, returns and other documents relating to the accounts mentioned above. The implication of the provision of the law is that financial audit is mandatory for the Government of Nigeria's parastatals. However, there is no provision in the Constitution of the Federal Republic of Nigeria 1999, with regards to the conduct of legal audit on businesses generally and specifically on the Government of Nigeria's parastatals. There also seems to be no history on the concept of legal audit although, the conduct of legal audit exercise exists in some parts of the world.

Presently, audits are not restricted to financial auditing but also include non financial areas such as safety, security, information systems performance and the environment amongst others. Audits also include legal audit which is increasingly becoming an extremely important aspect or area in auditing. This is in view of the fact that every organization or business needs to conduct its affairs in accordance with the law which regulates that area of the organization. Failure to act in accordance with the law can lead to drastic consequences which would have been prevented if a legal audit was conducted. It is therefore contended that the emergence of legal audit can be said to have arisen from the need to prevent further legal and financial liabilities as a result of the action or omission of a company. The above assertion draws out the necessity to define the concept of legal audit below.

WHY NOT LEGAL AUDIT?

According to N. Madison, legal audit has two definitions, first it is generally defined as 'a process in which billing practices and policies are analyzed to check for inaccurate inefficient or abusive legal billing.' Madison explained that in such situation law firms engage the services of auditing companies to audit the law firm in order to ensure compliance with billing standards. In other words, a certain fraction of Madison's first definition of legal audit falls into financial audit being carried out on law firms. Second, legal audit means 'a process by which a company's risks are identified and analyzed with the goal of using the information to minimize the company's risk. It can be deduced from the second definition that companies engage the services of law firms to audit their documents, processes, procedures, etc. in order to prevent and/or mitigate whatever legal risk or liability that has been incurred. Hence, the second definition is very relevant in having a clearer understanding on the concept of legal audit as it relates to this article and as opposed to the first definition.

Sherman, on his part described legal audit as 'periodic reality checks to test and adjust the validity of a business model.'

From the above definitions proffered by Madison and Sherman, it can be said that the major aim of a legal audit is to examine a company's legal requirements while establishing in the process what that company's legal requirements would be in the future. In addition, legal audit is useful in assessing changes in laws, new dangers that can arise from such changes in law, business strategies and structures.

Although, it is not expressly stated in Nigerian laws that every company carrying on businesses in Nigeria must be legally audited periodically, the benefits that accrue from carrying out a legal audit exercise out shadows the non explicit provision in law. It must be pointed out here that different areas of law directly and indirectly make provisions for audit. For instance Companies and Allied Matters Act, 1990, LFN, Cap C20, provide for the audit of financial statements of companies in section 357 when it specifically stated that 'Every company shall at each annual general meeting appoint an auditor or auditors to audit the financial statements of the company ...'

Every company has concealed legal difficulties which can cost them crucial financial loss or even disrupt the smooth running of their business. In addition, companies can suffer destruction in their brand due to legal and financial liabilities. For instance, there's a report on the alleged theft of 87billion naira by the Ex Managing Director of Afribank and others. Amongst the charges before the Ikeja High Court was the alleged fraud of the conversion of 2 million Afribank shares belonging to 1,258 subscribers of Afribank Nigeria Plc. The case was brought under the Criminal Code Law, Laws of Lagos State, 2003; it is however contended that the alleged fraud is also covered by the Code of Corporate Governance. This assertion is supported by section 2(3) of the Code of Corporate Governance for Banks in Nigeria Post Consolidation, 2006 which highlighted fraudulent practices among members of the board, management and staff as one of the weaknesses in Corporate Governance of Banks in Nigeria. The alleged fraud was committed by the Managing Director and others who might have been staff, members of the board or the management.

The above cited example exhibits the need for legal audit, for Afribank would not have suffered terrible damage to their brand, and the scandal would have been prevented in the first place had there been a regular conduct of legal audit exercise. Thus, a legal audit would have ensured that Afribank was complying with the provisions of the Code of Good Corporate Governance, Companies and Allied Matters Act and a whole lot of laws that relate to the banking industry. Further, a proper assessment of the laws, procedures, documents and practices in Afribank would have revealed the alleged fraud committed and prevented a national scene as illustrated by the Economic and Financial Crimes Commission (EFCC)'s arrest of the bank's ex Managing Director. The financial loss and the brand destruction that Afribank has incurred as a result of the lack of confidence in the management preceding the arrest of the managing director would very well have been prevented.

