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Forensic Accounting: a Relief to Corporate Fraud

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ABSTRACT

We investigated the effect of forensic accounting on corporate fraud and performance outcome in the Nigerian manufacturing sector. Using a match sample of 306 manufacturing firms registered with the Manufacturing Association of Nigeria (MAN). 3 hypotheses proposed and tested and the findings revealed that corporate fraud is on the increase in this sector of the economy, and the reason is that most managers want to be independent at the expense of their employers. That most managers incorporate firms that supply goods to their company at very high prices thereby increasing cost of production.

Keywords: Corporate Fraud, Financial Reporting, Financial Statement, Forensic Accounting, Management

INTRODUCTION

Investment decisions are long-run decisions where consumption and investment alternatives are balanced over time in the hope that investment now will generate extra returns in the future (Lucey 2003). Maximizing opportunities is the ability to make the best use of the discovered opportunity (meaning you have to discover an opportunity before you can maximize it). It involves taking advantage to high capacity the available opportunity by judiciously taking necessary step for the usage of the opportunity. Many opportunities have been discovered but are yet to be fully maximized.

The past decade has shown an increased emphasis on internal corporate governance to monitor and implement controls over management's financial reporting decisions (Achambeault, DeZoort, and Holt 2008). For example, the New York Stock Exchange now requires that all of its listing companies maintain an internal audit function (NYSE 2004). A major objective of the internal auditing function is to help ensure reliable financial reporting (Mercer 2004; Bariff 2003) and to review and provide input on management's estimates and assertions in the financial statements (KPMG 2003). Prior research suggests that internal auditors are at least somewhat successful at constraining earnings management (Prawitt, Smith, and Wood 2009) and financial reporting fraud (Beasley et al. 2000). This study examines task factors at the organizational level that may determine how successful internal auditors are at influencing management's accounting estimates towards forestalling fraud in the system.

Prior research also suggests that oversight of management's financial reporting decisions can be friendly or turn contentious (McCracken et al, 2008; Bame-Aldred and Kida 2007), and interpersonal relationships vary substantially within an organization (Kida et al, 2001; Moreno et al 2002). Internal auditors' ability to influence management may depend not only on the strength of the accounting data supporting their preferred positions, but also on how they present that data and how they present themselves to managers. A better understanding of how these factors interact can help internal auditors adjust their interactions with management to better achieve their corporate governance objectives.

In practice, internal auditors attempting to influence managers could state their preferred position and either present supportive accounting information "raw" (i.e., letting the data speak for itself) or format it into an argument. Managers were randomly assigned to experimental conditions in which the internal auditor is interpersonally likable or dislikable, and presents accounting information that is either more or less supportive of obsolescence, either in an argument format or in a randomized list of the same statements about inventory.

However, recent fraud scandals involving highly known corporations like Enron, WorldCom, Adelphia, Global Crossing, Parmalat, Lucent, Tyco and Xerox, Cadbury Nigeria Limited, Allstates Trust Bank Nigeria Limited etc, have led to restatement and bankruptcies that have harmed several stakeholders. According to Rezzae *et al* (2004) fraudulent reporting has generated losses of more than 500 billion to investors in the last ten years. Thus, it has resulted in a financial statement's credibility loss, raising questions about its integrity. At the same time, fraud scandals have eroded the public confidence in the auditing process (Rezzae *et al*, 2004).

Despite the difficulty in fighting financial statement fraud, auditors should not ignore this issue. Instead, it is necessary to find mechanisms to combat fraudulent acts (Turner, 1999). At the same time, information technology is dramatically changing the way financial statements are prepared, audited and used (Zhao *et al*

2004). In this line of thinking, Flowerday and Von Solms (2005) suggest that auditors must find new ways to verify financial reports. In this sense, auditors and accounting scholars have been working in the development of mechanisms and technologies to audit financial statements and prevent fraud. Thus the aim of this study is to find out the impact of forensic accounting on corporate fraud in the Nigerian manufacturing sector

