

Application of Forensic Accounting: A Tool for Confidence in Auditors' Reports

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Abstract

The paper examines forensic accounting as a tool that complements various auditing concepts to establish confidence in auditors' reports to the users. In spite of the concepts of independence, integrity, fairness and objectivity auditors' reports are still challenged and most of the times are found vulnerable. Adequate knowledge of forensic accounting will aid experts' defence in fraud examinations and litigation support. In the analysis of data, a descriptive statistical analysis was used in the study. 400 questionnaires were administered on firms of auditors, legal luminaries and computer experts as respondents. The data were analysed using chi-square statistical techniques. Secondary data through the use of textbooks, journals, articles and internet materials were equally used. It is revealed that the situations in audit risk areas such as losses from theft of cash or goods, payments and receipts of bribes, intentional misstatement in financial information such as over statement of revenue and earnings, under statement of cost and expenses and intentional misrepresentations made to auditors are rampant occurrences. The study hereby recommends that forensic accounting courses become compulsory in the curriculum of all the tertiary institutions offering accounting as a discipline and all professional accounting institutes and accountants in practice should include forensic accounting in their regular mandatory continuing professional development (MCPD) programmes, workshops and seminars in order to produce reliable reports.

Keywords: Forensic Accounting, Confidence, Reliability, Auditors' report

1. Introduction

Audit is a quality assurance function. Quality assurance has become more necessary with the expansion of stakeholders and the need to take into consideration their individual needs (Mohammad, 2008). The current trend of events in the rapidly changing world of globalization and advancement in information technology had culminated in the necessity of accounting profession to be more dynamic and creative to enable the profession achieve its objective of steadily advancing the science of accountancy.

Suffice it to say that the recent occurrences and the various comments globally had put question mark on the reliance and reliability of the auditors' reports. Ajibolade (2008) posited that in Nigeria, the spate of corporate failure witnessed in the financial sector in early 1990's brought auditors into focus and caused Nigerian public to question the roles of auditors. Also, an emerging body of literature argues that accounting professionals have increasingly used their expertises to conceal and promote anti-social practices (Bakre, 2007)

The public confidence is rapidly eroding in the auditors' reports as a result of discovery of inadequacies such as fraud, errors and irregularities. In 2003, Arthur Anderson was implicated in the collapse of world com; one of the largest telecommunication companies in the US. Arthur Andersen, as auditors, was found to have failed in taking proper steps to detect accounting irregularities. (Wrong, 2004)

To consolidate the confidence of the users of accounting information in the auditors' reports, forensic accounting will play a major role. Price Water House Cooper (PWC, 2003) submitted that forensic accounting investigative specialists work on financial information for the purpose of conveying complicated issues in a manner that others can easily understand. Also forensic accountants are usually engaged to determine the true financial position of company and to investigate unusual transactions. The circumstances of such investigations normally fit either into at least one of the following sections:

- a. Assets have been misappropriated or are unaccounted for while transactions have not been authorized or are outside agreed terms.
- b. Financial misstatement where actual transactions have been omitted or incorrectly recorded to improve or over state assets.

It is upon this premise that this paper attempts to justify the application of forensic accounting as an indispensable tool for confidence in auditors' reports.

2. Literature Review

The credibility of financial statements prepared by the directors of limited liability companies and audited by external auditors remain the primary means of informing the shareholders and other stakeholders about the financial performance, progress and position of a firm (Dabor and Adeyemi, 2009).

Sikka and Hampton (2005) submitted that professionals should possess theoretical and practical knowledge and exercise high level of skills, technical conduct and social responsibility. Gafar (2008) while analyzing financial crime statistics in Nigeria documented that 78% of frauds are committed by employees, 200,000 directors have had more than 3 company failures and finally 25% of curriculum vitae contain questionable errors. He said these are some of the vital statistics of financial crimes that necessitate investigation. Hence, the evolvement of strategies for its executions. KPMG's fraud survey (2003) shows that more companies are recently experiencing incidents of fraud than in prior years and are taking measures to combat fraud and launching new anti fraud initiatives and programmes in response to the Sarbanes-Oxley Act of 2002.

PWC (2003) said global crime survey indicates that 37% of respondents in 50 countries reported economic crimes with the average loss per company of \$2,199,930. This shows that auditors must be aware of indispensability of forensic accounting. Razaee, Rainstan and Lander (1996) examined the coverage of forensic accounting in the accounting curriculum and find that only a handful universities offer a fraud and/or forensic accounting courses and suggest that the accounting curriculum provides a knowledge acquisition base in forensic accounting as part of curriculum changes in response to the mandated American Institute of Certified Public Accountants (AICPA) 150-hour programme.

