

# **EMPIRICAL ANALYSIS ON THE USE OF FORENSIC ACCOUNTING TECHNIQUES IN CURBING CREATIVE ACCOUNTING**

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## **Abstract**

*This study evaluated the use of forensic accounting techniques in curbing creative accounting. The objective of this study was to empirically examine forensic accounting techniques in curbing creative accounting. Primary source of data collection was employed and the statistical tools used in analyzing the data include: Kruskal-Wallis test Mean rank and percentage distribution. From the findings of the study it was revealed that strong evidence exists on the effectiveness of techniques used by forensic accountants in helping to curb the problem of creative accounting. The result further revealed the existence of strong evidence that forensic accountants have enhanced their efficiency overtime. Also, it was found that there exists strong evidence that the emergence of forensic accountants has restored confidence in the credibility of corporate firms and their report. Hence, by applying accounting principles, auditing skills and investigative procedures in solving certain legal problems, forensic accountants help lawyers, courts, regulatory bodies and other institutions in investigating financial frauds. It was established from the findings of this study that there is need that forensic accountants must possess solid knowledge and skills in the area of accounting and auditing.*

**Keywords:** Accounting principles, Auditing, Corporate firms, Credibility, Forensic accountants

## INTRODUCTION

Great financial frauds at the end of the past and the beginning of this century have imposed the need for deeper investigation of irregularities in the area of financial reporting. In many quarters, forensic accounting is equated to financial audit but they appear to be miles apart. Forensic accounting arises from the effect and cause of fraud and technical error made by human. Forensic accounting is usually described as the integration of accounting and auditing skills with investigative techniques and professional scepticism. According to Arokiasamy & Cristal (2009), forensic accounting can be described as the application of financial skills and investigative mentality to unsettled issues, conducted within the context of rules of evidence. Bologna & Lindquistn (1987) asserted that forensic accounting as a discipline encompasses fraud knowledge, financial expertise, and a sound knowledge and understanding of business reality and the working of the legal system. Mukoro *et al.* (2013) noted that the first and most convoluted means of carrying out fraudulent activities in many organizations is through the accounting and financial records. It was revealed that the management of Enron - the celebrated energy company in USA defrauded by her top management used creative accounting to make the company look good and powerful on paper than it really was using special purpose subsidiaries that have a single aim and that did not need to be included in Enron's balance sheet to hide risky investment activities and financial losses. However, forensic accounting helped subsequently to determine that many of Enron's recorded assets and profits were inflated, and in some cases, completely fraudulent and nonexistent. Some of the company's debts and losses were recorded in offshore entities, remaining absent from Enron's financial statements (Mukoro *et al.*, 2013).

The practice of creative accounting started since the industrial revolution and continued up to these days, but observations showed that these practices increased since the starting of 1980's of the previous century. As a result of the practices of creative accounting, several large firms failed and shut down around the world. Several terms appeared to express the effect of management on the amounts of items included in the financial statements. Those terms include: accounting manipulation, fraudulent reporting, income smoothing, earnings management, and creative accounting.

The questionable issue is why and how managements may practice creative accounting. A financial statement is a summary of all events that took place in a particular firm during an accounting period. These statements are expected to be prepared based on the generally accepted accounting principles (GAAP). The GAAP determines contents, items, order, form, measurement methods, and the time of recognition. Managements of firms are responsible for the preparation and for the contents of these statements through its determination of the

accounting methods and procedures that accountants of firms can use to prepare these statements. Hence, observations have shown that managements of some firms attempt to practice creative accounting.

Sometimes, managements often exploit the available high degree of flexibility in the accounting standards, such as the selection among the available methods of depreciation in determining the annual depreciation expense in order to reduce the total amount of expenses, and therefore, increase the amount of income. The selection among the available methods of inventory valuation sometimes appears approximate by some management to increase inventory thereby leading to higher amount of income generated by overvalued inventory. The Enron sage revealed that its officers had used creative accounting practices to conceal about \$600 million in net losses over a period of three years 1997-2000 which led to a crisis of confidence in the stock market. Another American giant firm that was victim of creative accounting was WorldCom where creative accounting was employed to re-classify and amortize revenue expenses amounting to \$3.85 billion over a long period of time consequently the company went for chapter 11 bankruptcy protections. There are many other corporate misadventures typified by such practices of using doubtful and questionable accounting practices to conceal huge losses, concealing extensive borrowing by keeping them off the balance sheet and consequently overall fraudulent reporting.