Considered by the AICPA - American Institute of Certified Public Accountants, one of the emerging technologies that will impact Certified Public Accountants' (CPA) firms, continuous auditing (CA) apparently could help to detect misstatements and frauds in financial reporting. In comparison with tradition financial statement audit, continuous auditing is more timely, comprehensive, accurate and less costly (Alles *et al* 2005). It refers to the audit of an accounting moving picture instead of the old accounting snapshot (Yang, 1990)

THEORITICAL BACKGROUND

Nobody has money to throw in the garbage. Thus, the expectation of every investor is Return on Investment (ROI). With the theory of separation of ownership from management, it is expected that professional managers who are considered more competent than the owners are employed to run and manage the affairs of the company. Reported financial scandals (e.g., Allstates Trust Bank in Nigeria, Cadbury Nigeria Limited-Nigeria, Enron, WorldCom, Global Crossing, Qwest, Parmalat) have eroded investors' confidence and made forensic accounting an attractive career opportunity for accountants to combat fraud.

Several scholars have come with various definition of the term 'Forensic Accounting'. According to Rezaee *et al* 2004, Forensic accounting is defined in this study as the practice of rigorous data collection and analysis in the areas of litigation support consulting, expert witnessing, and fraud examination. According to Journal of forensic Accounting, forensic accounting is sufficiently thorough and complete so that an accountant, in his considered independent professional judgment, can deliver a finding as to accounts, inventories, or the presentation thereof that is of such quality that it would be sustainable in some adversarial legal proceeding, or within some judicial or administrative review" According to Williams (2002), forensic accounting is recognized as a particular form of professional expertise and endowed with specific attributes. The recognition, is ascertained by possessing a formal certification in forensic accounting which provides symbolic value.

The AICPA defines forensic accounting as services that involve "the application of specialized knowledge and investigative skills possessed by CPAs". Forensic accounting services utilize the practitioner's specialized accounting, auditing, economic, tax, and other skills (AICPA 2010). Contributing to the definition of forensic accounting, Singleton and Singleton (2010), posit that forensic accounting is the comprehensive view of fraud investigation. It includes preventing frauds and analyzing antifraud controls It also includes the gathering of nonfinancial information. Crumbley *et al* (2009) distinguish forensic accounting from fraud auditing. A fraud auditor is an accountant especially skilled in auditing…A forensic accountant may take on fraud auditing engagements and may in fact be a fraud auditor, but he or she will also use other accounting, consulting, and legal skills in broader engagements. Stanbury and Paley-Menzies (2010) state that forensic accounting is, the science of gathering and presenting information in a form that will be accepted by a court of jurisprudence against perpetrators of economic crime. Hopwood *et al* (2008) defined forensic accounting as "the application of investigative and analytical skills for the purpose of resolving financial issues in a manner that meets standards required by courts of law". Thus, forensic accounting includes no explicit reference to fraud, although fraud investigations are a part of forensic accounting.

As can be seen from this sample of definitions, not only do they vary, but in cases are contradictory, especially as it pertains to the inclusion of fraud. In his own contribution Crumbley (2009), asserted that, term forensic accounting applies to evaluating accounting information without the constraints of GAAP. Herein lies possibly the most important factor to consider in answering the question, is forensic accounting in the United States becoming a profession. Only CPAs are allowed to express an opinion regarding whether financial statements are presented fairly according to GAAP. However, to the extent that forensic accounting is not constrained by GAAP requirements, then the necessity of having a CPA license in the performance of forensic accounting is rendered superfluous. As noted by Fogarty and Parker (2010), public accounting has a statutory monopoly only over auditing. Public accounting has no monopoly power over non-auditing functions or services. The absence of monopoly power over non-auditing services opens the door for an entirely new profession to emerge separate and distinct from public accounting—forensic accounting. It thus remains only to determine whether forensic accounting fulfills a significant number of the criteria of a profession.