Houck, Kranacher, Moris, Riley, Robertson and Wells (2006) define forensic accounting as the use of accounting, auditing and investigative skills to assist in legal matters. Price Water House Coopers (2003) posited that dealing with suspicion of economic crimes, such as fraud or corruption issues requires much more than simple know-how. It requires speed sensitivity discretion, and also an in-depth knowledge of the legal and regulating frame work in each jurisdiction. Fraudulent activities often hide behind complexity of financial systems and processes. Utilizing advanced data matching, PWC forensic accountants are able to detect improper transactions and relationships. For example inappropriate relationships between employees and contractors, abnormalities in financial transactions, duplicated payments, ghost employees and other accounting techniques used to hide fraudulent activities were discovered.

In Adamu (2012), Louis defines forensic as the application of science to law. Forensic science uses highly developed technologies to uncover scientific evidence in a variety of fields. He continues by saying that modern forensic science has a broad range of applications. It is used in civil cases such as forgeries, fraud or negligence. Adamu (2012) defines forensic accounting as the accounting that is appropriate for legal review, the highest level of assurance and including the now generally accepted connotation of having been arrived at in a scientific fashion. Adamu further said that forensic accounting is sufficiently thorough and complete so that an accountant in his/her independent professional judgement can deliver a finding that is of such quality which would be sustainable in some adversarial legal proceedings or within some judicial or administrative review. This submission is in line with Manning (2005) who defines forensic accounting as the application of financial accounting as investigative skills to a standard acceptable by the courts to address issues in dispute in the context of civil and criminal litigations. In Adamu (2012), Weaver (2007) opined that in order to gather detailed evidence, the investigator must understand the specific type of fraud that has been carried out and how the fraud has been committed. The evidence should be sufficient to ultimately prove the identity of the fraudsters, the mechanics of the fraud scheme and the amount of the financial loss suffered. He further said it is important that the investigating team is skilled in collecting evidence that can be used in court case and in keeping clear chain of custody until the evidence is presented in court.

Adamu (2012) recommends an aggressive study in forensic education to practitioners, academicians and students with a view to addressing the ugly incidence of fraud characterised by the significant changes in the business environment posed by globalization, technological advancement and high profile financial scandals. He said forensic accounting is another aspect of accounting which tends to further highlight the natural relationship existing between accounting and law just as auditing. As a result of recent highly publicized financial scandals, increases in occupational fraud, and heightened concerns over money laundering to support terrorism and racketeering legislative mandate, public expectations have heightened the necessity for gainful engagement of auditors and accountants with special skills for detecting fraud within organisations. He said forensic accounting is a highly specialized field that combines investigative skills with expertise. A forensic accountant identifies, retrieves and examines financial data, analyzes and dissects complex corporate, governmental and individual financial accounting issues. He also summarises the finding for legal use. A forensic accountant is typically retained by corporations, governmental entities or individual through their attorney in matters involving complex financial accounting issues and fraud investigations. He may be called upon to present and defend case in court as an expert witness. (Adamu, 2012)

Harris and Brown (2000) suggested that a forensic accountant should be able to demonstrate special skills in rules of evidence and the law. He possesses analytical and investigative skills for identification of pattern of abuse. He is endowed with excellent interpersonal and communication skills and outstanding organisational skills. Buckhoff and Hansen (2002) indicated that not only would excellent communications skills be important

but the fraud investigator should also be asking the right questions. They went further saying the accountant may not know how to ask the right questions unless he/she is well versed in forensic accounting and advanced information system. Recently researchers, understanding and adhering to the Rule 702 of the Federal Rules of Evidence, began to appreciate the importance of forensic accountants (Craig and Reddy, 2004; Manning, 2005; Rasmussen and Leauanae, 2004; Shrnukler, 2005; Wells, 2003 and Wells 2005).

Researchers specified specific areas of expertise which forensic investigators should possess in chiding investigative accounting, economic loss calculation and business and intangible asset valuation (Rasmussen and Leauanae, 2004). Lichtman (2009) stated that the forensic investigator makes the documents speak and many at times the documents themselves do not tell the whole story implying that the investigator must translate what the documentary evidence means.

Considering the immeasurable and invaluable significance of forensic accounting to the business world, this paper is set to justify whether effective and efficient use of forensic accounting will build quality assurance evidence to the reports of practising accountants in Nigeria.

3. Method and Materials

The research design used for this study is descriptive in nature. The population of the study comprises of the senior members of staff of some international auditing firms in Nigeria. These are: KPMG professional services, Akintola Williams, Deloitte and Touche, Price water house Cooper (PWC) and Ernst. 200 questionnaires were received from the members of staff of these firms of auditors out of 240 sent to them. 150 and 50 questionnaires were collected back from the chambers of legal luminaries and computer expert respectively. In all a total of 400 questionnaires were received. This formed the sample for the work. The sample was drawn from all relevant firms in the South Western Nigeria, Abuja and Lagos. Legal luminaries were also consulted in the same areas and those who are vast in the computer software. The Chi-Square method of analysis was adopted for the research and all the formulated hypotheses were tested at 5% level of significance.

