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## Theories in Auditing of Social Accounting, Service Organization and Financial Institutions

by

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### Abstract

*The study is centered on the theories in auditing of social accounting, service organization and financial institutions. Social accounting is a new phase to the development in accounting which aims to increase the social awareness and the social effect of business decision, in addition to the economic effects. Social accounting emerged from the developed countries in the 1960s and till the end of 1980; its prime area concerned was human rights and equal employment opportunity. In this study, social accounting involves social and public responsibility, and also employee treatment. The study concluded that management at all levels should understand the scope and contents of social accounting so that they can make value added contributions towards building the company's brand image and reputation. The recommended that the companies operating within and outside a locality should perform their corporate social responsibilities in the light of developing the area in which they operate.*

**Keywords:** Auditing, Social Accounting, Service Organization, Financial Institutions.

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### Introduction

Social Accounting is a new phase in the development of accounting which aims to increase the social awareness and the social effects of business decision in addition to the economic effects (Noor, 2010). It emerged in the developed countries in the 1960s and till the end of 1980; its prime area is concerned with human rights and equal employment opportunities (Noor, 2010). But in 1990s, social issues become the core issues of business concerns, due to the rise in adverse impacts of business operations on the nature, culture, economy, society and common people. In response to pressure from society, business

organizations and industries of developed countries began to embrace social accounting but in a less apparent manner (Ghosh, 2010; Noor, 2010). Social accounting is as old as human being (Noor, 2010) and as a social animal, every human being at certain extent performs his social responsibility and sacrifice some valuable for others whether the beneficiary of the same is known or unknown (Ghosh, 2010; Noor, 2010). According to Deegan (2019) opined that, in the earliest period, people were depending upon animals to hunt for them in order to fulfill their basic needs such as foods and cloths, which may bring about successful hunting, they also involve in group efforts with the help of animals like

Dogs. After the hunting, they would share the things hunted to all who made contribution for the same and gives little parts of the same to dogs, as they played important role in the activity. This is nothing but social awareness of human being about those who directly or indirectly co-operated to them to reach their pre-decided goal and from these days to 21st century the social awareness of human being is increased continuously.

Social Accounting, also known as social responsibility accounting, socio-economic accounting, social reporting and social audit, seeks to measure and inform the general public about the social welfare activities undertaken by the enterprise and their effects on the society (Deegan, 2019). It engages the stakeholders of an organization, involving them in the process of assessments and recognizing accountability to them. For any accounting system to be effective, social accounting must be customized to the needs of each organization starting from the stated values and objectives, social accounting is a framework which builds on the existing reporting, compliance and quality standards organizations already have, spotting the gaps to be filled and expecting to see in them an account of an organizations environmental policies and impact to how the companies has affected the society positively.

Over the years most companies has not been living according to the dictate of their social responsibility which has formed a huge challenge to society, thereby living the bulk of development in the hands of government. The developed society has seen this aspect of development long before hand and implementation of social accounting as been on in the development nation. Thus, the problem the paper seeks to address is the lack or limited responsibilities of companies failing to meet up with their social accounting responsibilities within and outside the localities in which they operate. It is a known fact that companies need to assist the government in the provision of some amenities that will improve the standard of living in the area where they operate hence the introduction of the auditing social accounting in other to assess the levels at which companies meet up with their social accounting

responsibility in their financial reporting. It is pertinent to state that some companies are trying to make efforts to earn customer loyalty through community development schemes, good corporate governance and by engaging stakeholders, within and outside the company. It is thus necessary that managements at all level understand the scope and content of social accounting so that they can make value added contributions towards building the company's brand image and reputation which will continually put the company in good light in the community and society at large. Following the above, it is worthy of note that social accounting, service organization and financial institutions could affect the society positively in they are willing to assume their corporate social responsibilities.