CORPORATE FRAUD

Accounting rules do not fully determine financial reporting practice, for reasons that include (Ball *et al*, 2000,): "practice is more detailed than standards; standards lag innovations in practice; and companies do not invariably implement standards." Financial reporting practice is influenced by the uses to which financial reporting is put, by managers' and auditors' incentives, and institutional variables such as regulation and litigation risk. Thus, firms actually do – not what they, their managers, their auditors or accounting standards say they do – is the more central issue in financial reporting. Objective, verifiable accounting information facilitates shareholder monitoring and the effective exercise of shareholder rights under existing securities laws; enables directors to enhance shareholder value by advising, ratifying, and policing managerial decisions and activities; and supplies a rich array of contractible variables for determining the financial rewards from incentive plans designed to align executives' and investors' financial interests (Bushman and Smith 2003).

Ball (2001) is of the views that timely incorporation of economic losses in the published financial statements (that is, conservatism) increases the effectiveness of corporate governance, compensation systems, and debt agreements in motivating and monitoring managers. It decreases the ex ante likelihood that managers will undertake negative NPV projects but pass on their earnings consequences to a subsequent generation, and it increases the incentive of the current generation of managers to incur the personal cost of abandoning investments and strategies that have ex post negative Net Present Values. Financial accounting information contributes directly to economic performance by disciplining efficient management of assets in place (for example, timely abandonment of losing projects), better project selection, and reduced expropriation of investors' wealth by the managers.

For instance, improved governance can manifest in a reduction of the private benefits that managers can extract from the company or in a reduction of the legal and auditing costs that shareholders must bear to prevent managerial opportunism. These two changes can have opposite effects on the observed equilibrium stock returns, and the size of these effects depends on the degree of international segmentation of equity markets.

Financial accounting information to enhance economic performance is by reducing adverse selection and liquidity risk. According to Amihud and Mendelson (2000), the liquidity of a company's securities impacts the firm's cost of capital. A major component of liquidity is adverse selection costs, which are reflected in the bid-ask spread and market impact costs. Firms' pre-commitment to the timely disclosure of high-quality financial accounting information reduces investors' risk of loss from trading with more informed investors, thereby attracting more funds into the capital markets, lowering investors' liquidity risk (see Diamond and Verrecchia 1991; Botosan 2000; Brennan and Tamarowski 2000; and Leuz and Verrecchia 2000).

It is the responsibility of management to put in place mechanism through which internal fraud can be minimize or totally eradicated from the system. A good internal control system will play a very significant role. Internal fraud is fraud, waste and abuse that occur within the organization. This may involve employees, contract employees, or vendors. Examples of internal fraud are falsifying of figures, pilfery, stores lifting, working with vendors by signing an invoice of items not supplied, etc. The potential for, or occurrence of, fraud and other illegal acts is a significant and sensitive management concern in any organization. This concern is heightened by the breadth and complexity of the responsibilities of this government, as well as the public expectation of honesty and integrity in individuals. This policy formalizes the process and responsibilities for deterring, detecting, reporting and investigating known, alleged or suspected fraud or other illegal acts in an organization.

Hypotheses

The framework for our tests can be understood by considering that there is a principal (i.e., the party for whom financial statements are prepared such as owners, creditors, regulators, suppliers, and the government) and two agents (the manager and the auditor). We observe the actions of these two agents – the manager's demand for belonging audit firms belonging to their friends and the auditor's make no effort – to understand the impact of ownership characteristics and family relationships on agency costs. For the purpose of this, we chose financial reporting, economic performance and cost of capital as control measures of corporate fraud. From the foregonigs, we hypothesize as follows:

H_1: There is a significant and positive association between forensic accounting and financial reporting.

H_2: There is a significant and positive association between forensic accounting and economic performance.

H_3: There is a significant and positive association between forensic accounting and cost of capital.

METHODOLOGY

To effectively carry out this study, a total of 1,500 middle and senior level organizational members of manufacturing firms based in the 2010 directory of the Port Harcourt zone of the manufacturers Association of Nigeria (MAN). From our pilot survey, it was discovered that a large of junior organizational members of manufacturing firms in Nigeria were casual workers. Also, a considerable number of this category of organizational members have very minimal formal education and may therefore find it difficult to comprehend the content of the of the research instrument. Since the study seeks to explain the effect of forensic accounting on corporate fraud, this group was not considered for the survey. Thus our population for the study was restricted to manufacturing firms in the organized private sector to ease accessibility. For this reason, we adopted the 2011 updated company directory of the Port Harcourt zone of the manufacturers' Association of Nigeria (MAN), which is the latest version available. The directory showed that fifty-five manufacturing firms were duly registered with the body (MAN).