According to Osisioma (2013), the global financial meltdown was made possible because there was failure on the part of gate keepers including the auditors. This has brought the indispensable corporate accountant into disrepute and ridicule and a crisis hour for the accountant profession. It was observed that new face of crime was mitigated by well articulated and professionally executed central schemes of an investigative, auditing and accounting nature. As expected this led to development of regulatory landscape for accountancy profession with new emphasis on forensic accounting. Accounting procedure simply makes historic reporting or recording while auditing verifies and validates the fairness of such recording. The auditors by the scope of his work cannot pontificate with any level of finality that fraud has occurred or not. Forensic accounting combines strong auditing procedure with sophisticated investigative techniques in verifying the accuracy and legitimacy of financial reporting. This drive towards a new type of "Corporate Cop" aimed at detecting and deterring occupational frauds. Creative accounting practices demands a change in scope, emphasis method and operational culture, if they are to contend with complex financial crime. In burgeoning cases of fraud and malfeasance in organizations and nations, it becomes important to empirically examine the techniques and skills of these fraudulent reporting messiahs so as to determine the efficacy of such techniques and skills on their mission of providing financial reporting to the world and

eradicating the disrepute and ridicule for the accounting profession. However, the question this study seeks to give answers to include: (a) To what extend has forensic accounting techniques helped in curbing of creative accounting; (b) To what degree has the skills of the forensic accountant enhanced his efficiency; and (c) To what extent has emergence of forensic accounting restored confidence in the credibility of corporate firms and their report. Hence, the purpose of this study was to empirically examine forensic accounting techniques in curbing creative accounting.

### **Purpose of the Study**

The main purpose of this study is to examine empirically forensic accounting techniques in curbing creative accounting. Also, to examine the technique used by the forensic accountants so as to determine if they are capable of curbing creative accounting. To examine the effectiveness of the skills of the forensic accountants so as to determine if these skills will give them an edge for good performance. In addition, to examine if the emergence of forensic accountant have restored confidence in the credibility of corporate firms and their report.

### **LITERATURE REVIEW**

Forensic accounting is a rapidly growing field of accounting that describes the engagement that results from actual or anticipated dispute or litigations. Forensic means suitable for use in a court of law, and it is to this standard forensic accountants generally work. Forensic accounting involves an investigative style of accounting used in determining whether an individual or an organization has engaged in any illegal financial activities.

According to Amat *et al.* (1999), they defined creative accounting as a process whereby accountants use their knowledge of accounting rules to manipulate the reported figures in the accounts of a business organization. Viewing creative accounting as a transformation from actual to in actual announced information connotes that creative accounting is a process where management attempts to inform actual financial information to incorrect information in order to satisfy the objectives of managements. According to Rosner (2003), accounting manipulation and fraudulent are two similar terms that represent management intent to interfere with the measurement and disclosure of accounting transactions and items of financial statements, even though the accounting standards do not permit these practices. He added that earnings manipulation is a studied selection method of the operating financing and investing operations. Moreover, since accounting methods and policies is permitted by accounting standards, methods of selecting, operating and investing operations should equally be disclosed to users. On his part, Bolkaoui (2004) explained that creative accounting is the process of converting

accounting numbers from its actual value towards a desired value by management, while, income smoothing is an intended smoothing of the announced number of income by management in order to decrease the variations in income from period to period, therefore, income appears at its normal amount. On income smoothing, Copeland (1968), opined that income smoothing is a repetitive selection of accounting measures in a considerable behaviour in order to avoid the fluctuations of income from period to period, and managements can affect accounting numbers under the following constraints: (a) no future obligations will appear on the firms during the future; (b) the effect of management should not violate the GAAP; (c) the effect should make a physical deviation in income from period to period; (d) the effect should not require actual transactions with external parties; (e) the effect should not require actual transactions with external parties, but just reclassifying account balances inside the firm; (f) methods and tools of effect that are used separately or through the connection with other practices along the accounting period. Lungu *et al.* (2009) identified the following in their not exhaustive census of techniques: (a) manipulation of tangible assets through the practice of subjective depreciation and lease-back arrangements; (b) goodwill through underestimation of assets purchased which may lead to increased goodwill; (c) depreciation through using different methods and/or review of useful life of an asset; (d) inventories through the manipulation of which affects subsequence years; and (e) provisions for liabilities and charges which are employed as tools for "leveling" financial outcomes. Lungu *et al.* (2009) added that the creative accounting mechanisms which involve tangible assets, equity, minority interest, loans and customers' claims usually have an impact on the balance sheet.

