
Rethinking the periodic audit model; a thought about forensic accounting: evidence from Nigeria

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Abstract: Amidst various concerns about the fidelity of the periodic audit model as an assurance tool for establishing reliability of information, this paper seeks to provide a different dimension to the periodic audit model that may rebuild trust in it as an efficient tool for attesting information reliability. It explores a number of literatures to establish the weaknesses of audit as a fraud control mechanism and adopts a case to prove the potency of forensic accounting as a more viable tool for unveiling fraud. The combination of forensic accountant and an auditor working in an audit team under the guise of periodic audit should reduce if not completely eliminate fraud and other financial crimes. However the appointment and remuneration of the forensic accountant should be under a different authority, say the state. The paper encourages some reflections on an alternative practice of auditing given the increasing criticism of the long established accounting practice.

Keywords: audit; forensic accounting; fraud; financial crimes; weak guardianship; vulnerable targets; Nigeria.

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1 Introduction

Corporate fraud in recent times appears to have outgrown the methods of the periodic audit. More so, the drive for increased profits and market sustainability by audit firms has undermined the urge for effective conduct of audit engagements (Sikka and Hampton 2005; Otusanya and Lauwo, 2010). As noted by Sikka et al. (2009, p.9), “the commercialization of audits produces fault-line”. Hence, the occurrence of white collar crime has taken over the corporate world (Mitchell et al., 1993). The menace has caused, among other problems, swooping of shareholders’ investment, unemployment, loss of confidence in accounting profession and the death and dearth of ‘giant’ companies in the world (Mitchell et al., 1993).

Efforts by regulatory bodies to stymie the spate of corporate collapse have only succeeded in adding to the problem (see Sarbanes-Oxely Act, 2002; IFAC Task Force 2003; Roberts et al., 2005). More technical standards issued to strengthen the audit model against fraud have also added to the complexity of the audit model thereby providing loopholes for those who possess the acumen to break rules in the guise of seeking reliefs. Jamal (2008a, p.100) observed that:

“The accounting profession itself has relied on standard setting process that is top-down that is, expert-oriented instead of consensus-oriented and has led to the proliferation of technical standards written in form that is incomprehensible to most people, including most accountants.”

Several scholars (see Enyi, 2008; Njanike et al., 2009; Carpenter et al., 2011; Owojori and Asaolu, 2009; Kasum, 2009), have made efforts to identify and possibly suggest a succour to victim companies and individuals. However, they have either examined the problem from micro viewpoint or suggested the adoption of the failed proposal of the regulatory bodies (see Sikka and Willmott, 2009; Sikka 2008). Based on this, this paper seeks to identify the potential strength of forensic accounting in checkmating the growing spate of fraud in Nigeria, using the widely reported case of the Nigerian Stock Exchange.

2 Theoretical framework

Routine Activity Theory propounded by Cohen and Felson (1979), provides the explanation of crime focusing on the offender (employee or management), the suitable targets (shareholders or stockholders), and the guardians (auditors) of those targets. The theory holds that crime occurs during every-day routine in normal life when a suitable target is in the presence of a motivated offender and is without a capable guardian. Sometimes called opportunity theory (Tittle, 2000), the theory contends that the rates of predatory crime reflect how three specific variables are distributed in time and space. Crime occurs when there are motivated offenders and suitable targets in the absence of guardianship converge. Cohen and Felson (1979) explain further that motivated offenders are individuals and groups who have both the inclination and ability to commit crime for various reasons while guardianship refers to the capability of persons and/or objects that prevent the motivated offender from injuring or attacking the target. To explain the application of this theory in this context, the weak guardianship in corporate entities can be conceptualised as the current audit model as both the internal and external audit have

been unable to checkmate the ever-increasing white-collar crimes in recent times. Sikka et al., 2010 observe that:

‘the auditing model requires one set of entrepreneurs (auditors) to watch over another set of entrepreneurs (directors). The success of both is measured by revenues, profits and market shares rather than by pursuit of any broader social goals’. (p.9)

Although the routine activity theory signifies the weakness of the guardian (i.e., the audit model), it fails to explain the qualities of a strong guardian. The deprivation of law theory provides a guide to the identification of the guardianship strength. This is explained by the presence of an effective law which could serve as deterrence to the prevalence of fraud as with “the absence of law, inevitable human conflicts will produce high rate of crimes and individuals and groups seek to redress their own wrong” [Tittle, (2000), p.79]. Deprivation of law theory is a theory of ecological variation developed by Black (1976) to explain the variation of crime with inverse relationship with the availability of law for resolving disputes. It therefore implies that a periodic check (for example audit) could not be sufficient to checkmate financial crime. Although the periodic audit is performed in compliance with technical standards, the rules appear not to be working as predatory crimes is on the increase by the day (see Sikka, 2009; Mitchell and Sikka, 2003). Clark et al. (1997) observe that

“In nearly all cases [of corporate collapse], the companies had clean audit reports attesting to the state of their financial affairs and results and their compliance with accounting standards. The coming collapses were not detected much in advance” (p.40).

