

The Role of Forensic Accounting in Detecting Misstatements in The Financial Reporting: A Theoretical Framework and Descriptive Modeling

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Abstract

Financial crimes have endangered the businesses of individuals, groups, institutions and even governments as a huge amount of money is lost as a result of these crimes. This had created a problem for the survival and successful operations in business organizations, which necessitates this study to examine the application of forensic accounting skills in the detection of financial crimes of companies registered in Egyptian stock exchange. The paper's findings are based on an empirical study through a questionnaire created from the literature and distributed among auditors, financial statement preparers of the publicly traded companies listed in the Egyptian stock exchange, law companies and academics in the Accounting and Law Department of the Faculty of Administrative and Financial Sciences at Egyptian University.

This suggests that an increase in the forensic level of skills by accountants and forensic financial crime investigation would lead to an increase in the detection of financial crimes. Therefore, the study recommended among others that the management of the firms should employ more forensic accountants who have the requisite knowledge, skills, competence, capability, experience and experts in forensic financial crimes investigation.

Key Words: Forensic Accounting - Financial investigation - Financial Crimes.

1-Introduction:

Financial crimes and fraudulent activities have been one of the most popular challenges to the worldwide economy. Corruption and other fraudulent practices seem to be a global menace that affects severely the economy of any nation and the society where it exists. It has been subject of continuous discussions in literature as the cause of retardation to developing economies like Africa, Latin America, and Asia as seen today.

Forensic accounting is a field of specialization that has to do with information that is being used as evidence especially for legal purposes. Forensic accounting encompasses both litigation support and investigative accounting. Litigation support provides assistance of all nature in a matter involving existing or pending litigation. It deals primarily with issues related with the quantification of economic damages, while investigative accounting is associated to the investigation of criminal matters (Economic and Financial Crimes Commission, 2017).

Business organizations have been threatened globally with the incident or occurrence of financial crime due to the failure of the proper recording keeping process of the financial transactions. That has resulted in an unprecedented increase in fraud and fraudulent practices in a most business environments. Financial crime has grown to a point where its perpetration poses a threat not only to the concerned organization but also the entire economy (Okoye & Ndah, 2019)

Most often, financial crime takes place in the process of acquiring raw materials, conveying the materials to the company's premises, engaging field workers and other inputs necessary to change the raw materials into finished goods. This process, however, in recent times has recorded an unprecedented increase in fraud and fraudulent practices as a result of greater size and complexities in the manufacturing firms (Okoye & Ndah, 2019).

Forensic accounting depends on different pillars. These pillars include the character of an accountant, experience and tools required, and the knowledge of law (Hamdan, 2018) The character of an accountant is concerned with the experience of the accountant Independence, creativity, and investigation capabilities. This investigation capability requires a forensic accountant to have basic accounting skills, such as level of education, writing communication level, verbal communication level, computer literate level, investigation and litigation level, among others (Abu & Okpe, 2021).

2- Literature review and Theoretical Background

2.1 Forensic Accounting

In the beginning of the twenty-first century, along with accounting scandals, frauds, fraudulent financial reports, fraudulent explanations; regulations and techniques to prevent fraud were started to be spoken about. Therefore, it has been important to determine the fraud and the implementation of legal sanctions due to the significant increase in the cost of the fraud. Therefore, the need for experts in the fields of accounting, finance, and law has increased. That is, the need for forensic accounting profession has increased (Selimoglu & Altunel, 2020).

Forensic accounting is a multidimensional field of activity that encompasses various kinds of professional services (Abdul-Baki, 2019); (Crumbley, 2019). In forensic accounting literature, there is no agreement between researchers on a “precise definition” of forensic accounting (Sahdan, Cowton, & Drake, 2020).

According to (Keskin & Ozturk, 2013), forensic accounting is defined as a science that differs from traditional accounting in which leads getting accounting facts throughout using procedures and audit method that dealt with legal problems and financial attributes. (Hao, 2012) believes that the forensic

accounting is the result of the integration between the legal framework and the accounting framework.

(Zysman, 2004) defined forensic accounting as the process to integrate accounting, auditing and investigative skills, while (Dhar & Sarkar, 2010) define forensic accounting as the application of accounting concepts and techniques to legal problems.