Without doubt, the role of forensic accountants under contemporary conditions is very important and stems from the need for identifying and analyzing certain causes of fraud appearance as well as the jobs and task that forensic accountants perform.

According to Osisioma (2013), forensic accounting clearly demands a change in scope, method and operational style for accountants. In financial audits, accountants are alert to signs or evidence of errors and irregularities of a material nature. Small errors are of less concern to financial auditors. Conversely, forensic accountants are very much concerned about small errors and irregularities, particularly if they seem to be related to the modus operandi of corrupt employees and fraudsters. Criminals usually cannot bury all their tracks; small errors and irregularities may therefore be the tip of a fraudulent iceberg. Hence, the forensic auditor is expected to look out for evidence of control procedure exceptions, accounting classification anomalies and oddities in financial trends. According to Jafaru (2011), forensic and investigative accounting should be seen as the application of financial skills and investigative mindset conducted within the context of the rules of evidence to resolve unresolved issues. Bologna and

Lindquist (1995) as cited by Chariri (2009) noted that as an investigator, forensic accountants should be seen as those who are specialists in fraud detection, and particularly in documenting exactly the kind of evidence required for successful criminal prosecution; able to work in complex regulatory and litigation environments; and with reasonable accuracy, can reconstruct missing, destroyed, or deceptive accounting records. Schafer (2008) explained that forensic science deals with the application of a broad spectrum of sciences which answer questions of interest to a legal system. This may be related to a crime or a civil action. In their contribution, Hopwood *et al.* (2012) defined forensic science as the application of science to legal matters. They noted that one of the earliest application of forensic science dates back to the 17th century when fingerprints on loan documents were used to prove debtors' identities. Since then, forensic science has become much more sophisticated, especially with the explosion of scientific knowledge in the 20th century. According to Hopwood *et al.* (2012), forensic science has numerous branches, many of which are important to forensic accountant. These include the following: (a) forensic ballistics : these deals with firearms; (b) computer forensics : these also deals with computer technology; and (c) criminalistics: its deals with the collection processing and analysis of crime scene evidence.

### **Corruption and Forensic Accounting**

Corruption has invaded the warp and woof of most society such as Nigeria unlike most civilized societies which are dependent upon people doing the right thing. Regardless of rewards, punishment, and deterrence, the resources required to fully enforce all the laws would be astronomical. Even deterrence is expensive to implement and does not guarantee an adequate level of compliance. The bottom line is that a person's normative values of right and wrong dictate his behaviour and determine compliance or noncompliance with the law. Corruption as a concept is usually difficult to define, because of its relativity but one can put it in a perspective when it is identified for the purpose of outlining ways and means of combating it. Nye (1967) explained that corruption is a behaviour which deviates from the normal duties of a public role because of private; regarding family, close private clique, pecuniary or status gain, or violates rules against the exercise of private-regarding influence. This includes such behaviour as bribery (use of reward to prevent the judgment of a person in a position of trust); nepotism (bestowal of patronage by reason of inscriptive relationship rather than merit); and misappropriation (illegal appropriation of public resources for private-regarding use). Mukoro, *et al.* (2011) defined corruption as tendency and likelihood to do what is wrong, evil or harmful to one's neighbour in spite of the knowledge of what is good. It is an attempt of subverting the rule of the game using trick to take public fund and using them for one's personal interest. The

dishonest and illegal behaviour exhibited especially by people in authority for their personal gain is corruption. In the Nigerian scenario, the boss and his messenger, the police officer and the recruit, the classroom teacher and his student, the politician and the voter, the judge and the lawyer, the pastor and his parishioner; none can remain untainted by this stigma. Two main factors which have played upon each other in destroying the moral fibre of the nation include abject POVERTY and malevolent GREED. The greed of the ruling class plays upon the poverty of the larger majority of the people to perpetuate the scourge of fraud and corruption. Why would a serving Inspector –General of police misappropriate the sum of 17 billion Naira of police fund in less than four years? What would generate accusation of supply of government arms, ammunitions and important information to militants and insurgents? Why would a serving Permanent Secretary in a Government Ministry be found with the sum of 2 billion Naira in his residence? These are obvious cases of greed.