3.1 Research Questions

- i. Can forensic audit give sufficient evidence during litigation?
- ii. Can forensic audit aid auditors in quantifying losses from theft of cash or goods?
- iii. Can application of forensic audit significantly detect payments or receipts of bribes?
- iv. Can application of forensic audit significantly detect intentional mis-statement in financial information such as over-statement of revenue and earnings and under statement of losses and expenses.
- v. Can forensic audit help to detect the intentional misrepresentations made to auditors in the course of their duties?
- vi. Can forensic auditors be employed to act in advisory capacity to assist directors in developing more effective control to reduce the risk of fraud?
- vii. Can application of forensic audit be applied in the investigation of disputes involving shareholders, partners, contract and valuation of business?
- viii. Can application of forensic audit detect frauds perpetrated through thumb prints and signatures?

3.2 Research Hypotheses

The following research hypotheses are considered adequate for the study and are hereby stated in their null forms:

- i. Forensic audit on transactions cannot significantly give sufficient and reliable evidence during litigation.
- ii. Forensic audit cannot significantly aid the auditors in quantifying losses from theft of cash or goods.
- iii. Application of forensic audit cannot significantly detect payment or receipts of bribes.
- iv. Application of forensic audit cannot significantly detect intentional mis-statement in financial information such as over-statement of revenue and earnings and under statement of losses and expenses.
- v. Application of forensic audit cannot significantly detect intentional misrepresentations made to auditors in the course of their duties.
- vi. Forensic auditors cannot be significantly engaged to act in advisory capacity to assist directors in developing more effective control to reduce the risks of fraud.
- vii. Application of forensic audit cannot be significantly applied in the investigation of disputes involving shareholders, partners, contracts and valuation of business.
- viii. Application of forensic audit cannot significantly detect frauds perpetrated through thumb prints and signatures.

4. Results and Discussion

4.1 Results Presentation

Research Hypothesis1: Forensic audit on transactions cannot significantly give sufficient and reliable evidence

during litigation.

Table 1: Chi-square (χ^2) results

χ^2 Cal	χ^2 Table	Dof	Level of significance
87.44	7.81	4	0.05

Source: Authors' Computations

Since χ^2 calculated value is 87.44 which is greater than χ^2 table value, 7.81, the null hypothesis is rejected meaning that forensic audit on transactions can give sufficient and reliable evidence during litigations.

Research hypothesis 2: Forensic audit cannot significantly aid the auditors in quantifying losses from theft of cash or goods.

Table 2: Chi-square (χ^2) results

χ^2 Cal	χ^2 Table	Dof	Level of significance
226.78	7.81	4	0.05

Source: Authors' Computations

Since χ^2 calculated value is 226.78 which is greater than χ^2 table value, 7.81 the null hypothesis is rejected implying that forensic audit can aid the auditors in quantifying losses from the fit of cash or goods.

Research Hypothesis 3: Application of forensic audit cannot significantly detect payment or receipts of bribes.

Table 3: Chi-square (χ^2) results

χ^2 Cal	χ^2 Table	Dof	Level of significance
11.06	7.81	4	0.05

Source: Authors' Computations

χ^2 calculated value is 11.06 which is greater than χ^2 table value 7.81. It is therefore established that the null hypothesis is rejected while the alternative research hypothesis which states that the application of forensic audit can significantly detect payments or receipt of bribes.

Research Hypothesis 4: Application of forensic audit cannot significantly detect intentional mis-statement in financial information such as over-statement of revenue and earnings and under statement of losses and expenses.

Table 4: Chi-square (χ^2) results

χ^2 Cal	χ^2 Table	Dof	Level of significance
82.1	7.81	4	0.05

Source: Authors' Computations

The fact that χ^2 calculated value of 82.1 which is greater than χ^2 table value attests to the fact that application of forensic audit can significantly detect intentional mis-statement in financial information such as over-statement of revenue and earnings and under statement of losses and expenses.

Research Hypothesis 5: Application of forensic audit cannot significantly detect intentional misrepresentations made to auditors in the course of their duties.

Table 5: Chi-square (χ^2) results

χ^2 Cal	χ^2 Table	Dof	Level of significance
12.68	7.81	4	0.05

Source: Authors' Computations

Since χ^2 calculated is 12.68 which is greater than χ^2 table value of 7.81, the alternative hypothesis stating that application of forensic audit can significantly detect intentional misrepresentations made to auditors is accepted.

Research Hypothesis 6: Forensic auditors cannot be significantly engaged to act in advisory capacity to assist directors in developing more effective control to reduce the risks of fraud.