Sarantakos (2005) states that the use of tables is an easier way of estimating the right samples size from a given population. Consequently, in determining the sample size for this study, we adopted the Krejcie and Morgan (1970) table (Sarantakos, 2005; Sekaran 2003). The table according to Sarantakos (2005) computes the sample size by means of a formula developed by the research division of the National Education Association of the United States of America, 'which takes into consideration chi-square for 1 degree of freedom, the population size, the population proportion, which is set at 0.05, and the degree of accuracy, which is set at 0.05". The table has figures for population ranging from 10 to 1,000,000. The selection of the sample size only requires an accurate matching of the appropriate cell in the sample size column to the corresponding cell in the population column. Therefore, for our population of 1.500 middle and senior staff, corresponds to 306. For data we used questionnaire which was administered to our study sample.

Association between Forensic Accounting and Corporate Fraud

The result of the Pearson Correlation Coefficient for the association between forensic accounting and corporate fraud is presented in table 1 below. In addition to the correlation matrix obtained for the first research question, the table also gives the result of the statistical test of significance (p-value), which enables us to answer the question and generalize our finding to the population of the study.

Table 1: Correlation Matrix for Forensic Accounting Measures and Corporate Fraud

		FA	FR	EP	CoC
FA	Pearson Correlation	1	423**	220**	440**
	Sig. (1-tailed)	.	.000	.000	.000
	N	235	235	235	235
FR	Pearson Correlation	423**	1	148*	.578**
	Sig. (1-tailed)	.000	.	012	.
	N	235	235	235	235
EP	Pearson Correlation	.229**	.148*	1	.428**
	Sig. (1-tailed)	.000	.012	.	.000
	N	235	235	235	235
CoC	Pearson Correlation	.440**	.576**	.428**	1
	Sig. (1-tailed)	.000	.000	.000	.
	N	235	235	235	235

** Correlation is significant at the 0.01 level (1-tailed).
* Correlation is significant at the 0.05 level (1-tailed).

Source: Research Data

Key: FA= Forensic Accounting
FR= Financial Reporting
ER= Economic Performance
CoC= Cost of Capital

The result of the correlation in the table above shows that there is a significant and positive association between Forensic Accounting (FA), and Financial Reporting (FR) Economic Performance (EP) and Cost of Capital (CoC). Forensic Accounting is significantly and positively correlated to financial reporting ($r = 0.423$, $p = 0.000 < 0.01$). Also, forensic accounting is significantly and positively correlated to organization's economic performance ($r = 0.229$, $p = 0.000 < 0.01$). Finally, forensic accounting is significantly and positively correlated to cost of capital ($r = 0.440$, $p = 0.000 < 0.01$). The association that exists between forensic accounting and corporate fraud control measures is thus significant and positive at the 0.01 significance level and thus accept all our three hypotheses.

H_1: There is a significant and positive association between forensic accounting and financial reporting.
H_2: There is a significant and positive association between forensic accounting and economic performance.
H_3: There is a significant and positive association between forensic accounting and cost of capital.

The coefficient obtained for the first cluster of research hypotheses is shown in Tables 1.1 to 1.3 below.

Table 1.1: Regression analysis on the association between Forensic Accounting and Financial Reporting

Model Summary

Model	R	R^2	Adjusted R^2	Std. Error of the Estimate
1	.423[a]	.179	.175	.67365

a. Predictors: (Constant), FORENSIC ACCOUNTING

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig
1	Regression	22.997	1	22.997	50.677	.000[a]
	Residual	105.736	233	.454		
	Total	126.733	234			

a. Predictors: (Constant), FORENSIC ACCOUNTING
b. Dependent Variable: FINANCIAL REPORTING
c.