### **Theoretical Framework**

The test of a theory is the extent to which its formulation seems congruent with our own perception of real world situation. the basic theory that has been established in this study is "white collar crime theory" (Sutherland, 1947; Michael, 2004). To build upon prior studies and establish a conceptual framework, focus on relevant theories related to expected criminal behaviour and management were discussed.

### **Differential Association Theory of Crime**

White collar crime can be defined as a crime committed by a person of respectable and high social status in the course of his occupation (Sutherland, 1983). In this context, the concept of "respectability" defies precision of use. Thus, the requirement that a crime cannot be a white collar crime unless perpetrated by a person of "high social status" is an unfortunate mixing of definition and explanation, especially when Sutherlan (1983) used the widespread nature of white collar crime to refute class-based theories of criminality. These deficiencies have rendered white collar crime an impotent construct for theory building in sociology. No influential theory of white collar crime has develop, let alone attempt to link such work to wider sociological theory. Sutherland's theory of differential association in White Collar Crime was a general theory of all crime, one whose generality borders on a plitudinous restatement of social learning (Albanese, 1995). Fredrichs (2007) explained that the only way one crime differs from another is in the background and characteristics of its perpetrators. Most, if not all white-collar offenders are distinguished by lives of privilege, much of it with origins in class inequality. It is estimated that majority of white-collar crimes is undetected or if detected, it is not reported. This is

because of the high status of the perpetrators of these crimes, which requires a highly trained and experienced examiner or investigator like the professional forensic accountant to forestall the occurrence of such high profile fraud.

## METHODOLOGY

For the study purpose, a descriptive research design was adopted. A self-constructed questionnaire was administered to practicing professional Accountants (Chartered, Certified, PhD and MSc) and the university lecturers of Accountancy Department, Nnamdi Azikiwe University, Awka, Nigeria.

A sample of 100 respondents were administered questionnaire from a population size of 133 using the Yamane's sample size determination technique (see Yamane, 1967) and a simple random sampling technique which gives every member of the target population equal chances of being included in the study. The statistical tools used in this study include the Kruskal-Wallis test, Mean rank, percentage distribution and Cronbach's Alpha reliability method.

## ANALYSIS

Table 1: Case Processing Summary

		N	%
Cases	Valid	5	100.0
	Excluded <sup>a</sup>	0	.0
	Total	5	100.0

a. Listwise deletion based on all variables in the procedure.

Table 2: Reliability Statistics

Cronbach's Alpha	N of Items
.949	38

Cronbach's Alpha of 0.949 suggests that the internal consistency of the responses of the research instrument (Questionnaire) is 94.9% consistent, indicating a very high degree of internal reliability.

### ***Kruskal-Wallis Test on whether techniques used by forensic accountants have not helped in curbing creative accounting***

H0: Techniques used by forensic accountants has not helped in curbing creative accounting

H1: Techniques used by forensic accountants has helped in curbing creative accounting

Table 3: Ranks

	Option	N	Mean Rank
Forensicacctech	Not Available	19	24.92
	Very Low	19	53.37
	Low	19	16.79
	High	19	77.32
	Very High	19	67.61
	Total	95	

Table 4: Test Statistics<sup>a,b</sup>

	Forensicacctech
Chi-Square	70.960
df	4
Asymp. Sig.	.000
a. Kruskal Wallis Test	
b. Grouping Variable: Option	

**Kruskal-Wallis Test on whether forensic accountant have enhanced their efficiency overtime**

H0: Forensic accountants have not enhanced their efficiency overtime.

H1: Forensic accountants have enhanced their efficiency overtime.