It is also contended that legal audit exercises are not only conducted to prevent and/or mitigate losses, but can also be used to increase and reveal new areas which can be another source of revenue to the organization. It is against this background that the question: 'why not legal audit' is very appropriate in Nigerian businesses.

ELIGIBILITY TO ACT AS LEGAL AUDITORS

Legal audit like financial audit can only be conducted by professionals. The term legal audit connotes the legality involved in a legal audit exercise. Thus, just as financial audit is conducted by accountants; legal audit exercise is conducted by lawyers. In the case of Nigeria, it is conducted by a Barrister and Solicitor of the Supreme Court of Nigeria who has knowledge on the subject matter of legal audit. A legal audit cannot be conducted by an in-house counsel of a company. The rapid rise in operations, the swiftness in changing business scenarios and compliance with different laws necessitate the need for an external support such as legal auditors as against in-house counsel. The reason is quite simple and lies in the fact that every company needs a third eye to scrutinize the conduct of its business.

TYPES OF LEGAL AUDIT

Traditionally, law firms are known to practice law, rather than combining the practice of the law with the business of the law in other to achieve the full potentials of law. Auditing companies on the other hand are known to be responsible for financial audit of companies. It becomes a question of the competency of audit companies as legal and financial auditors versus competency of law firms as legal auditors. While not out-rightly condemning the importance of audit companies/accountants as financial auditors, it must be emphasized that accountants cannot conduct a legal audit exercise due to the specialty of legal audit and categories of people who should conduct a legal audit exercise as discussed above.

Generally, legal audits are of different types and can be rightly described as a tree with many branches. Comprehensive or all-inclusive legal audit is, however, the major type of legal audit. A comprehensive legal audit consists of an audit of all the laws and processes that govern the effective running of a company in relation to the requirements of the law. It encompasses an analysis of the corporate records of the company, registration of the company, restructuring, an examination of statutory documents, other corporate acts and regulatory bodies in relation to that particular industry. It also involves the subject of shares, i.e. how they were issued, the placement, the legacy of ownership, records of general meetings since the incorporation of the company, conflicts amongst shareholders and directors, amongst others. In sum, the above is referred to as corporate audit and it's only a fraction of a comprehensive legal audit. This is in view of the fact that a comprehensive legal audit contains fractions of all other types of legal audit.

Simply put, a comprehensive legal audit will examine a wide range of issues commencing with the obvious such as: from whether or not the company is qualified to carry on the business it does, to an examination of the company's compensation and retirement plans in order to ensure compliance with the relevant tax and employment laws. Failure of a company to act in accordance with the relevant laws can lead to drastic implications. For instance, failure to put a contributory requirement scheme in place where a company has more than 5 people in its employ violates the requirement of the Pension Reform Act. In such a case the National Pension Commission can impose an administrative sanction or a fine in relation to the erring company. In turn the administrative sanction can lead to irreparable brand damage of the company and this in turn could lead to losses rather than maximization of profit.

A comprehensive legal audit therefore consists of the following: Contract audit; Corporate structure audit; Litigation audit; Intellectual property audit; Environmental law; Taxation audit; Labour law/ employment law audit; Credit management audit; Insurance audit; Aviation audit; Regulatory compliance audit; Assets and property audit etc. This list is in itself not exhaustive of the extent and depths of a comprehensive legal audit for whenever there are laws governing a corporation, there are liabilities, offences or penalties that accrue from not abiding by that particular law. Thus, whenever there is a law governing a company's operations, then it must be borne in our minds that a legal audit will be necessary in that specific area to avert whatever risks that might arise from lack of compliance.

Apart from the legal auditing of the documents of a company, there should also be an audit on how things are done in practice.

Specific legal audit on the other hand can be described as an umbrella to the different components which makes up a comprehensive legal audit. It therefore refers to the legal audit of the laws that governs a specific department or a specific issue in the company. Specific legal audits can be conducted on a complex transaction or on a labour, administrative, legal or civil conflict. For instance, a company may wish to audit the cases which have been instituted against it or which it has instituted against a person(s) or legal entity(ies). In that case, the legal auditor will revert only to documents or transactions which have brewed litigation since the inception of the company. The legal auditor will advise the company accordingly on what to do and if the position of the law is tilted in its favour. In that circumstance, the legal auditor need not review the company's labour policies except if there's a case in that respect. The legal auditor can also dig into previous court cases where the judgment of the court requested that large sums in damages be paid by the company for the commission or omission of an act. The legal auditor can identify practices which gave rise to the litigation, with a view to advising the company on how to prevent a re-occurrence of litigations of similar nature and hence reduce the legal and financial liabilities that can arise from such practices.