To Sahana and MariGowda (2016), some problems of social audit accounting and CRS has been taking care of in Accounting Standards which enhances quality, transparency, and comparability and also helps for calculating the appropriate value for the business with regard to the item presented in the Financial Statements. However, the recognition, measurement and disclosure criteria should be observed while treating the elements that make up the Financial Statements. With the Companies Act 2013 being passed, it is observed that, corporate entities must earmark certain percentage of their profits towards social responsibility, but the spending should be made in accordance with the rules laid down in the Section 135 of the Companies Act 2013 and also observing the Income Tax provisions. The spending made by the corporate entities in fulfilling or honouring of the Corporate Social Responsibility aspects may be for short term or long term benefits of the society. But the lack of accounting regulation in recognizing, measuring and disclosing of the different types of social spending leads to impair the real value of the organisation. Hence the efforts should be made to make the spending to bring into the fold of the accounting.

### **Social Accounting, Service Organization and Financial Institutions**

#### **Social Accounting**

According to Noor (2010), social accounting has become more important as a result of industrial growth, which has brought in prosperity as well as problems to society. If an industry has to function effectively, it has to be accountable to the public at large. Social accounting measures, analyses and record the society and industries itself both in qualitative and quantitative terms. It includes disclosure of such information in annual report. According to Noor (2010), Social accounting is a process whereby an organisation may monitor and evaluate its work, report honesty on its achievements and improve its performance through more informed planning and better management. To Gray (2002), social accounting is the preparation and publication of an account about an organisation's social, environmental, employee, community, customer and other stakeholder interactions and activities and, where possible, the consequences of those interactions and activities. Social accounting is the process of communicating the social and environmental effects of organizations' economic actions to particular interest groups within society and to society at large (Aguilera, Rupp, Williams, & Ganapathi, 2007).

According to Crowther (2000) and Nkaiwatei (2011), social accounting is commonly used in the context of business, although any organization, including Non Governmental Organizations (NGOs), charities, and government agencies may engage in social accounting. External social accounting or reporting seeks to demonstrate how the reporting organization integrates (or wishes to be seen to integrate) with the society and systems within which it operates (Centre for Good Governance [CGG], (2005). Internal social (management) accounting seeks to provide information to help an organization's managers operate in a more socially sustainable manner (Aguilera et al. 2007; Nkaiwatei, 2011). Ideally, these internal and external social accounting processes are not completely separate from the mainstream financial or management accounting processes within an organization, and both sustainability and financial employees would be involved in collecting and presenting the data (Crowther, 2000). There exist several audit theories that

explains the audit processes and helps to better understand the reality of how audit is undertaken which includes agency theory, contingency theory, stewardship theory, policeman theory and so on. Some of these theories have more relevance and application in better explaining some aspects of audit than others. Hence this work aims to make an exposition on audit theories that pertains to the audit of social account, service organizations and financial institutions.

### Theories in Auditing of Social Accounting

Social audit is a formal review of a company's endeavors, procedures, and code of conduct regarding social responsibility and the company's impact on society (Chris, 2019). A social audit is an assessment of how well the company is achieving its goals or benchmarks for social responsibility. Ideally, companies aim to strike a balance between profitability and social responsibility. A social audit is an internal examination of how a particular business is affecting society. The audit helps companies to determine if their objectives are met, which may include measurable goals and benchmarks. A social audit serves as a way for a business to see if the actions being taken are being positively or negatively received and relates that information to the company's overall public image. Consistent with this, in the era of corporate social responsibility, corporations are often expected to deliver value to consumers and shareholders as well as meet environmental and social standards. Social audits can help companies create, improve, and maintain a positive public relations image. For many companies, a good public perception helps to foster a positive image of the company and ultimately reduce negative impacts on earnings from bad press.

The scope of a social audit can vary and be wide-ranging. The assessment can include social and public responsibility but also employee treatment. Some of the guidelines and topics that comprise a social audit include the following:

1. Transparency in reporting any issues regarding the effect on the public or environment.
2. Accounting and financial transparency.
3. Community development and financial contributions.
4. Charitable giving.
5. Volunteer activity of employees.
6. Worker pay and benefits.
7. Work environment including safety, free of harassment, and equal opportunity