In the words of Black (1983, p.79) “although, legal decisions actually closely follow lines of status and therefore are not impartial, they are upheld by force exercised by state authorities who claim a virtual monopoly on its use”. The application of forensic accounting, as it rigidly applies the dictates of the statute in carrying out investigation, aligns with Black’s (1983) statement: ‘the greater the development of law, the lower the rates of crime’. More so, on the ground that forensic accounting has litigable support for every detected crime; the defiance theory (Sherman, 1993) has a theoretical relevance for advocating forensic accounting in enhancing financial investigations. The theory builds on the notion of shame and explains that all societies (macro or micro) impose or threaten negative sanctions for misbehaviour, and the deterrent success of sanctioning accounts for differences in crime rates. Accounting scholars have proposed the integration of forensic skill in the current audit model to obviate the weakness observed in the current periodic audit model (see Durkin and Everett, 1997; Dorrell, 2000; Bologna, 2000; Carmichael et al., 2002; Telpner and Mostek, 2003; Huber and Donald, 2005; Coppolla, 2006; Hochberg, 2006; Gray and Moussali, 2006). Hence, the periodic audit will not be seen as a mere periodic exercise to stamp the account prepared for publication but as a deterrence factor for predatory crimes in corporate entities.

3 Statutory periodic audit– a weak strategy for fraud investigation

For the existence of ‘self-serving bias’, the principle of agency theory assumes that “no agents are trustworthy and if they can make themselves richer at the expense of their principals they will” (ICAEW, 2005). Thus, “the separation of ownership from

management of modern businesses has advisably called for some forms of check on the fidelity of the management in carrying out their stewardship functions” [Millichamp and Taylor, (2008), p.2]. A form that is globally accepted in practice is the mandatory periodic audit. Different definitions exist for the term ‘audit’ in the financial reporting context and they all appear to have a common end. That is, the examination of financial statements to ensure conformity with underlying rules and the expression of unbiased opinion on the truth and fairness of such statements. Millichamp and Taylor (2008) define it in relation to its objective, they view auditing as the:

“examination of financial statement to enable the auditor to express an opinion whether the financial statements are prepared, in all material matters, in accordance with an applicable financial reporting framework” (p.4).

The Auditing Practices Board (APB) cited in Olowookere (2005) defines audit as:

“an exercise whose objective is to express an opinion whether the financial statements give a true and fair view (or equivalent) of the entity’s affairs at the period end and of its profit and loss (or income and expenditure) for the period ended and have been properly prepared in accordance with the applicable reporting framework (for example relevant legislation and applicable accounting standards) or, where statutory or other specific requirements prescribe the term ‘present fairly’.”(p.3)

Auditing is thus described as an independent examination of the books of accounts by a qualified auditor in order to attest to the truth and fairness of the financial statement and ensure conformity with applicable legal and institutional frameworks. To pinpoint the main idea of auditing, Gray (2008) describes it as “a process of reviewing others work to determine if they have followed the prescribed policies, procedures and practices” (p.116). The crux of the definitions cited so far is the opinion on the truth and fairness of financial reports. The audit report conveys an opinion- that is, a warranted conclusion made by the auditor based on argument (Smieliauskas et al., 2008). Despite the much pronounced objectives of mandatory audits of financial reports, accounting scandals are on the increase by the day due to the inability of the auditors to detect and prevent fraud. Clark et al. (1997) observe that

“In nearly all cases [of corporate collapse], the companies had clean audit reports attesting to the state of their financial affairs and results and their compliance with accounting standards. The coming collapses were not detected much in advance”. (p.40)

However, scholars in accounting have examined the reasons why mandatory audit is unable to ‘fix’ the recurring problem of the fraudulent financial reporting (see Colbert and Turner, 2000; Weirich and Rouse, 2003; Smieliauskas, 2007; Jamal, 2008a, 2008b). Some major reasons expounded are discussed below.

3.1 Concerns about the proliferation of accounting standards

Some scholars have ascribed the reasons for the inability of the mandatory audit to check the tide of the increasing accounting scandals to the regulation of mandatory audit through the issuance of standards. Explaining the object of the auditing standard setting bodies, Simnett (2007) states that:

“The International Auditing and Assurance Standards Board (IAASB) is the major standard setting body designated by, and operating independently under the auspices of, the International Federation of Accountants (IFAC). The IAASB has as its stated aim, “to serve the public interest by setting high quality auditing, assurance, quality control and related services standards and by facilitating the convergence of international and national standards, thereby enhancing the quality and uniformity of practice throughout the world and strengthening public confidence in the global auditing and assurance profession” (p.28).

Although the primary role of standard setting bodies is to look after the public interest and not to represent the firm’s interests, the proliferation of their outputs – technical accounting standards is seen as a major impediment to the achievement of this primary aim. As various professional standards exist across the globe to ensure that auditors perform their duties as expected of them so as to safeguard the assets of the stockowners in their respective client companies, the technical standards that guide the audit profession, according to Jamal (2008a), instead of safeguarding the assets of owners have rather provided a fertile ground for those who want to cheat. He argues that:

“The accounting profession itself has relied on standard setting process that is top-down that is, expert-oriented instead of consensus-oriented and has led to the proliferation of technical standards written in form that is incomprehensible to most people, including most accountants. To maintain the monopoly of standard setting both nationally and internationally, the profession has also advocated for harmonization of standards”. (p.100)

