Forensic Audit and Corporate Fraud

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Abstract

This study is examined the impact of forensic audit on corporate fraud in Nigeria. The objective of the study is to determine the relationship between forensic audit and corporate fraud. In order to collect sufficient primary data, the survey method was employed and questionnaires designed and distributed to collect the needed data, while the data were analyzed using IBM SPSS Statistics 21ordinary least square (OLS) regression technique. The study concluded based on the statistical analysis that the frequent utilization of forensic audit services will significantly help in the detection, prevention as well as reduction of incidences of fraud in and businesses. Consequently forensic audit was adjudged to be an efficient and effective tool against corporate fraud. It therefore recommended that forensic audit be made statutory for businesses and organizations.

Keywords: Forensic audit, fraud detection, fraud prevention, fraud reduction, corporate fraud

1. Introduction

There is a growing demand for forensic audit service as a result of increasing fraudulent practices in businesses and government agencies around the world in recent time. Often quoted in fraud scandals that almost swallow the corporate world are cases of Enron, Arthur Anderson, and WorldCom. These cases have, therefore, brought forensic auditing to limelight. Forensic audit is seen as summarizing and adapting investigative auditing, criminology, litigation services, and financial skills to uncovering fraud. The increasing complexity of fraud requires that forensic auditing be included in the tools required to successfully investigate and prosecute cases of fraud and those involved in fraudulent practices (Njanike, Dube, and Mashayanye, 2009). Though quite new in Nigeria today, companies' chief executives have realized that there is need for the services of forensic auditor, as the frequency of fraudulent financial practices have continued to be on the increased. Meanwhile, Arokiasamy and Cristal (2009) had described forensic audit as the application of financial skills and investigative ability within the context of rule of evidence to examine unsettled issues. Also, Linquistn and Bologna (1987) affirmed that forensic accounting as a discipline is made up of fraud knowledge, financial expertise and a sound knowledge and understanding of business reality and the working of the legal system. Forensic audit may be one of the most effective and efficient way to detect, reduce and prevent fraud; hence, forensic accounting is taught as a major course in many educational institutions in some countries of the world.

The Institute of Forensic Accountants (IFA) of Nigeria depict forensic auditing is the specialty of accounting that describes forensic auditor/accountant's engagement resulting from anticipated dispute or litigation. Timbee (2011) opined that there is need for medium sized firms to have forensic accounting department within which expert forensic accountant may specialize in forensic audit and fraud investigation. Therefore, forensic auditing or accounting is that aspect of accounting that provides analysis suitable to the court which will form the basis for discussion, debate and ultimate dispute resolution (Wallace, 1991).

The Association of Certified Fraud Examiners (ACFE, 2014) also defined occupational fraud as one in which an employee uses his or her occupation to enrich himself or herself through the deliberate misuse or misappropriation of employer's resources or assets. A classical example of this type of fraud is employee embezzlement. There is also vendor fraud (a type of external fraud), which is usually in the form of overcharge for purchased goods, over-invoicing, shipment of inferior good or the non-shipment of goods even though payment was made; and lastly is customer fraud. According to Nipion (2015), fraud usually occur in different form and can lead to bankruptcy, inflation, increase in crime, reduced income per head, unemployment, and can also affect the economic system of a country. Hence, forensic auditing needs to be adapted to every organization internal control system (Onuorah and Ebimobowei, 2012).

A glance at audit exercise defines audit as an independent examination of the financial statement of an enterprise prepared by management of that enterprise by independent third party or parties known as the auditor(s) in order to express a professional opinion as to the true and fair view of the financial statement. However, beyond expressing a true and fair view opinion of the enterprise's financial statement (Izedonmi, 2000) the forensic auditor is one who goes beyond the routine audit to conduct a massive investigation into the material in question, develops intuitive intentions and is willing to ask question in order to dig deep into the investigation at hand. He does not focus on the control system in place alone but uses extensive testimonial evidence gathered to reach conclusion on certain investigation. Therefore, he is concluded to be one who possesses expertise in financial investigation processes in order to unravel fraud perpetrated earlier.