Coefficient[b]

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig
1	(Constant)	1.658	.235		7.054	.000
	FORENSIC ACCOUNTING	.423	.059	.423	7.119	.000

a. Predictors: Variable: FINANCIAL REPORTING

Source: Research Data

Table 1.2: Regression analysis on the Association between Forensic Accounting and Economic Performance

Model Summary

Model	R	R^2	Adjusted R^2	Std. Error of the Estimate
1	.229[a]	.052	.048	.65461

a. Predictors: (Constant), FORENSIC ACCOUNTING

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig
1	Regression	5.510	1	5.510	12.859	.000[a]
	Residual	99.843	233	.429		
	Total	105.353	234			

a. Predictors: (Constant), FORENSIC ACCOUNTING
b. Dependent Variable: ECONOMIC PERFORMANCE

Coefficient[b]

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig
1	(Constant)	2.115	.228		.9.259	.000
	FORENSIC ACCOUNTING	.207	.08	.229	3.586	.000

a. Dependent Variable: ECONOMIC PERFORMANCE

Source: Research Data

Table 1.3: Regression analysis on the Association between Forensic Accounting and Cost of Capital

Model Summary

Model	R	R^2	Adjusted R^2	Std. Error of the Estimate
1	.440[a]	.193	.190	.64492

a. Predictors: (Constant), FORENSIC ACCOUNTING

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig
1	Regression	23.231	1	23.231	55.855	.000[a]
	Residual	96.909	233	.416		
	Total	120.140	234			

a. Predictors: (Constant), FORENSIC ACCOUNTING
b. Dependent Variable: COST OF CAPITAL

Coefficient[b]

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig
1	(Constant)	1.477	.225		.6.565	.000
	FORENSIC ACCOUNTING	.426	.057	.440	7.474	.000

a. Dependent Variable: COST OF CAPITAL

Source: Research Data

DISCUSSING OF FINDINGS

The coefficient r for hypothesis 1 is 0.423 significant at 0.01 level; that for hypothesis 2 is 0.229; while that of hypothesis 3 is 0.440. Basing our decision on (Irving 2005:16) benchmark, we thus accept H_1, H_2 and H_3, that there is a significantly positive association between forensic accounting and financial reporting, economic performance and cost of capital.

The rate of corporate fraud is on the increase and evidence abound that most financial reports are not properly stated. Accounting information system is an integral part of an organization's control system and thus provides critical decision-influencing and decision-facilitating information for control (e.g., Baiman 1982; Birnberg et al. 1983; Merchant 1985a; Tiessen and Waterhouse 1983). Corporate fraud is becoming very rampant in Africa. Our study reveals that most high level managers do not want to work for too long rather would prefer to work for a short whole and become owners.

The study further revealed that the supplying firms are owned by these managers thereby ignoring the much pronounced 'due process'. In some cases, there is no internal control unit and where one exists, the staff are relations of the managers or under the supervision of the managers. Management decides what to include in the financial report.

CONCLUSION AND RECOMMENDATION

Neoclassical economics and several management theories assume that the corporation's objective is profit maximization subject to capacity constraints. The central focus is shareholders as the ultimate residual claimant, providing the necessary financial capital for the firm's operations (Jensen and Meckling, 1976; Zingales, 2000). Most managers think more of themselves thereby thinking of loopholes to enrich themselves. Universities all over the world should run a forensic accounting degree so as to create more awareness of what it entails. Costs of capital are always influenced by management. GAAP and IFRS are not adhered to by financial reporting accountants. Based on the foregoing we make the following recommendations:

1. In the case of Nigeria the Economic and Financial Crime Commission (EFCC) and other related bodies as it applies to other countries should be allowed free hand without government intervention.
2. All culprits should be tried publicly.
3. All cash or fixed assets confiscated from the culprit should be made known and publish in the internet for world consumption.
4. The individual should not be allowed asylum in any country.
5. All accomplishers should suffer the same fate as the principal actor.
6. The accomplisher and the culprit should be made to suffer the same fate.
7. Finally, financial reporting accountants should work independent of management.

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