Motivated by the desire to serve the informational need of investors, the accounting standards setting bodies were mandated to increase the accounting standards. This led to complexity thereby affecting the costs of preparing financial statements and leading to accountants losing sights of their real jobs hence, resulting in audit failures (Belkaoui, 2004). Rather than relying on professional judgement of auditors, the standard overload which consists of more and more detailed rules has constrained the auditor from being sceptical about unusual transactions. “What detailed rules have done is handcuff the auditors” [Jamal, (2008a), p.100]. It is very difficult for an auditor to say ‘no’ when a transaction has been carefully structured to comply with an explicit threshold in an accounting standard (Nelson et al., 2002; Jamal, 2008a). In the same vein, Lindquist and Bettinghaus (2011) explain why more standards do not translate to improvement, they relate that:

“On December 23, 2010, the Securities and Exchange Commission approved eight new audit standards of the Public Company Accounting Oversight Board (PCAOB). These standards all focus on the auditor’s assessment of and responses to risk in an audit. The eight standards are primarily fresh codification of existing interim standards, but they make a few substantive changes as well”. (p.31)

The Centre for Capital Market Competitiveness (CCMC) is equally opposed to these standards and has called for their rejection or reconsideration. The basis of this view point of the CCMC is that “the new standards were overly prescriptive in nature and limited the use of auditors’ judgement in the process of performing the audit” (p.37).

3.2 *Independence concerns*

The audit concerns in relation to independence are essentially twofold. First, in relation to the independence of the auditing standards setting bodies; and second, in relation to the auditor carrying out the audit assignment on a particular corporate financial report. Auditors' independence is of great importance to the effective conduct of an audit engagement. "It is imperative for the International Auditing and Assurance Standards Board (IAASB) to be, and appear to be, impartial and unaligned with the accounting profession" [Simnett, (2007), p.29]. The independence is however, difficult to achieve as most auditing standard setting bodies across the globe comprise of members from among public practitioners and others with significant experience in auditing and assurance services. IFAC's members are accounting organisations around the world. They form the population of both accountants and consulting auditors. The financial statements prepared by accountants are audited by the consulting auditors. Hence, the auditors set standards for themselves. In an IFAC publication in respect of the IAASB, The following pronouncement was made:

"The IAASB consists of a full-time chairman and 17 volunteer members from around the world comprising practitioners in public practice with significant experience in the field of auditing and other assurance services and individuals who are not in public practice. Members are appointed by the IFAC Board based on recommendations from the IFAC Nominating Committee and are approved by the Public Interest Oversight Board (PIOB)". [IFAC, (2011), p.2]

It has however become a widely held view that the profession has failed in its attempt to set standard for itself as a result independence impairment (Simnett, 2007). The weak independence framework of the IAASB is further buttressed by the fact that "the members of the IAASB, including the Chair and Deputy Chair, are appointed by the IFAC Board on the recommendation of the Nominating Committee and with the approval of the PIOB" (IAASB, 2010). Thus, the composition and control of standard setting bodies will eventually lead to selected people setting standards for themselves and their professional colleagues across the globe. To control the problem, there should be a separation of standard setting body from the profession on which the standard is set. In fact, this has occurred in some jurisdictions (e.g., Australia and the USA). In the USA, "auditing standard has been taken away from the American institute of Certified Public Accountants (AICPA) and now resides with the Public Company Accounting Oversight Board (PCAOB), a body independent of the profession" (Simnett, 2007). In the case of Australia, the Australian Auditing and Assurance Standards Board (AUASB) has become a government body as distinct from its earlier life as a body of Certified Public Accountants (CPA) Australia and the ICAA (Institute of Chartered Accountants in Australia) (Australian Government Treasury, 2006).

With regards to an auditor carrying out the audit assignment of a particular corporate financial report, accounting literature is replete with arguments on independence in the conduct of the audit work. Tension regarding the independence of auditors has existed for decades. Conceptually, "independence, both historically and philosophically, is the foundation of the public accounting profession and upon its maintenance depends the profession's strength and its stature" [Carey, (1970), p.182]. It therefore follows that, if the auditor must form and express an unbiased opinion on financial statements, he must be independent of the preparers of such statements. The agency theory upon which the requirement for a third party (external auditor) is based would become a mere academic

exercise if independence is not well upheld. Hence, relationship or incidence that could render the auditor vulnerable to impairment of independence and objectivity should be avoided as much as possible. According to Mutchler (2003), independence is the “freedom from material conflicts of interest that threaten objectivity”. The importance of safeguarding the objectivity in auditor’s judgement cannot be overemphasised. An auditor must be an attitude of mind which does not allow the viewpoints and conclusions of its possessor to become reliant on or subordinate to the influence and pressures of conflicting interest (Baker, 2005). Given that the acknowledgement of the auditor’s state of mind is not determinable (see Baker, 2005), the practicability of the much pronounced independence is shaky. Despite its much pronounced importance, “the psychology of the independence of the auditor is not realistic” (Bazerman et al., (1997), p.91]. They argue that “audit failures rarely result from the deliberate collusion of auditors with clients. Instead, auditors may find it psychologically impossible to remain objective” (p.89). Bias typically enters unconsciously and unintentionally at the stage of making judgements because the economic bond between the audit firm and client increases the firm’s dependence on the client. In other words, auditors concerned with the possible loss of fee revenue are more likely to acquiesce to clients’ wishes (Ashbaugh et al., 2003; Hope and Langli, 2009). This has consequently taken the form of commercialisation of audit as against upholding social goals and hence increasing their dependence on the directors who pay their fees as well as prepare the accounts they examine. Otusanya and Lauwo (2010) argue that:

“The commercialisation of audits whereby auditors are dependent upon directors for their fees may result in auditors being unable to maintain a sufficient ‘distance’ and unable to deliver independent audits. Auditors may also develop strategies that maximise audit profits, possibly by performing less stringent audits or by developing strategies which increases private profits but reduce quality” (p.173)

Apart from the psychological impossibility to maintain independence and successive increase in audit fee, scholars of accounting have also mentioned other causative variables such as: provision of non-audit service, financial interest in client company, employment relationship, business relationship and contingent fees (see O’Connor, 2002; DeFond et al., 2002; Gul et al., 2007). Although the existence of the mentioned variables may enhance the longer-term interest of the auditors, it will however impair their independence hence reducing their objectivity and the possibility of their fraud detection. Jamal (2008a) opines that “each wave of fraud in the economy is accompanied with audit failure and cries of “where were the auditors?”. The question has perhaps, been answered in the statement of Sikka (2003):

“Auditors can continue to sell consultancy services to their audit client and effectively audit the transactions they themselves have created. They will not owe a ‘duty of care’ to individual stakeholders relying on audit reports. It is business as usual for the audit firm barons, who will be quaking in their boots all the way to the bank” (p.22)

3.3 Concerns about the auditor’s communication tool – the audit report

The auditors communicate their views of the state of affairs of the audited company through the audit report. They are limited in the way they communicate such opinions to readers of financial statements as the wordings of the audit report are standardised and

codified in different forms suitable for varying situations. Dickins and Higgs (2009) observe that:

“As the audit report is required to be standardized, the auditor has limited ability to modify or to provide additional explanation about the conduct of the audit or the judgment that is part of the auditing process. These judgments include an assessment of materiality, an assessment of going concern, a determination of the existence of errors and fraud, and a determination of whether internal control violations meet the criteria of being material weaknesses, among other things.” (p.52)

The most crucial aspect of the auditor’s report is the phrase ‘true and fair view’. Although accounting scholars have tried to define the ‘true and fair’ opinion, it has nonetheless been explained with different phrases such as ‘having unclear meanings’ and ‘being controversial’ (Smieliauskas, 2008), an abstraction and inexplicable phrase (Millichamp and Taylor, 2008). “The audit report needs a clearer communication of purpose and stronger argument in support of the audit opinion. It needs a more defensible and ‘unbefuddled’ operationalisation of its ‘hoary’ ‘elusive touchstone’ – the ‘true and fair’ principle” [Cunningham, (2003), p.1, 12]. It is in line with this notion that Smieliauskas et al. (2008) argue that the truth and fairness opinion be replaced with ‘acceptable risk of material misstatement’. The unclear nature of the concept of ‘true and fair view’ further increases the risk associated with audit model (Jamal, 2008a).

3.4 *Concern about the pursuit of profits*

“The commercialization of audits produces fault-lines” [Sikka et al., (2009), p.9]. Just like every other business undertakings, accounting firms are established to make returns that are sufficient to cover their operating costs and accumulate profits well above their costs. Accountancy firms have developed other non-audit products (often illegal and harming the public interest) in pursuit of increased profits and these include the sale of tax avoidance schemes (Sikka and Willmott, 1995; Financial Reporting Council, 2005; Sikka and Hampton, 2005). However, being professionals whose objective is mainly to checkmate activities of fraudulent financial reporters, overconcentration on the pursuit of profit may hamper the objectivity of the auditor’s judgement. In the pursuing profits, accounting firms have been widely reported to have traded their integrity and professional ethics for monetary gains (Sikka and Hampton, 2005; Otusanya and Lauwo 2010). “Accountancy firms are part of the contemporary ‘enterprise culture’ that persuades many to believe that ‘bending the rules’ for personal gain is a sign of business acumen” [Sikka and Hampton, (2005), p.8]. The profits accrued by audit firms are however, not limited to fees received on audit services alone, they provide other non-audit services through which they amass wealth. “Auditing firms have used their control of auditing markets to colonise adjacent markets in order to sell consultancy services to auditing clients” [Otusanya and Lauwo, (2010), p.172]. It is further argued by Otusanya and Lauwo (2010) that:

“The public is persuaded to believe that auditors collect relevant and reliable evidence in order to form their opinion. The reality is that in their pursuit of profits, auditors do not always bother with such niceties. This is because audit assignments are based on tight budgets and idealised procedures which limit audit verifications and examination of records to specific items” (p.173)

The Public Oversight Board (2000) states that “prospective revenues from the provision of non-audit services, extending into the future, create precisely the kind of financial stake that produces a conflict of interest capable of impairing independence” (p.121). The concern is that auditors, although possess monopoly of auditing financial statements, they engage in other forms of consultancy services for corporate entities including their audit clients. The existence of this will increase the economic bond between the auditor and the management of the client company and thus create a dangerous friendship that could jeopardise the interest of the business owners. Although, Wallman (1996) is of the argument that non-audit services performed for audit clients complement the audit function by providing more information about the clients firm’s business and hence increase the quality of financial reporting, other scholars (see Simunic, 1984; Parkash and Venable, 1993; Firth, 1997; Dee et al., 2001) are of opposite views. In this case, the information advantage from the other services would not improve the quality of financial reporting if the economic bond is significant enough to convince auditors to compromise their objectivity (Simunic, 1984; Parkash and Venable, 1993; Firth, 1997; Dee et al., 2001). The close ally formed by the existence of these services, having hampered objectivity, will reduce the potency of auditors in preventing fraudulent financial reporting.