1.1. Research problem

Fraud is a feature of every organized society in the world and Agbadua (1980 as cited in Fadipe-Joseph and Titilayo, 2012) opined that fraud is an anti economic process and must be properly and adequately dealt with. He stated further that for any organization to stand there must be proper management and trusted workforce that are psychologically fit before employment. Again, in the words of Ade and Whole (1982), fraud is seen as a virus which spreads from employees of an organization to other economic activities even the government. So for any economy to be solid and balanced there is the need for anti-fraud virus to be injected into our system to completely eradicating fraud from the system. Added to this, management and personnel of organization should maintain constant vigilance in order to detect and prevent fraud in their organization.

The issue "Forensic audit and corporate fraud" was coined to focus on the problem facing corporate organizations especially as it relates to corporate fraud. The failure of statutory audit to prevent, detect, and reduce misappropriation of corporation's financial and non-financial assets, and the increase in corporate crime necessitated the need for professional accountants and legal practitioners to jointly fashion out alternative means of dealing with this menace called fraud eating deep into businesses across the world. Against this backdrop, the study is expected to answer the following questions:

1. Can forensic audit significantly detect fraud in firms?
2. Can forensic audit significantly prevent fraudulent activities in firms?
3. Can forensic audit significantly reduce fraud in firms?

1.2. Research objective

The objective of this study is to examine the impact of forensic audit on corporate fraud and also determine the relationship between corporate fraud and forensic audit, while the specific objectives of the study are to:

1. ascertain whether forensic audit can significantly detect fraud in a firm.
2. examine whether forensic audit can significantly prevent activities in a firm.
3. find out whether forensic audit can significantly reduce fraud in a firm.

1.3. Research Hypothesis

The hypotheses below are formulated to test our model.

Ho1: Forensic audit cannot significantly detect fraud.
Ho2: Forensic audit cannot significantly prevent fraudulent activities.
Ho3: Forensic audit cannot significantly reduce fraud in firms.

2. Literature Review

2.1. Corporate Fraud

Fraud is a menace whose potential impact is devastating to any business, economy, security, and social and economic wellbeing of a people (Ajayi, 2003), and according to KPMG (2004) fraud is any dishonest activity involving the extraction of value from a business either directly or indirectly, regardless of whether the perpetrator benefits personally from his or her action. While, Black law dictionary as cited in Ogun-Alolade (2015) defined fraud as a knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment. Consequently, fraud includes any intentional or deliberate act to deprive another of money or money's worth by deception, guile, or other unfair means. Also, AUS (2010) sees fraud as an intentional act by one or more individuals among management and those charged with governance, employees or third parties, who use deception to obtain an unjust or illegal advantage. Mobile Wise Geek (2011) on the other hand defined fraud as a deliberate misrepresentation that bring about a form of monetary losses either to an individual or a body corporate. In the same vein, United States Legal (2011) defined fraud as an intentional misrepresentation of material existing fact made by one person to another with the knowledge of it been falsified and for the purpose of inducing the other person to act, and upon which the other person relies with resulting injuries or damages.

Russel (1978 as cited in Bello, 2001) remarked that fraud is a generic term and is used in different ways. This is because fraud has assumed different degrees and shapes, hence our judicial system is compelled to context themselves with only few general rules for its discovery and defeat. Fraud is an act of deception, which is deliberately practiced in order to gain unlawful or unfair advantage over another person. In other word, accounting fraud or corporate fraud involve falsifying accounting records and information which bothers on sales or cost records in order to boost sales figure or net income of an organization (Anyanwu, 1993). However, it must be understood that corporate fraud is illegal and subjects the organization and its executive to civil lawsuits as posited by Arokiasamu and Cristal (2009). One reason why company's officials engage in fraud is to reverse loss or ensure that they are able to meet earnings expectations from shareholders or from members of the public.

Ogun-Alolade (2015), Karwai (2002), Ajie and Ezi (2000), Anyanwu (1993), Okafor (2004) as well as Adeniji (2004) in their various studies highlighted the types of fraud in occurrence to include tax fraud, bankruptcy fraud, theft of intellectual property and proprietary information, embezzlement, fraudulent substitution, unauthorized lending, tempering with reserves, insider abuses and forgeries, defalcation, suppression, unofficial borrowing, impersonation, teeming and lading, fraudulent use of the company's documents, use of fictitious accounts, manipulation of vouchers, over invoicing, dry posting, inflation of statistical data, ledger accounts manipulation or falsified account information, duplication of cheque books, fictitious contracts award/execution, lending to ghost workers, kite flying and cross firing, misuse of suspense accounts, computer fraud and false declaration of cash shortage.