Chris (2019) further pointed out that there is no standard for the items included in a social audit. Social audits are optional, which means that companies (including public limited companies) can choose whether to release the results publicly or only use them internally. The flexibility surrounding social audits allow companies the ability to expand or contract the scope based on their goals. While one company might wish to understand the impact it has on a particular town or city, other companies might choose to expand the range of the audit to include an entire state, country, or throughout the globe. Based on the above explanations; the major theories that apply to social accounting being a voluntary practice by companies are: credibility theory, rational control theory, normative theory, the stakeholders' theory and the social contract theory. As posited by Bjorkman and Wong (2013), the main arguments of implementing social auditing in the supply chain of companies is the perceived need of control (Boyd, Spekman, Kamauff, & Werhane 2007; Kok, Van der Wiele, McKenn, & Brown, 2001). Owen, Swift, Humphrey, and Bowerman (2000) argue that social audit as a concept has a strong emphasis on being a useful method when managing organizations. According to Barley and Kunda (1992) cited in Seeck and Laakso (2010), prior theories together with practitioners themselves have long had a focus on rational control. Monitoring is one type of rational control that has been highly recommended by researchers who believe that monitoring, as a control mechanism, is the most effective method to minimize the risk of opportunistic behavior (Jensen & Meckling, 1976; Williamson, 1981; cited in Björkman & Wong, 2013;).

Rational control theories are based on the belief that all employees are potential cheaters who will not follow the proper procedures unless they are monitored (Coyne, 2006). Several researchers state that these ideas also get support in practice by a lot of companies, NGOs and other stakeholders who emphasize monitoring actions through social auditing in the supply chains (Locke, Qin, & Brause, 2007; Mamic, 2005; Pruett, 2005).

Third is normative theory which, according to Bjorkman and Wong (2013), is an alternative to monitoring. Following from this, Boyd et al. (2007) suggest that Corporate Social Responsibility (CRS) implementation should be characterized by procedural justice, which relates to mutual respect, shared goals, commitment and trust. Boyd et al. argued that procedural justice, together with fairness, between the two parties of buyer and supplier results in a high degree of compliance. In this sense, they argued that the perception of fairness is created in a situation where an individual feel that they have greater control and a voice in the exchange. Moreover, Boyd et al. (2007) argued that having frequent communication, sharing information, being open and giving constant feedback enables a shared vision which may increase collaborative behaviour in the supply chain. Thus, instead of rational monitoring systems the normative theories emphasize collaboration, openness, trust building, volunteer actions from suppliers and more partner based relationships in order to increase the level of compliance (Abey, 2017; Boyd et al., 2007; Cheung, Welford, & Hills, 2009; Handfield & Bechtel, 2002; Locke et al., 2007). The previous theory shows that companies as well as practitioners favor the practice of monitoring and social auditing in order to fulfill the need of control. However, since companies often do not own their suppliers there is low formal control, therefore trust and collaboration are presented as alternative control mechanisms. In addition, several authors promote shared values, communication and fairness as effective ways to build buyer-supplier relationships which is argued to improve compliance in the supply chain.

The fourth is stakeholder Theory and CGG (2005) noted that social audit uses participatory techniques to involve all stakeholders in measuring, understanding, reporting and improving the social performance of an organisation or activity. They can be the shareholders, the employees, the customers, the community, the state, the local administration, the competitors, the banks, the investors etc. Thus, the connectivity between the organisation and stakeholders forms the core of the concept of Social Audit. Consistent with this, there are two versions of the theory of stakeholders, which portray the connectivity: the interrelation between the organisation and stakeholders is guaranteed by the society and implies the undertaking of responsibilities and the duty to spread information on the activities of the organisation. In this case, social audit represents a way to fill the gap between the organisation's responsibilities and the dissemination of information; and the organisation itself identifies the stakeholders according to the importance given to certain interrelations with external agents. In this case, information becomes one of the most important elements to manage relations with stakeholders in order to earn their support and approval. However, difference between these two theories agree on giving the power of spreading information more widely to the organisations in order to strengthen their own legitimization and the social consent arising out of public opinion.

Finally is the social contracts theory According to Gray, Dillard, and Spence (2009), society is a series of social contract between members of society and society itself. In the context of social accounting practices, an alternative possibility is not that business might act in a responsible manner because it is in its commercial interest, but because it is part of how society implicitly expects business to operate. Donaldson and Dunfee (1999) develop integrated social contracts theory as a way for managers to take decisions in an ethical context. They differentiate between macro social contracts and micro social contracts. Thus a macro social contract, in the context of communities, would be an expectation that business provide some support to its local community and the specific form of

involvement would be the micro social contract. Hence companies who adopt a view of social contracts would describe their involvement as part of societal expectation. However, whilst this could explain the initial motivation, it might not explain the totality of their involvement.