3.5 Concerns about the responsibility for fraud detection

“If there is one factor that best explains why the Sarbanes-Oxley Act was enacted, it is the failure of certified audits to detect rampant and massive accounting frauds prior to a corporation’s imploding” [Kaplan, (2004), p.378]. Historically, fraud detection has rather been perceived as a by-product and not one of the primary responsibilities of the audit process (Gray and Moussalli, 2006). Auditors believe that the primary responsibility for fraud detection is a managerial endeavour (Dye, 2007) and therefore, did not see fraud and corruption busting as their main goal. In other words, they believe that an auditor was expected to ferret out fraud and inconsistencies in the examination of company’s accounts. The primary responsibility of the auditors is to carry out investigations to reach an opinion on whether proper books have been kept and whether the accounts comply with the underlying entries and opine on the truth and fairness of the audited accounts (see Baxter, 1970; Cunningham, 2003). When commenting on the implosion of WorldCom and HealthSouth corporations, Kaplan (2004) noted: “.....while the specifics vary from case to case [in those corporations], the bottom line was the same: the certified audit failed to prevent serious financial misstatements before they became public” (p.379). In addition to this, some scholars have also argued that financial audits are actually not very effective at detecting fraud (see Kaplan, 2004; Gray and Moussalli, 2006; Singleton and Singleton, 2007).

With the increasing trend of financial scandals, various regulatory bodies have been stirred to react in different ways¹ to nip the epidemic in the bud. These reactions, just like the current audit model, were either palliative or absolutely ineffectual because they followed the failed policies of the past (Ribstein, 2002; Jamal, 2008a; Ball, 2009). Jamal linked the inability of audit to detect fraud to its compulsion by the statute and the freedom of management to make a choice of auditor. He argues that:

“While the statutory compulsion would weaken the product market discipline that normally exists in the economy, the freedom of management to choose their auditors creates the potential for a conflict of interest where the auditor might collude with management rather than serve the public interest”. (p.123)

Conclusively, Christensen et al. (2005) argue that:

“..... despite the new requirements specified in SAS No. 99 for the independent auditor to detect fraud within financial statements, fraud is difficult to detect depending on the employee’s ability and knowledge of how to hide the deception..... many independent auditors do not have the experience and working knowledge of how to detect fraud because they receive no training in this area.....and fraud detection is beyond the scope of a typical financial audit engagement” (p.70)

4 Conceptualisation of forensic accounting

The term *forensic* is widely used in various subject areas. It has an exotic connotation but is really a very basic concept (Douglas, 2003) as it mostly applies in the fields of medicine, criminology, law and accounting (see Crumbly and Apostolou, 2007; Perri and Lichtenwald, 2009; Greenall and West, 2011; Holliday et al., 2011). The popularity is perhaps, due to the probative value of its evidence determined by the numerous characteristics of the evidence within the context of a particular crime scene (Holliday et al. 2011). While the term is being applied differently in these professions, it has been given a variety of meanings. It has been defined in the Merriam Webster’s dictionary as “relating to or dealing with the application of scientific knowledge to legal problems”. It is a scientific technique that is capable of recovering and analysing a wide range of materials that can be used to establish connections between a source and a criminal act or crime scene [Holliday et al., (2011), p.409]. In forensic psychology, it has been defined as the ‘advancement of opinions about criminal matters based on the extrapolation of academic research on psychological concepts involving criminal cases’ [Perri and Lichtenwald, (2009) p.52]. In geosciences, it is simply “a field of enquiry that utilizes techniques developed in the geosciences (such as geology, geomorphology, botany, biology and statistics) for the application to criminal judicial proceedings” [Morgan and Bull, (2007), p.73]. Although the term forensic has currently and consistently been applied to accounting, the profession itself does not have a standard definition for it. Forensic accounting covers a broad spectrum of activities, with terminologies not strictly defined in regulatory guidance (Weaver, 2008). While it is a term that is being used more and more, it has different connotation to different people (McKittrick, 2009). Some accounting scholars are of the view that forensic accounting services are services strictly used in the legal system (Coppolla, 2006; Dorrell, 2000; Durkin and Everett, 1997; Hochberg, 2006; Telpner and Mostek, 2003; Bologna, 2000; Huber and Donald, 2005; Carmichael et al., 2002; Gray and Moussali, 2006). Douglas (2003) defines it as an accounting that includes any engagement in support of a legal case. Christensen et al. (2005) perceive it as the “application of techniques and guidelines that come from areas of computer technology, ethics, criminology, accounting and law in researching numbers to discover fraud and to determine how internal control can be bypassed to commit illegal

acts” (p.71). Vasudevan (2004) also describes it as the audit that involves the examination of legalities by blending the techniques of propriety (value for money audit), regularity and investigative and financial audits. Although, the above mentioned definitions address forensic accounting in relation to its application in legal context, broader views of the phrase are given in a wider definition of the Association of Certified Fraud Examiner cited in Olowookere (2005). It was defined as:

‘... the use of professional accounting skills in matters involving potential or actual civil or criminal litigation, including, but not limited to, generally acceptable accounting and audit principles; the determination of lost profits, income, assets, or damages; evaluation of internal controls; fraud; and any other matter involving accounting expertise in the legal system’. (p.15)

Crumbly (2001) also posits that:

‘Forensic accounting is the accounting that is suitable for legal review, offering the highest level of assurance, and including the now generally accepted connotation of having been arrived at in a scientific fashion. That is, forensic accounting is sufficiently thorough and complete so that an accountant, in his/her 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’. (p.1)

In addition to its application in the court of law, the above definitions give more insight on the integration of accounting and auditing skills with thorough legal and scientific enquiry as the backdrop against which forensic accounting is adopted. However, the term forensic is evidential in application and thus appears incomplete without a mention of provision of evidences in support of whatever judgment the forensic accountant arrives at. Hence, according to Weaver (2008) defines forensic accounting is the “specific procedure carried out in order to provide evidence” (p.58). He further states that forensic investigation is the practical steps that the forensic accountant takes in order to gather evidence relevant to the alleged fraudulent activity. Given this background, Vasudevan (2004) argues that “since the object is to relate the findings of audit by gathering legally tenable evidence and in doing so the corporate veil may be lifted to identify the fraud and the persons for the criminal offence” (p.360). Hence, the forensic accountant takes more active, as well as more sceptical approach to examining the financial records of a company than the ordinary mandatory audit (Crumbly and Apostolou, 2007). Furthermore, forensic accounting can be argued to be both proactive as well as reactive in nature. Christensen et al. (2005) argue that forensic accounting skills “enable forensic accountant to dig deeply into individual accounting transactions looking for any type of suspicious activities and to assess the potential for employees to commit fraud” (p.70). They argue further that forensic accountants use specific techniques and guidelines in addition to past experience and knowledge to identify white collar crimes. Hence, what is at heart regarding the services of forensic accountants is ‘search for fraud’ (Gray and Moussalli, 2006). The term forensic is thus introduced in the accounting domain to serve as a more reliable and evidential means of ensuring protection of owners’ investment and the prevention and reduction of financial impropriety in all forms, hence enhancing credibility of financial reports and restoring public confidence in the profession.

5 Forensic accounting and fraud investigation

“Many times fraud is not easy to detect...it requires suspicion and thinking outside the box in an effort to know where the fund may be hidden” [Christensen et al., (2005), p.71]. The perpetration of fraud is done with intelligent schemes and counterfeit documents that make it difficult to be detected as a by-product of a periodic audit. In the words of Lannacci and Morris (2000), the plan of the perpetrators is to “obtain or make counterfeit cards, checks, and identification documents (ID) necessary to further their operation.” (p.67). “The production and use of high-quality documents are critical to the success of these operations” [Lannacci and Morris, (2000), p.68] hence requiring high level of sophisticated investigation and extensive experience in fraud detection to identify the existence of fraud. Plethora of research in fraud investigation incline toward the proclamation of forensic accounting. Although, started with little acceptance (Telpner and Mostek, 2003), today a forensic accountant possesses skills exceeding those of a traditional auditor and provides services beyond the scope of a typical financial audit engagement (Harris and Brown, 2000; Christensen et al., 2005). This statement informs the fact that forensic accounting is wider in scope and more effective in fraud detection than the usual periodic audit. Noting however, that the place of the current audit system in the corporate world cannot be completely undermined, it can be enhanced by the introduction of forensic accountant into the current audit team. Although it may be argued that the role of an auditor is widely different from that of a forensic accountant (Arens and Leobbecke, 2000), it is advantageous to an audit team to include a forensic accountant and for the upper management to require a forensic accountant to be on the team (Christensen et al., 2005). As the current audit boarders around giving opinion on truth and fairness, “forensic accounting is based on the premise on looking for indicators of abnormal occurrences in the accounting and financial reporting systems” [McKittrick, (2009), p.2]. Hence, its inclusion in the current audit model will equip the system with proactive measures in the identification of fraud.

Going by a simple logic, it is practically difficult for anyone to be a forensic accountant except that such person has mastered the science of accounting. As such, the divorce of forensic investigation from the current audit team may water down the standard of forensic science in accounting and render it impotent. According to Telpner and Mostek (2003), forensic accountants are of two categories: as expert witnesses and as consultants. In his capacity an expert witness, a forensic accountant is “one who has mastered the science of accounting and is able to assist lawyers and the courts to understand and apply accounting issues to the law and to dispute matters” [Telpner and Mostek, (2003), p.1]. As a consultant however, a forensic accountant according to Telpner and Mostek (2003), “might be hired to review and strengthen internal controls, to determine if assets are missing, or to discover if tax laws or accounting rules have been applied correctly to company transactions” (p.2).