LEGAL AUDIT AS A NECESSITY

Law is one of the most vital factors affecting businesses. Legal audit basically aids the compliance of companies with existing laws that regulate the conduct of their businesses. Legal audit also assists companies to help achieve their goals and objectives in a more effective way through the implementation of a legal compliance framework. The consequences of legal non compliance can attract varying degrees of penalties ranging from lawsuits, fines and terms of imprisonment to financial losses. Failure of a company to conduct a legal audit can also lead to loss of intellectual property and competitive advantage where some legal measures are not taken to protect the company's interests. These measures range from the registration of intellectual property to the signing of confidentiality agreements with employees or contractors. In addition, a company can suffer closure from the regulatory bodies, where it fails to obtain/ renew the necessary licenses or permits for the running of its business.

In recent times in Nigeria, lawsuits have been instituted against Organizations claiming damages for the acts or omission or ignorance of the company in relation to its actions. The damages awarded by the court where such case is decided against the company are always running into millions and in some cases billions of naira or dollars. This would have been avoided if such organizations requested the conduct of a legal audit. For example, in United Bank for Africa Plc v BTL Industries Limited, judgment was entered in favour of the claimants/respondents at the lower court in relation to the failure of the defendants/appellants to remit GBP 3,632,872.93, US$3,384,264.37, French Francs 3,478,031.85, Dutch MarkS3,M431,790.47, Belgian Francs 3,758,533.10, Dutch Krone 79,515.00 to the claimants/respondents. In sum, UBA Plc had to part with about 4.1 billion naira to BTL Industries Limited as a result of its negligence in holding the money of BTL Industries Limited while relying on the fact that it did not know whom the money belonged to. However, the conduct of a legal audit exercise in UBA Plc would have revealed

that an inter-pleader's summon would readily resolve the issue of the rightful owner, thus saving the 4.1billion naira which UBA had to pay the claimant.

Another instance which shows the necessity of the conduct of a legal audit is the case of Pfizer and the Government of Kano State. In that case, Pfizer conducted clinical tests by administering the experimental antibiotic Trovan on children suffering from meningitis in Kano without obtaining prior informed consent from the parents of the children. Hence, Pfizer was made to pay $75,000,000.00(seventy five million dollars) as compensation to the families of the children who died and or were harmed from the administration of Trovan. The conduct of a legal audit on Pfizer would have simply revealed that due process was not been followed in the conduct of clinical trials. Hence, a recommendation would have been made with regards to putting in place a mechanism such as a compliance unit as it relates to the procurement of informed consent from patients. Thus, legal audit has become a necessity in Nigeria and in the world at large as a result of the reasons and consequences advanced above.

CONCLUSION

All organizations desire to improve upon their business by maximizing profit year-on-year. The drive to make profit can be said to be the power house or the engine room of all organizations with the exception of nonprofit organizations, which can also be said to make 'profit' according to their own metrices. After all, nonprofit organizations also strive to be effective in delivering their services or accomplishing a particular project or objective in which they have developed interest. Hence, all organizations have realized the need to conduct financial audit in order to ascertain their profit and loss margins. Presently, there is a need for organizations to take a step further in realizing and actually requesting for the conduct of a legal audit, because legal audit is a necessity to all organizations. Organizations that intend to stay in the competitive environment of business must always conduct a legal audit for an absolute maximization of profit, loss minimization, and cost effective and smooth running of their operations.
Nonprofit organizations that intend to retain their relevance in that field must always conduct a legal audit for an avoidance of interference by regulatory bodies governing the businesses of nonprofit organizations.
In conclusion, it is recommended that a company which has never been legally audited since its incorporation and which desires to have its business legally audited must undergo a comprehensive legal audit. Subsequently, the company can periodically request for a specific legal audit in order to ensure overall compliance at all times with the laws. It is also extremely important for companies to have their businesses audited as the conduct of a legal audit exercise can uncover business opportunities which will maximize the profit of the company as well as enhance excellence, thereby, achieving the exact reason for which the company was incorporated.

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