According to Bozkurt (2003), it is seen that fraud committed in businesses are of two types and these are; personal use of business resources and the drawing up of false financial statement for the business. The latter is to give the business a robust look in order to boost investors' confidence on the business. There are classical examples such as embezzlement of company's cash during its collection before it is recorded in the book of accounts. Another example is when the bank records are tampered with so as to gain advantage of the system in monetary terms. Added to this is gaining advantage through forgery of documents, making payments which ordinarily should not be made or payment that has been previously been made. The creation of fictitious debt, inventory and scrap theft, office supplies and fixed assets theft or creating fictitious expenses are avenues through which fraud is perpetrated. Rezaee (2004) hinted that in years past financial statement fraud had cost market participant up to $560 billion with serious litigation consequences. Meanwhile, it is estimated that between $3.5 trillion and $3.7 trillion are lost to fraudulent financial practices worldwide on an annual basis, through fraudulent financial statements, assets misappropriation and corruption (Association of Certified Fraud Examiners [ACFE], 2012; 2014) and in a survey conducted by Ernst and Young (2014), Nigeria is reported to have thirty percent (30%) incidence of fraud.

2.2. Forensic Audit

The need for internal controls in exercise of good corporate governance cannot be over emphasized as one aspect of these controls is financial oversight. Regrettably, the number of frauds that have been repeatedly committed within Nigerian firms raises weighty query as to whether traditional financial controls are working or whether the traditional audit system is still efficient in providing its oversight over financial activities of firms. Forensic audit's focus is on the detection, analysis, and communication of evidence of underlying financial and reporting events. Unlike the traditional audit which is rule-base and single-event based, forensic audit is not conducted for the purpose of rendering audit opinion. Hence, forensic audit operates in a principle-based environment (Public Company Accounting Oversight Board, 2007; Simth and Crumbley, 2014).

Forensic auditing arises from the integration of accounting, investigative auditing, criminology, and litigation services (Dada, Owolabi, and Okwu, 2013), as Singleton et al (2000) and Levi (2001) concluded that a forensic accountant is part cop, part lawyer, part auditor and part psychologist and a skeptic (van Horenbeeech, 2002). Hence forensic auditing is the application of accounting, investigative, criminology, and litigation services skills for the purpose of identifying, analyzing, and communication of evidence of underlying reporting event. In the opinion of Institute of Forensic Accountants of Nigeria (IFA, 2011) Forensic audit is the activity that consists of data gathering, verifying, processing, analyzing and reporting in order to obtain material facts and/or evidence in the area of legal or financial disputes and or financial irregularities including fraud and giving preventive advice.

2.3. Forensic Audit and Fraud

Fraud is rarely seen, but what is observed or noticed are the symptoms, hence forensic audit services provide firms with the necessary tools to detect and deter fraudulent practices (Enofe, Okpako, and Atube (2013). Thus forensic audit can be adapted as internal audit strategy to prevent fraudulent activities. Onuorah and Ebimobowei (2012) in their study on the effect of forensic accounting services on fraud detection in Nigerian banks concluded that forensic accounting services offer banks with the necessary tools to deter fraudulent activities.

Similarly, Islam, Rahman, and Hossan (2011) found that forensic accounting is a critical tool in the fight against corruption, detection and prevention of fraud in Bangladesh. While, Dada, Owolabi, and Okwu (2013) and Modugu and Anyanduba (2013) found a positive linkage between forensic accounting and fraud reduction, consequently forensic audit is a useful tool in fraud detection and reduction. Concurring, Njanike, Dube, and Mashayanye (2009) recognized forensic accounting as administrative function in Zimbabwe whilst they identified forensic auditor's duties to include detection and prevention of fraud as well as detection of potential red flag.

2.4. Theories behind this study

This study is driven by some known theories that are use in crime detection, prevention, and reduction as well as auditing. These theories are the policeman theory and the routine activity theory. Under the policeman theory, it is assumed that the forensic auditor is a policeman whose primary concern is to the detection and prevention of fraud so as to reduce the overall cases of reported corporate fraud incidence (Ittonen, 2010). On the other hand, the routine activity theory assume that for fraud to occur in a business, there must be a unison in time and space of a likely offender, a suitable target, and the absence of a competent sentry with functioning internal control mechanism against fraud occurrence (Felson and Clarke, 1998). The theory therefore assume the existence of a fraudster and the need to employ the services of a forensic auditor to help identify red flags and build efficient and effective internal control mechanism for the organization to prevent fraud.