The major reason for most fraud investigation is the suspicion of fraud or accounting misstatement (Vasudevan, 2004; Gray and Moussalli, 2006; Weaver, 2008) and in most cases the services of lawyers would be required. The lawyer may be incapable of understanding the rudiments of accounting as it diverges widely from his profession, “even lawyers who are also accountants (Chartered Accountants) but have not practised public accounting, or have minimal accounting experience, often misunderstand accounting” [Telpner and Mostek, (2003), p.2]. Thus, the service of a practising certified accountant will be required and in this case, the accountant is referred to as an ‘expert

witness' in the court. In his capacity as expert witness, the forensic accountant's opinion on a particular case is imperative to prove the occurrence or otherwise of a breach of care. The involvement of the accountant in the court case makes him a forensic accountant and hence an expert witness (Telpner and Mostek, 2003; Christensen et al., 2005). More so, it is important to note that vast experience in the practice of accounting cannot be effective in isolation of knowledge in forensic science. As training in forensic science alone is not sufficient for one to become a forensic accountant, mere experience gathered by a chartered accountant over several years of practical accounting practices may also not be sufficient to qualify one as a forensic accountant. There exist several specialised institutions in scientific skills of investigation involving police training, laboratory testing of evidence and sharing experience with an experienced investigator on prominent cases (Lannacci and Morris, 2000). Lannacci and Morris (2000) further state that:

“However, the successful completion of a college program, even a Master's degree program in forensic science, does not automatically qualify the graduate to work and testify in court as a forensic expert in his field. After completing his college work, the forensic scientist receives several additional years of training in an apprenticeship program learning how to apply his formal educational knowledge with new skills on how to examine evidence”(p.72)

Having got the requisite training, the forensic accountant approaches his engagement in fraud investigation by following procedures similar to that of a periodic audit. The procedures according to Weaver (2008), includes:

“planning the investigation by considering the best way to gather evidence; gathering evidence by getting an understanding of the specific type of fraud that has been carried out and how it was conducted; reporting, which entails the summary of evidence and a conclusion as to the amount of loss suffered as a result of the fraud with emphasis on how the fraudster set up the fraud scheme; court proceeding, this involves presenting the evidences gathered to the court and presence of the team members in the court to describe the evidence they have gathered and to explain how the suspects were identified especially where it involves complex accounting issues that may seem vague to non accountant.”
(p.60)

Given these descriptions of a forensic accountant, it may be argued that the conduct of the forensic accountant's work is more thorough than the periodic auditor's and requires full understanding of every fraudulent case before proceeding with any investigation. The training acquired in forensic skills will enhance the accountant's scepticism and eventually the ability and courage to probe relevant areas of suspicion. It is noteworthy to say that the forensic accountant may not have become a 'superman' in fraud detection; he perhaps would be able to discover fraud more easily as he conducts his investigation with a mindset on fraud detection.

6 Methodology

This paper does not pretend to adopt any positivistic methodology of analysis as genuine data on fraud are usually kept confidential. More so, people, who are supposed to give opinion on research instruments are usually averse to providing information on fraud related occurrences as such information is regarded as top secrets. Hence, data gathered

from subjects may be overly biased and insufficient. The nascence of forensic accounting is also feared to be a deterrent factor. Therefore, the use of samples will hardly produce any reliable result on fraud examination. Given these, this paper relies on the use of publicly available information such as newspaper publications, website information, published documents of court cases on fraud and fraud related offences and authoritative reports. The information obtained from the said sources have however been used in the context of this paper as representing the reports of the various sources as referred to in the reference list.

6.1 The case of the Nigerian Stock Exchange

“Capital market is a network of financial institutions and facilities that interact to mobilize and allocate long term savings in an economy” [Adeyemi, (2010), p.120]. The market that serves this purpose in Nigeria is the Nigerian Stock Exchange (NSE).² In order to attract foreign investment in the Nigerian securities, The Nigerian capital market was deregulated in the years 1993 and 1995. As with other deregulation policies, the control of government over the exchange was delimited in scope, hence exposing the Nigerian capital market to bubbles and bursts. These took the forms of repeal of certain laws in favour of unrestricted foreign participation by investors.

“The Nigerian capital market was deregulated in 1993, and in 1995, certain laws were repealed in favour of unrestricted foreign participation by investors. Since then, foreign flows into the Nigerian capital market have continued to rise, in the form of foreign portfolio investment.” (<http://www.nse.com.ng/AboutUs/Pages/The-NSE.aspx>)

The Nigerian Stock Exchange claims to have “been an indispensable vehicle that has contributed to the nation’s development and to the development of the Nigerian financial and capital markets”³. Its mission statement conspicuously reads on its official website how ethical the exchange purports to be:

“To promote increased capital formation in Nigeria by providing issuers and investors with a responsive, fair and efficient stock market through competent and dedicated professionals using the latest technology, thus assuring local and foreign investors access to the Nigerian stock market with confidence both in the regulatory framework and in the reliability of trading and settlement systems.”⁴

However, in order to provide adequate regulation for the capital market in Nigeria and instil discipline in the participants of the capital markets, a regulatory body was established by the Security and Exchange Commission Act of 1979 to oversee the operation of Nigerian capital market. Adeyemi (2010) states that:

“The Security and Exchange Commission (SEC) was established as the apex regulatory body in 1979 by the Security and Exchange Commission Act of 1979. The commission was further strengthened and re-enacted in 1999 by the Investment and Security Act No. 45 to license the stock exchanges and capital trading points as well as provide operational guidelines for institutions in the capital market.” (p.56)

The 1999 act was however repealed and re-enacted as the Investment and Security Act of 2007. The Commission was set up to, among other things “act in public interest having regard to the protection of investors and the maintenance of fair and orderly

markets.....” (Investments and Securities Act of 2007, p.13). Despite the highly pronounced strict supervision by the regulatory bodies, the Nigerian capital market has been faced with an unprecedented scandal in recent times with prime causes emanating from the unethical practices of the top officials of the Nigerian Stock Exchange. It was observed that:

“regulatory authorities are today exposed for their poor oversight functions in the capital market, as over N700billion belonging to individual and institutional investors are trapped in various forms to private placements in the market, some of which are aimed at defrauding unsuspecting investors.” (Businessday, June 13, 2012)

This has taken the form of the loss of several billions of naira to crash in share prices within a very short period. Subsequent to this were publicly reported cases of corporate fraud in the capital market. The Securities and Exchange Commission (hereinafter referred to as ‘SEC’) received, allegations which suggested that the affairs of the Nigerian Stock Exchange (hereinafter referred to as ‘NSE’ or ‘the Exchange’) may have been managed in a manner that is detrimental to the interest of the investing public⁵. The suspected mismanagement took several forms such as: unauthorised sales of shares; creation of moribund companies; capitalisation of expenses; wrong classification of assets and abandonment of project on which payments have been fully made.⁶ Following these allegations, an investigation panel was set up in line with the provision of the Articles of the NSE⁷ to investigate allegations of breaches of the rules and other applicable laws of dealing members. More so, the SEC commissioned two accounting firms – KPMG and Aluko Oyeboode and Co., to carry out a forensic investigation into the affairs of the NSE in 2010. The forensic investigation revealed quite a heap of anomalies (KPMG and Oyeboode, 2010). It was discovered that the Long Service Award that took place in 2008 on which about 398 million naira was reported to have been spent actually gulped about 593 million naira when the balance of N195 million was reclassified as market development expenses to conceal the untoward act. The investigation revealed further that the long service award was organised by one Yinka Idowu⁸ who concealed expenses to the tune of N342 Million through Candy Floss Limited, his moribund company. Furthermore, it was revealed that the actual expenditure on the Business Travel Overseas embarked upon in 2007 was 650% more than budgeted amount thereby leading to the siphoning of 390 million naira. A similar travel expense in 2008 took a similar shape of concealment. A sum of 1.3 billion naira was embezzled through reclassification under different fictitious expense description or classes. Other discovered frauds include: the maintenance and furnishing of staff quarters with stupendous amounts that could not be accurately verified due to claims of non-computerisation of accounting systems, expenditure on staff training which also was not verified due to the same reason stated above and sharing of ‘productivity/surplus’ to the tune of 340 million naira, 425 million naira and 480 million naira in year 2008 by the management, management staff and the council members of the NSE respectively.

Reacting to the report of the audit and finance committee of the SEC, Arunma Oteh, the director-general of the SEC was sent on compulsory leave on the 13th June 2012. (Businessday, June 13, 2012).

This case addresses two issues. Firstly, the complete absence of a periodic audit leaves us a situation that is worse than having a periodic audit.⁹ Secondly, the investigative dimension of forensic accounting can unveil untold secrets.

7 Conclusions and recommendations

The fidelity of auditors no longer presents surety as revealed by the recent accounting scandals. Indubitably, the complete elimination of the periodic audit does not submit a better idea. The threats to independence, the profit maximisation 'race' by the audit firms and other miscellaneous factors that may imprison the trustworthiness of the auditors do not necessarily make us subscribe to the elimination of periodic audit. What is needed is a way of rejuvenating the 'process'. Although it is difficult to unravel the mystery of the 'accounting empire', a modification of the existing status quo should change our bitter experiences.

The above case shows how forensic investigation can explain the extent of fraud and other financial crimes. Forensic accounting comes with a questioning mind and scepticism. It assumes the occurrence of fraud or corrupt practices and employs all possible means to unveil the truth.

Forensic accounting is still employed as a post mortem exercise and may not offer a reasonable ground to prevent fraud. The incorporation of this new technique into periodic audit perhaps should curb this endemism of fraud.

To continually reassure us of the independence of and effective discharge of duty by the forensic accountant in the audit team (as proposed herein), the regulation of the possibly emerging forensic accounting industry and the appointment of the forensic accountant should be under the control of an independent authority, say the state. This will equally control the oligopolistic tendency of the overall accounting industry.

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Notes

- 1 Such as; the establishment of the Economic and Financial Crimes Commission (EFCC) in Nigeria, the enactment of Sarbanes-Oxley Act in the USA, the idea of auditing the auditors being a central feature of the Public Company Accounting Oversight Board (PCAOB), the setting of a specific standard on auditors' responsibility for fraud detection, i.e., (SAS 99) and the enactment of Security and Exchange Act in the United Kingdom to protect investors from fraud.
- 2 The NSE is a metamorphosis of the old Lagos Stock Exchange established in 1959 by the Federal Government of Nigeria to cater to the need of indigenous companies to participate in capital market operations, maintaining fair prices through stock-jobbing and restricting the business of its members.
- 3 <http://www.nse.com.ng>.
- 4 http://www.nigerianstockexchange.info/mission_statement.
- 5 *Businessday*, 8 November 2010

- 6 Status update/report on the investigation of the affairs of the Nigerian Stock Exchange. September 2010.
- 7 Terms of reference and code of conduct of the investigation panel (2011).
- 8 Yinka Idowu is the personnel that led the corporate affairs department of the Nigerian Stock Exchange.
- 9 The NSE has produced no annual accounts that could be audited.