### **Service Organisation**

Following from the above, a service organization is a voluntary non-profit organization where members meet regularly to perform charitable works either by direct hands-on efforts or by raising money for other organizations (Wikipedia, 2019).

### **Theories in Auditing Service Organisation**

According to Statement on Auditing Standards (SAS) 70, one of the most effective ways a service organisation can communicate information about its controls is through a service auditor's report. There are two types of service auditor's reports: Type I and Type II. In a Type I report, the service auditor will express an opinion on: whether the service organization's description of its controls presents fairly, in all material respects, the relevant aspects of the service organization's controls that had been placed in operation as of a specific date; and whether the controls were suitably designed to achieve specified control objectives. In a Type II report, the service auditor will express an opinion on the same items noted above in a Type I report, and whether the controls that were tested were operating with sufficient effectiveness to provide reasonable, but not absolute, assurance that the control objectives were achieved during the period specified. Hence theories that explains audit in service organisations are: The agency theory, the theory of inspired confidence, the policeman theory.

### **Financial Institutions**

According to Business Dictionary.com (2019), a financial institution is a private (shareholder-owned) or public (government-owned) organisation that acts as a channel between savers and borrowers of funds (suppliers and consumers of capital). There are two types of financial institutions which are;

depository banks and credit unions, and non-depository insurance companies and mutual funds. Owing to this, there are some theories that will best explain the financial institutions as it relates to social accounting as discussed below:

### Theories in Auditing Financial Institutions

Situating this on the bank industry, the Institute of Chartered Accountants of England and Wales [ICAEWJ (2010) robustly explained that risk information is often presented in a piecemeal manner in bank annual reports, spread between the audited financial statements and the unaudited front sections. Banks need to focus on clearer presentation which allows users to understand the big picture, which is currently often obscured by the volume of detailed information. Auditors should be asked to provide assurance on new summary risk statements to provide confidence to readers of financial statements. Bank reporting has been criticized for not providing sufficient early warning of bank failures. This makes banks inherently risky as their services involve holding long-dated assets, in the form of long-term loans, and short-dated liabilities, in the form of customer deposits. In addition, significant information is provided outside annual reports. However, the volume and complexity of information and the way it is presented has made annual reports less accessible to non-experts. There has been particular concern that it is difficult to understand risk, business models or going concern assumptions from reading annual reports

As financial reporting standards have become increasingly complex, reflecting the growing complexity of financial markets and business generally, the perceived focus of preparation of true and fair financial statements may have shifted away from the big picture towards compliance with the requirements of standards. Audits therefore provide greater levels of confidence in information presented by directors by providing an independent opinion on its truth and fairness. The audit process is highly valued by investors and banks, and seen as essential in providing discipline to directors

in their presentation of information, and to the control environment around their financial processes. One of the reasons given by investors for wanting more commentary from auditors is a feeling that the information provided by directors in the front section of annual reports is presented in a favourable light and a desire for better transparency. Consequently, the theories underpinning audit in financial institutions are: The theory of inspired confidence, agency theory, the credibility theory, stewardship theory.

### Conclusion

The concept of social Accounting emerged in the 1960's when social values and expectations gave rise to a debate about the role of business in society. This debate focused on the nature of corporate social responsibility and gave rise to the possibility that this responsibility could be discharged through a method of social accounting. Flowing from this, social accounting has become an integral part of good management globally and most of the enterprises are making efforts to earn customer loyalty through community development schemes, good corporate governance and by engaging stakeholders, within and outside the company. It is thus necessary that managements at all level understand the scope and content of social accounting so that they can make value added contributions towards building the company's brand image and reputation.

### Recommendations

In the light of the discussion above, the following recommendations were made:

1. The companies operating within and outside a locality should perform their corporate social responsibilities in the light of developing the area in which they operate.
2. The auditors should disclose the activities (corporate social responsibilities) of the companies in the financial report as a non financial transactions as required by Section 135 of the Companies Act 2013.
3. Social accounting audit should be giving prominence in the preparation of

companies financial statements as it act as goodwill to the company.

4. There should be machinery whereby the government can check company's financial statement for compliance.

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