3. Methodology

In order to collect sufficient amount of primary data for the purpose of this study, the survey method was selected. The primary data was collected with the aid of a well structured questionnaire in table 5 which was administered to one hundred and twenty five (125) respondents in the management cadre spread across various discipline to solicit their opinion. Responses for the questions was keyed using likert 5 point scale with strongly agree-5, Agree-4, Undecided-3, disagree-2 and strongly disagree-1 are logically employed to quantitatively reflect this order of ranking. The data collected is analyzed with the use of Ordinary Least Square (OLS) regression technique (Murray, 2013; Johns, 2010; Winship and Mare, 1984) to determine the impact on forensic audit on corporate fraud.

3.1. Model specification

This study examined corporate fraud (CFD) as a function of Forensic audit. Forensic audit is thus proxied by fraud detection (FDD) and fraud prevention (FDP) and the function is represented as follows.

Corporate fraud = f(Forensic Audit)

The following model is specified and shall be used to analyze the data collected.

$CFD = \beta_0 + \beta_1 FDD + \beta_2 FDP + \mu_t$

Where: CFD = Corporate fraud.

FDD = Fraud detection.
FDP = Fraud prevention.
μ_t = Error term.
$\beta_0, \ldots \beta_2$ = Regression coefficients of the model.

3.1.1. A priori expectation

A priori expectation is defined as a theoretical statement set to establish what the probable result any analysis would be. It is therefore anticipated that fraud detection (FDD) and fraud prevention (FDP) are to be positively related to corporate fraud (CFD) incidence. In other word, the coefficient of fraud detection (β_1) is expected to be greater than zero and the coefficient of fraud prevention (β_2) is also expected to be greater than zero. Representing these expectations mathematically, we have:

$\beta_1 > 0$ and $\beta_2 > 0$.

4. Presentation and Interpretation of Results

The result of the analysis of the properties of the measurement of likert scales and the items that compose the scales are presented in Table 1. Cronbach's alpha being a lower bound: for coefficient of precision and to the proportion of the variance attributable to common factors among the items, normally ranges between 0 and 1. There is actually no lower limit to the coefficient. The higher the Cronbach's alpha coefficient is, the greater the internal consistency of the items in the scale (Crombach, 1951; Gliem and Gliem, 2003). Hence, the Cronbach's Alpha coefficient for this study performed satisfactorily with a value of 0.748 and 0.822 for the standardized items, an indication that the research instrument's scale and the items, to a large extent, exhibit high internal consistency.

$$CFD = 9.152 + 0.88FDD + 0.502FDP$$

The equation above shows the substituted coefficients of the model specified in the study as extracted from table 2, and a closer examination of the results in the table reveals that the a priori expectations of the model are satisfied and that the results in general are satisfactory. The diagnostic statistics obtained from the regression of Corporate fraud (CFD) incidence in Nigeria against forensic audit as proxied by Fraud detection (FDD) and Fraud prevention (FDP) as shown in table 3 below reveals that the R-squared (R^2) value is 0.619, and after adjusting for degree of freedom the Adjusted R-squared (Adjusted R^2) value is 0.613, indicating that the application of forensic audit could increase the chances of corporate fraud incidence detection and prevention by 61.9%. This justifies the fact that the fit of the data to the model was good.

Reinforcing the justification of the fit of the model to the data is the F-statistics. The F-statistics being a test of appropriateness with a value of 99.304 and a significance value of 0.000 as shown in table 4 below means that the model is found to be significant and that a significant linear relationship exists between forensic audit and corporate fraud, consequently forensic audit can be used as a measure for checking corporate fraud incidence in an organization.