Table 6: Chi-square (χ^2) results

χ^2 Cal	χ^2 Table	Dof	Level of significance
29.14	7.81	4	0.05

Source: Authors' Computations

Since χ^2 calculated 29.14 which is greater than χ^2 table value of 7.81, the alternative hypothesis declaring that forensic auditors can be significantly engaged to act in advisory capacity to assist directors in developing more effective control to reduce the risk from fraud is accepted.

Research Hypothesis 7: Application of forensic audit cannot be significantly applied in the investigation of disputes involving shareholders, partners, contracts and valuation of business.

Table 7: Chi-square (χ^2) results

χ^2 Cal	χ^2 Table	Dof	Level of significance
15.72	7.81	4	0.05

Source: Authors' Computations

Since χ^2 calculated value 15.72 is greater than χ^2 table value of 7.81, the null hypothesis is rejected while the alternative research hypothesis asserting that application of forensic audit can be significantly applied in the investigation of various disputes is accepted.

Research Hypothesis 8: Application of forensic audit cannot significantly detect frauds perpetrated through thumbprint and signature.

Table 8: Chi-square (χ^2) results

χ^2 Cal	χ^2 Table	Dof	Level of significance
32.46	7.81	4	0.05

Source: Authors' Computations

Since χ^2 calculated value is 32.46 which is greater than χ^2 value of 7.81. The null hypothesis is therefore rejected. The alternative hypothesis which says that application of forensic can significantly detect frauds perpetrated through thumb print and signature is accepted.

4.2 Discussion of Findings

A causal look at application of forensic accounting as a tool for confidence in auditors' reports revealed that forensic audit on transactions will invigorate the auditors' assurance in the evidence provided by their clients. The findings so far have shown that forensic audit can aid auditors in quantifying losses from theft of cash or goods. Findings also revealed that application of forensic audit can help detect payments or receipts of bribes. It was equally ascertained that forensic audit can detect intentional mis-statements and misrepresentation in the financial information. It was also discovered that forensic auditors can be significantly engaged to act in advisory capacity to directors of companies for effective control of operations. In the process of this research, it was equally confirmed that forensic audit is an indispensable tool for setting disputes involving shareholders, partnerships, contracts and valuation of business. Finally, findings revealed that forensic audit can detect fraud perpetrated through thumb prints signatures.

5. Summary, Conclusion and Recommendations

5.1 Summary

Assessment of forensic account as a tool for confidence in auditors' report shows that the quality of evidence accepted by the auditors in the process of discharging their own task will be reliable. Suffice it to say that the audit risks are reduced to the barest minimum since the high risk areas like cash theft and goods pilfering can easily be uncovered and quantified through forensic audit. In addition, forensic audit can check corruptions perpetrated through receiving and giving of bribes, misstatement and misrepresentation of items in the financial statement. Apart from the fact that forensic auditors can be good advisers in corporate organizations on financial issues, they can equally proffer solutions to misunderstandings among investors. Finally the fraud perpetrated through thumb prints, signature and initials can be uncovered.

5.2 Conclusion

Considering the findings of this study, it is concluded that reliable auditors report is germane to the economic robustness of organizations. Audit is a quality assurance function in which the concepts of integrity, fairness and objectivity need to be strictly adhered to by the accountants in practice. For the report of auditors to show the "true and fair view" all the leakages must be truly closed. Wastages must be frowned at on the organization operations. The findings also revealed that fake overhead expenses can be detected by the adoption of forensic audit. Not this alone, all kinds of misrepresentation; that is initials and signatures will be reduced to controllable size in the organizations. Theft of any kind will be made almost impossible. Forensic audit enhances harmony among the investors. Furthermore, forensic audit will assist the auditors in all the audit-risk areas such as cash, goods and inventory management in the corporate organization. Finally, it is also concluded that forensic audit will engender integrity, fairness, objectivity that will culminate in a robust report that can enhance the economic viability of organizations.

5.3 Recommendations

The indication from this study points to the fact that practicing accountants need additional tools to combat the world of corruption and fraudulent practices. The report from the auditors should be a reliable document that will show unequivocally the true statement of affairs of the organization after their functions and certification. In view of the aforementioned and based on the empirical results of this study, the following recommendations are made:

- i. Forensic accounting should be inserted and be made compulsory in the curriculum of accounting studies in all the tertiary institutions.
- ii. All the professional bodies regulating accounting profession should include it as a course.
- iii. Directors and management team in corporate organizations should be adequately educated about forensic audit.
- iv. All organizations must be made to subject their transactions to forensic audit and evidence before the

- statutory auditors.
- v. The auditing firms must be current about changes and development in forensic accounting.
- vi. Corporate organizations must be educated about legal implications of forensic accounting.

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