Table 5: Ranks

	Option	N	Mean Rank
Forensicaccskill	Not Available	16	19.56
	Very Low	16	44.91
	Low	16	13.44
	High	16	69.19
	Very High	16	55.41
	Total	80	

Table 6: Test Statistics<sup>a,b</sup>

	Forensicaccskill
Chi-Square	68.058
df	4
Asymp. Sig.	.000
a. Kruskal Wallis Test	
b. Grouping Variable: Option	

**Kruskal-Wallis Test on whether the emergence of forensic accountants have restored confidence in the credibility of corporate firms and their report**

H0: The emergence of forensic accountants have not restored confidence in the credibility of corporate firms and their report

H1: The emergence of forensic accountants have restored confidence in the credibility of corporate firms and their report

Table 7: Ranks

	Option1	N	Mean Rank
Forensicacccredibility	Not Available	3	3.83
	Very Low	3	8.83
	Low	3	3.17
	High	3	12.50
	Very High	3	11.67
	Total	15	

Table 8: Test Statistics<sup>a,b</sup>

	Forensicacccredibility
Chi-Square	11.472
df	4
Asymp. Sig.	.022
a. Kruskal Wallis Test	
b. Grouping Variable: Option1	

## EMPIRICAL FINDINGS

- (1) The result of the analysis presented in Table 1, showed that majority of the respondents believes that techniques used by forensic accountants have highly helped in curbing creative accounting since the mean rank for the option "High"= 77.32 and appears to be the highest mean rank. Also, Table 2 revealed a Chi-square measure of 70.96 and p-value of 0.00 which falls on the rejection region of the hypothesis assuming a 95% confidence level. This result gives strong evidence of techniques used by forensic accountants in helping to curb the problem of creative accounting.
  
- (2) The result of the analysis presented in Table 3, revealed that majority of the respondents highly believed that forensic accountant have enhanced their efficiency over time since the mean rank for the option "High"= 69.19 and appears to be the highest mean rank. In addition, Table 4 showed a Chi-square measure of 68.058 and p-value of 0.00 which

falls on the rejection region of the hypothesis assuming a 95% confidence level. This result implies that there exists strong evidence that forensic accountants have enhanced their efficiency overtime.

- (3) It was found from the result of the analysis presented in Table 5 that majority of the respondents highly believed that the emergence of forensic accountants have restored confidence in the credibility of corporate firms and their report since the mean rank for the option "High" = 12.50 and appears to be the highest mean rank. In addition, Table 6 revealed a Chi-square measure of 11.472 and p-value of 0.022 which falls on the rejection region of the hypothesis assuming a 95% confidence level. This result connotes that there exists strong evidence that the emergence of forensic accountants has restored confidence in the credibility of corporate firms and their reports.

## **CONCLUSION**

The role of a forensic accountant under contemporary conditions is very important and vital. This is because forensic accountants, in accord with the essence of forensic accounting, investigate and document frauds. From the findings of this study it was revealed that strong evidence exists on the effectiveness of techniques used by forensic accountants in helping to curb the problem of creative accounting. The result further showed that there exists strong evidence that forensic accountants have enhanced their efficiency overtime. Also, it was found that there exists strong evidence that the emergence of forensic accountants have restored confidence in the credibility of corporate firms and their report. Hence, by applying accounting principles, auditing skills and investigative procedures in solving certain legal problems, forensic accountants help lawyers, courts, regulatory bodies and other institutions in investigating financial frauds.

It was established from the findings of this study that there is need that forensic accountants must possess solid knowledge and skills in the area of accounting and auditing. Also, forensic accountants should be considered independent if they are intellectually honest, ready to make impartial decisions and have no interest or obligations in relation to the client and management. In addition, forensic accountants are expected to develop capability in verbal and written communication, potentials in perceiving details and of the efficient application of investigative activities as well as a considerable degree of knowledge about information technologies in accounting and auditing procedures. Since, this study assessed the impact of technique used by forensic accountant in curbing creative accounting and found them to have

contributed significantly in curbing the challenge of creative accounting, thus, determining the technique and skill that is most effective in curbing creative accounting becomes fruitful area for future research.

## LIMITATION OF THE STUDY

This study was challenged by the primary data reliability this is because most of the accountants and Lecturers have busy schedule which resulted to the questionnaire not being completed in due time and few of the questionnaires were not returned. However, appropriate statistical level of confidence was taken to fortify the degree of reliability.