Considering the nature and task of forensic audit within the ambit of the theories stated above, and given the confidence interval at 5% significance level, the application of forensic audit would result in a 0.088 unit increase in the detection of corporate fraud incidence. In the same vein, the application of forensic audit would also result in 0.502 unit increase in the prevention of corporate fraud incidence. With t-statistics of 2.868 and 10.368 for fraud detection and fraud prevention respectively and their respective significance values of 0.005 and 0.000, we are inclined to reject the respective null hypothesis which say that "forensic audit cannot significantly detect fraud" and "forensic audit cannot significantly prevent fraudulent activities." These findings are in line with Enofe, Okpako, and Atube (2013), Dada, Owolabi, and Okwu (2013), Modugu and Anyanduba (2013), Onuorah and Ebimobowei (2012), and Rahman, and Hossan (2011) where they concluded that forensic accounting is an efficient and effective tool against fraud with relation to fraud detection and prevention. Also, the null hypothesis which says that "forensic audit cannot significantly reduce fraud in a firm" is rejected on the premise that fraud prevented hitherto reduces the incidence of fraud in a firm. This result seems to be at variance with the findings of Enofe, Okpako, and Atube (2013) where they concluded that though forensic accounting serves as tool for detecting and preventing fraudulent activities but cannot reduce fraud. The Durbin-watson statistics value of 2.177 shows that the problem of serial correlation associated with the Ordinary Least Square (OLS) regression result have been eliminated, implying that the model is economically viable. Hence, the model can be useful in policy formulation.

5. Conclusion and Recommendations

It has been established empirically that forensic audit is an efficient and effective tool against corporate fraud. Based on our analyses and findings, the frequent utilization of forensic audit services will significantly help in the detection and prevention of cases of fraud in businesses. Thus, with forensic audit services, incidence of fraudulent practices in and against businesses would have drastically reduced. With these findings, the literature on the effect of forensic audit and fraud has moved a step further. This issue could be a subject for further analysis. Consequently, it is advised that the study results be considered care. We therefore recommend that, if the incidence of fraud in and against Nigerian businesses must be curbed effectively, the Nigeria government must institutionalize forensic audit as a separate audit service. Like the conventional audit, forensic audit be made statutory for businesses and organizations.

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7. Tables

Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items

.748	.822	3

Table 1. Reliability Statistics; Source: The researcher's computation using SPSS 21.

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
	(Constant)	9.152	.853		10.726	.000
1	FDD	.088	.031	.187	2.868	.005
	FDP	.502	.048	.675	10.368	.000

a. Dependent Variable: CFD

Table 2. Coefficients[a]; Source: The researcher's computation using SPSS 21

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.787[a]	.619	.613	1.234	2.177

a. Predictors: (Constant), FDP, FDD

b. Dependent Variable: CFD

Table 3. Model Summary[b]; Source: The researcher's computation using SPSS 21

Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	302.283	2	151.141	99.304	.000[b]
1	Residual	185.685	122	1.522		
	Total	487.968	124			

a. Dependent Variable: CFD

b. Predictors: (Constant), FDP, FDD

Table 4. ANOVA[a]; Source: The researcher's computation using SPSS 21

1.	Income smoothing increases the risks of fraud in an organization.	SA	A	U	D	SD
2.	None inclusion of fraud reporting in the duties of The conventional auditor increases risks of fraud.	SA	A	U	D	SD
3.	Lack of segregation of increases the risks of fraud.	SA	A	U	D	SD
4.	CEO's override increases the risks of fraud.	SA	A	U	D	SD
5.	Security breach increases the risks of fraud.	SA	A	U	D	SD

6.	Key objective of forensic audit is to detect fraud and report same.	SA	A	U	D	SD
7.	Forensic audit can guarantee prompt detection of fraud in a firm.	SA	A	U	D	SD
8.	Forensic audit would help in detecting fraud in firms.	SA	A	U	D	SD
9.	Forensic audit is a novel model used in Nigeria for the detection of fraud.	SA	A	U	D	SD
10.	The use of previous records for litigation purposes would deter others from engaging in fraudulent activities.	SA	A	U	D	SD
11.	Fraud examination can help in building an efficient internal control system so as to prevent future occurrence of fraud.	SA	A	U	D	SD
12.	Forensic audit can help in reviewing existing internal control.	SA	A	U	D	SD
13.	Forensic audit can help guarantee the safeguard of assets from unauthorized use.	SA	A	U	D	SD
14.	Efficient internal control system guaranteed by fraud audit can help prevent fraud as far as possible.	SA	A	U	D	SD
15.	Forensic audit can guarantee strategic prevention of fraud.	SA	A	U	D	SD

Table 5. Questionnaire: Key: **SA**=Strongly Agree, **A**=Agree, **U**=Undecided, **D**=Disagree, **SD**=Strongly Disagree. **Source: The researcher's computation using SPSS 21.**