Forensic accounting can also be referred to as fraud auditing or investigative accounting (Ndubuisi, Beatrice, & Chinyere, 2017). The Association of Certified Fraud Examiners (ACFE) defines forensic accounting as follows "Forensic accounting is the use of professional accounting skill in matters involving potential or actual civil or criminal litigation including but not limited to generally accounting and audit principles and concepts in the determination of lost profits, income, assets or damages, evaluation of internal control, fraud and other matters involving accounting expertise in the legal system".

Furthermore, (Botes & Saadeh, 2018) found that professional accounting bodies and various researchers have adopted three approaches to defining forensic accounting: "narrow approach," "broad approach" and "more comprehensive." These three approaches to defining forensic accounting have been evaluated over the past few decades as forensic accounting has evolved.

The narrow approach is the first approach and indicates the legal and adversarial role of forensic accounting. (Bologna & Lindquist, 1995), were among the first authors to define forensic accounting based on the narrow approach as they defined forensic accounting as the use of financial and investigative skills to resolve legal problems. Furthermore, (Siegel & Shim, 2010), saw legal issues as the only outcome of Forensic Accounting. In addition, definitions such as these appear to concentrate narrowly on results in litigation services and the skill and technique in Forensic Accounting methods.

The "broad approach" to define forensic accounting is adopted by the professional bodies of accounting (Botes & Saadeh, 2018). This approach mainly focuses on the forensic accounting services that can be provided by professional bodies' members. For example, The American Institute of Certified Public Accountants (AICPA) in 2011 defined forensic accounting as: Services involving the application of specialized knowledge and investigative skills possessed by CPAs to collect, analyze and evaluate the evidential matter and to interpret and communicate findings in the courtroom, boardroom or other legal or administrative venues (Botes & Saadeh, 2018). In comparison, the APES 215 stated that: Forensic accounting services mean expert witness services, lay witness services, consulting expert services and investigation services.

Subsequent studies on forensic accounting definitions and scope have provided a "more comprehensive definition" that integrates the investigative role of forensic accounting and its legal role (Botes & Saadeh, 2018). For example, (Rezaee, Crumbley, & Elmore, 2004), have defined forensic accounting as the practice of rigorous data collection and analysis in the areas of litigation support consulting, expert witnessing and fraud examination.

The narrow approach has a legalistic focus and specifies the application of Forensic Accounting methods and techniques to resolve legal problems. The more comprehensive approach moves towards describing Forensic Accounting more in terms of outcomes applicable to not only the legal but also to other different environments, while still confining the definition to FA methods.

Based on previous definitions of forensic accounting, the scope of forensic accounting encompasses legal, adversarial, investigative and analytical roles. The legal role of forensic accountants

encompasses in-court and out-court roles, as a forensic accountant may be an expert witness, a consultant, arbitrator or mediator (Curtis, 2008); (Heitger & Heitger, 2008); (Pagano & Buckhoff, 2005). In regard to the investigative role, forensic accountants may engage in services of fraud investigation, anti-corruption, anti-money laundering, antibribery, financial statements fraud, asset tracing, fraud risk assessment, intellectual property theft, employee dishonesty and identity theft (Honigsberg, 2020); (Sahdan, Cowton, & Drake, 2020).

Also, As it is understood from above definitions, forensic accountants should have a number of characteristics different from normal accountants or auditors and they should have some knowledge about some subjects. These are intensive accounting knowledge, auditing, statistical, computer applications, law, psychology, research techniques, crime science, and business management (Selimoğlu & Altunel, 2020).

Finally, Forensic Accounting is a comprehensive field of professional practice for fraud investigation services. In fact, a forensic accountant plays a significant role in the process of detecting, preventing and prosecuting those individuals who are involved in criminal activity such as financial misstatement, money laundering, and identity theft (Alshurafat, Al Shbail, & Mansour, 2021).

2.2. Financial Crimes

Financial crimes are a form of theft/larceny that occur when a person or entity takes money or property, or uses them in an illicit manner, with the intent to gain a benefit from it. These crimes typically involve some form of deceit, subterfuge or the abuse of a position of trust, which distinguishes them from common theft or robbery.

Financial crimes according to Eiya and Otor (2013) may involve fraud or any other crime against property. It may be in respect of falsification of the ownership of property belonging to another as one's own personal use and benefit. Financial crimes may be carried out by individuals, corporations, or by organised crimes against individuals, corporate bodies and governments. Financial crimes involve corruptions, bribery, political donation, nepotism, kickbacks, artificial pricing and frauds of all kinds.