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## APPENDICES

### Summary of responses obtained from the Research Instrument

#### Section A

S/N	ITEMS	H	VH	L	VL	NA
1.	<b>CRITICAL POINT AUDITING</b>					
	Filtering out the symptoms of fraud from regular and normal transactions in which they are mixed or concealed	20	27	11	12	30
	Make trend analysis by tabulating significant financial transactions	20	25	15	25	15
	Ascertaining unusual debit/credits in accounts normally closing to credit/debit balances	35	25	5	25	10
	Ascertaining false credits to boost sales with corresponding debits to non-existent during personal accounts	31	28	10	19	12
	Filtering discrepancies in debtors/creditors/stock balances as evidenced from the non-reconciliation between financial records and corresponding subsidiary records	35	25	5	25	10
	Analyze books with a view to ascertaining accumulation of debit balances in loosely controlled account	20	25	15	25	15
	Analyze cross debits and credits and inter-account transfers	35	30	5	25	5
	Ascertaining weakness and inadequacies in internal central/ check system	35	25	10	20	10
2	<b>PROPERTY AUDIT</b>					
	Make a compliance test to ascertain if all expenditures sanctioned and incurred are need based	31	28	10	19	12
	Ensure that all due revenues have been realized in time and entered in the necessary account	35	25	5	25	10
3	<b>VALUE FOR MONEY TECHNIQUES</b>					
	Report if the goal of economy, efficiency and effectiveness have been achieved in the transactions for which expenditures have been incurred or revenue collected	20	25	15	25	15
4	<b>RELATIVE SIZE FACTOR</b>					
	This states that each field in any transaction has a normal range and any data falling outside the range is unusual and need to be further investigated	35	30	5	25	5

<b>5</b>	<b>DATA MINING TECHNIQUES</b>				
	The objective is to dig up large amount of data to discover previously unknown, action oriented, hidden trends, patterns and complex relationships. The three major activities of data mining techniques are Discovery, Predictive Modelling and Deviation Analysis	31	28	10	19
<b>6</b>	<b>INVESTIGATING THE EARLY WARNINGS OF CREATIVE ACCOUNTING such as</b>				
	Cash flows that are not correlated with earnings	20	25	15	25
	Debtors balances that are not correlated with revenue	35	25	5	25
	Allowances for bad debt that have no correlation with debtors balances	35	30	5	25
	Resources that are not correlated with balance sheet items	35	25	10	20
	Acquisition with apparently no business purpose	31	28	10	19
	Earnings that consequently precisely meet the expectations of analyze	35	25	5	25

Sources: Field survey 2014

#### Section B

S/N	ITEMS	H	VH	L	VL	NA
	To what extend do you believe that the under listed skills will enhance the work of the forensic accountant					
1	Being calm, collected and good listener	35	25	5	25	10
2	Curiosity	35	30	5	25	5
3	Having good idea of human psychology in order to understand the impulse behind criminal behaviour	35	25	10	20	10
4	An indent knowledge of financial books	31	28	10	19	12
5	Interpersonal and communication skills which and conducting of interviews and extracting critical information from employees	35	25	5	25	10
6	Proficiency in computer and knowledge of network system	20	25	15	25	15
7	A thorough understanding of fraud schemes	35	25	10	20	10
8	Thorough knowledge of company's governance makes out the laws that regulate these policies	31	28	10	19	12
9	Command of criminal and civil law, as well as of the legal system, law of evidence and court procedures	35	25	5	25	10
10	Creative i.e. ability to venture into new things and depart from the norm	35	25	5	25	10
11	Independent	35	30	5	25	5

12	Sense of urgency and commitment	35	25	10	19	12
13	Ability to communicate complex theoretical ideas in a manner which is really understandable by the layman	31	28	10	19	12
14	Sound understanding of peculiarity of various business methods	35	25	5	25	10
15	Ability to review large volume of documentation	20	25	15	25	15
16	Ability appears objective and professional even when taking part in the inherently partisan process in a court	35	25	10	20	10

Sources: Field survey 2014

### Section C

S/N	ITEMS	H	VH	L	VL	A
1	Do you think that the activities or the role forensic accountants have played so far in investigation and detention of fraud in Nigeria has restored confidence in the credibility of corporate firms and their report?	20	25	15	25	15
2	Would you advocate that forensic audit should be made mandatory for every company and all public sector organization?	35	25	10	20	10
3	Do you think their mandatory existence in all company and all public sector organization will reduce corruption and give quality assurance to financial reporting?	31	28	10	19	12

Sources: Field survey 2014