Furthermore, Financial crimes may involve (cheque fraud, credit card fraud, mortgage fraud, medical fraud, corporate fraud, securities fraud (including insider trading), bank fraud, insurance fraud, market manipulation, payment (point of sale) fraud, health care fraud); theft; scams or confidence tricks, tax evasion, bribery, embezzlement, identity theft, money laundering, and forgery and counterfeiting, including the production of counterfeit money and consumer goods. Financial crimes may be carried out by individuals, corporations, or by organized crime groups. Victims may include individuals, corporations, governments, and entire economies (Ndubuisi, Beatrice, & Chinyere, 2017).

Arjan (2013) defined financial crime as acts and statements through which financial market participants misinform or mislead other participants in the market by deliberately or recklessly providing them with false, incomplete, or manipulative information related to financial goods, services, or investment opportunities in a way that violates any kind of legal rule or law, be it a regulatory rule, statutory law, civil law, or criminal law. In legal and regulatory parlance, such acts are often described in terms of “misrepresentations,” “misreporting,” “false disclosure,” “non-disclosure,” or “fraud.”

Financial Conduct Authority (FCA) defined financial crime as any kind of criminal conduct relating to money or to financial services or markets, including any offence involving: (a) fraud or dishonesty; or (b) Misconduct in, or misuse of information relating to, a financial market; or

(c) Handling the proceeds of crime; or (d) The financing of terrorism.

The EFCC Act (2004) attempts to capture the variety of economic and financial crimes found either within or outside the organization. The salient issues in the definition include violent, criminal and illicit activities committed with the objective of acquiring wealth illegally in a manner that violates existing legislation.

In the opinion of (Okafor, 2004), fraud can be said to be a non-violent crime and illicit activity committed with the aim of acquiring illegal wealth either individually, as a group or an organised manner which violates existing legislation governing the economic activities of government and its administration. Fraud, according to (Ramamoorti, 2008), involves deceit, purposeful intention, risk of being cut, rationalisation, strong desire and violating trust. Fraud is a planned tricky process or device usually undertaken by a person or group of persons with the full intention of cheating another person or organisation to gain ill-gotten benefits (Onodi, Okafor, & Onyali, 2015).

(Ngai, Hu, Wong, Chen, & Sun, 2010) observe in their study that financial fraud is becoming an increasingly serious problem and effectively detecting an accounting fraud has always been an important but complex task for financial experts. Forensic accountants are therefore expected to be proactive and possess professional and expert skills not found in traditional auditor in identifying and preventing fraud.

2.3. Forensic accounting as a tool for combating financial crime

Many literary studies have examined forensic accounting as a tool for fraud detection and prevention. (Ehioghien, 2016) in his study about forensic accounting and fraud management evidence in Nigeria, revealed that forensic accounting significantly influences fraud detection and control and that there is a significant difference between the duties of professional forensic accountants and that of traditional external auditors.

(Enofe, Olorunnuho, & Okporua, 2016) studied the association between forensic accounting and fraudulent financial reporting in Nigeria. The study population consisted of 150 Professional Accountants and employees selected from the 10 banks in Edo State with 87 firm-year observations for the year 2015. Forensic accounting was the dependent variable measured by the respondent's responses. The fraudulent financial reporting was the independent variables proxies by the role of forensic accounting, financial performance, the relevance of the financial statement, and true and fair view of the audited financial statement. Primary data was collected from the respondents through the administration of a questionnaire. Multiple regression was employed for data analysis. The result revealed a positive and insignificant association between the role of forensic accounting, financial performance (FEC) and detection of financial crimes.

(Olaoye & Adebayo, 2019) Examined the impact of forensic accounting on fraud prevention and detection in deposit money banks in Nigeria. The study population covered 12 deposit money banks in Ekiti State. The primary sources of data were utilized the study adopted a well-structured questionnaire to 44 respondents. The simple linear regression was used for data analyses. The study outcome revealed a positive and significant impact of forensic accounting on the detection and prevention of fraud in deposit money banks in Nigeria.

(Okoye & Ndah, 2019) Examined the relationship between forensic accounting practices and fraud prevention in manufacturing companies in Nigeria. The study population consists of 10 manufacturing firms in Nigeria. The forensic accounting practice was the independent variable

proxies by fraud investigation and fraud litigation, while fraud prevention was the dependent variable. Data was collected through primary sources by administering a questionnaire to fifty (50) accounting staff of ten (10) manufacturing companies. The Ordinary Least Square (OLS) statistical techniques were employed for data analyses. The findings revealed that there is a positive and significant relationship between fraud investigation practices and fraud prevention in manufacturing firms in Nigeria.

(Adegbe, Dada, Owoeye, & Siyanbola, 2020) researched the application of forensic accounting techniques as an antidote for curbing fraud in Nigeria budget implementation. The population consisted of 195 staff of federal government establishments connected with the budgetary system and fiscal policy. The study utilized a primary source of data by administering a questionnaire to 195 respondents with a retrieval rate of 150 copies (77%). The study employed a survey cross-sectional research design while adopting descriptive and inferential statistics to analyze the data. The finding revealed that the application of forensic accounting techniques

(Abu, Olatunji, & Mike, 2022), examined the application of forensic accounting skills in the detection of financial crimes of quoted manufacturing firms in Nigeria. Data were collected from primary sources through the administering of forty-five (45) structured questionnaires to the staff within the accounting department of fifteen (15) manufacturing firms operating in Kano State. Multiple regression analyses were employed for analysis. The findings revealed that forensic level of skills by accountants and forensic financial crime investigation has a positive and significant relationship with the detection of financial crimes of quoted manufacturing firms in Nigeria. This suggested that an increase in the forensic level of skills by accountants and forensic financial crime investigation would lead to an increase in the detection of financial crimes.

(Navarrete & Gallego, 2022) carried out a study using a qualitative exploratory study with a phenomenological approach conducted through in-depth interviews with professional experts in the forensic field. They found that the use of forensic accounting techniques and tools could contribute to the prevention of fraud in financial reporting not only when the risk of fraud has been materialized.

3- Hypotheses:

The following null hypotheses are formulated and shall be tested:

- H01: The level of accountants' skills had no positive and significant effect on the detection of financial crimes of quoted manufacturing firms
- H02: The nature of forensic investigation had no positive and significant influence on the detection of financial crimes of quoted manufacturing
- H03: The number of experts consulted had no positive and significant effect on the detection of financial crimes of quoted manufacturing firms.

4- Conclusion

4.1. Future and Proposed Methodology

The choice of design in any research depends on the purpose of the problem and variable alternatives for the problem of that nature. The future study must employ the descriptive survey research design. The descriptive survey design method must adopt due to the desirability of the researcher getting the feedback from the respondents without any inducement. This method (descriptive survey design) of research approach enables the audience to give information freely without surpassing, influencing or promising for something. The study employs a primary source of

data collection through the administration of a questionnaire. The questionnaire deals with the research subject matter titled: The Role of Forensic Accounting to detect Financial Crimes.

The population of the study is comprised of four diverse groups: auditors (internal and external), those involved in financial statement compilation, users and academics. The survey design was used in the study with a sample consisting of among auditors, financial statement preparers of the publicly traded companies listed in the Egyptian stock exchange, law companies and academics in the Accounting and Law Department of the Faculty of Administrative and Financial Sciences at Egyptian University. Simple random sampling was done. Primary data was used in the study. The data were generated using a well-structured Likert questionnaire. A five-point scale – Strongly Agree - 5, Agree - 4, Undecided - 3, Disagree - 2 and Strongly Disagree – 1 – is logically employed to quantitatively reflect this order of ranking and to ensure validity of the questionnaire.

4.2. Descriptive Modeling

The model specification for the future study:

$$\text{Financial Crime Detection} = f(\text{Forensic Accounting Skills})\dots\dots(1)$$

Where Forensic Accounting Skills is proxies as Forensic Level of Skills by Accountants (FLSAs); Forensic Financial Crime Investigation (FFCINV); and Forensic Expert Consultation (FEC), equation 1 is restated as:

$$\text{FCDECT} = \text{B0} + \text{B1FLSAs} + \text{B2FFCINV} + \text{B3FEC} + \text{U} \dots\dots (2)$$

Where:

FCDECT = Financial Crime Detection

FLSAs = Forensic Level of Skills by Accountants

FFCINV = Forensic Financial Crime Investigation

FEC = Forensic Expert Consultation

B0 = Constant Terms

B1, B2, B3 = Coefficients of the Independent Variables

U = Error Term

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