

## INFLUENCE OF FORENSIC AUDIT DRIVERS ON QUALITY OF INTERNAL AUDIT FUNCTIONS IN NIGERIA

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**Abstract:** *This study evaluates the influence of forensic audit drivers on quality of internal audit function in Nigeria with reference to medium scale firms in Lagos and Ogun States. The population of the study comprises of stakeholders of forensic auditing in the sampled states including internal auditors of sampled firms, forensic accountants and other relevant stakeholders considered appropriate for the study. A sample of 72 medium scale firms representing 10% of the total population (723) of Lagos and Ogun States was used as sampling frames for the study, chosen purposively in proportion of 60% and 40% for Lagos and Ogun firms respectively. Three (3) internal audit staff including internal auditors and assistant internal audit staff who were Chartered Accountants were used as respondents through purposive sampling technique. The results of the study showed that there is a strong and positive relationship between forensic audit and quality of internal audit function in medium scale firms in Nigeria. It also revealed that Forensic audit influence quality of internal audit function in medium scale firms. The study concluded that forensic audit enhances internal audit function for stronger internal control system. It is therefore recommended that medium scale firms need to employ quality forensic analyst and make use of modern-day technology to aid forensic audit.*

**Key words:** *Forensic Audit, Internal Audit Quality, Medium Scale Firms, Nigeria.*

**JEL Classification:** *M42.*

### 1. Introduction

Auditing according to Raffa, (2003) is a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users. Auditing has its history to a large extent determined by the history of accounting, as the latter metamorphosed and culminated with the development of the world economy (Tanko, 2011). For instance Salehi (2008) observed that although ancient cultures of Mesopotamia, Egypt, Greece and Italy show evidences of highly developed economic systems, yet the economic fact during these periods were limited to the recording of single transactions. Also, Mukoro, Faboyede and Eziamaka (2014), believed that internal auditors can assist in the deterrence of fraud by examining and evaluating the adequacy and the effectiveness of the system of internal control. In Nigeria, the incorporation of modern forensic auditing techniques in audit is seen as timely in order to prepare the accounting profession to deal effectively with the problem of unearthing ingenious fraud schemes arising from audit failure to detect frauds in Nigeria. Centre for Forensic Studies (2010) report in Nigeria states that if well applied, forensic auditing could be used to reverse the leakages that cause corporate failures. This can be attributed to the fact that proactive forensic accounting practice seeks out errors, operational vagaries and deviant transactions before they crystallize into fraud.

The Association of Certified Fraud Examiners (2014) also defined occupational fraud as one in which an employee uses his or her occupation to enrich himself or herself through the deliberate misuse or misappropriation of employer's resources or assets. A

classic example of this type of fraud is employee embezzlement. There is also vendor fraud which is usually in the form of overcharge for purchased goods, over-invoicing, shipment of inferior good or the non-shipment of goods even though payment was made; and lastly is customer fraud. According to Nipion (2015), fraud usually occur in different form and can lead to bankruptcy, inflation, increase in crime, reduced income per head, unemployment, and can also affect the economic system of a country. Hence, forensic auditing needs to be adapted to every organization internal control system as suggested by Onuorah and Ebimobowei, 2012).

Studies in forensic audit relationship with quality of internal audit function are few in developing economy like Nigeria. Those that exist were more on fraud control or prevention than the totality of benefit of forensic audit. The extent to which adoption of forensic approach would influence the quality of internal audit is therefore worthy of exploration. In a nut shell, forensic audit does not focus on the control system in place alone but uses extensive testimonial evidence gathered to reach conclusion on certain investigation. All these shall form the subject matter of the current study that examines the effect of forensic audit drivers on quality of internal audit function in Nigeria

### **Objectives**

The broad objective of this study is to examine the influence of forensic audit drivers on quality of internal audit function in Nigeria while the specific objectives are as stated below:

- i. Investigate the relationship between forensic application and quality of internal audit function in medium scale firms in Nigeria.
- ii. To examine the influence of forensic investigation on quality of internal audit function in medium scale firms in Nigeria.

### **Hypotheses**

The following null hypotheses were tested in the course of the research:

Ho<sub>1</sub>: Forensic application has no significant relationship with quality of internal audit function in medium scale firms in Nigeria.

Ho<sub>2</sub>: Forensic investigation has no significant influence on quality of internal audit function in medium scale firms in Nigeria.

## **2. Literature Review**

### **The Concept of Forensic Audit**

Forensic audit is seen as summarizing and adapting investigative auditing, criminology, litigation services, and financial skills to uncovering fraud. The increasing complexity of fraud requires that forensic auditing be included in the tools required to successfully investigate and prosecute cases of fraud and those involved in fraudulent practices (Njanike, Dube and Mashayanye, 2009). Though quite new in Nigeria today, companies' chief executives have realized that there is need for the services of forensic auditor, as the frequency of fraudulent financial practices have continued to be on the increased. Meanwhile, Arokiasamy and Cristal (2009) had described forensic audit as the application of financial skills and investigative ability within the context of rule of evidence to examine unsettled issues. Also, Linqvistn and Bologna (1987) affirmed that forensic accounting as a discipline is made up of fraud knowledge, financial expertise and a sound knowledge and understanding of business reality and the working of the legal system. Forensic audit may be one of the most effective and efficient way to detect, reduce and prevent fraud; hence, forensic accounting is taught as a major course in many educational institutions in some countries of the world. The Institute of Forensic Accountants (IFA) of Nigeria depict forensic auditing as the specialty of accounting that

describes forensic auditor/accountant’s engagement resulting from anticipated dispute or litigation.

Grippo and Ibex (2003) submits that forensic audits are more intensive than regular audits and are usually conducted in a series of steps to determine if allegations can be substantiated and to identify the nature of any further work needed. Thornhill (1995) stated that forensic audits require a clear and detailed audit plan that is designed to obtain information on how, when, and where a wrong doing occurred and who committed such a wrongdoing. Ghali (2001) submits that forensic audit reports are usually lengthy and extensively substantiated and contain a clearly documented chronology of events.

Finally, ‘forensic auditing’ refers to the specific procedures carried out in order to produce evidence. Audit techniques are used to identify and to gather evidence to prove, for example, how long the fraud has been carried out, and how it was conducted and concealed by the perpetrators. Evidence may also be gathered to support other issues which would be relevant in the event of a court case.

### Distinction between Statutory Audit and Forensic Audit

S/N	Particular	Statutory Audit	Forensic Audit
1.	Objective	Express opinion as to “true & fair view” presentation	Determine correctness of the accounts or whether any financial fraud has actually taken place.
2.	Techniques	“Substantive” and “compliance” procedures	Analysis of past trend and substantive or in-depth checking of selected transactions.
3.	Period	Normally, all transactions are for particular accounting period	No such limitations. Accounts may be examined in details from the beginning.
4.	Verification of stock, estimation of realizable value of current assets, provision/liability estimation, etc	Relies on the management certificate/representation of management	Independent verification of suspected/selected items carried out.
5.	Off-balance sheet items like (contracts)	Used to vouch the arithmetic accuracy & compliance with procedures.	Regularity and propriety of these transactions/contracts are examined.
6.	Adverse findings if any	Negative opinion or qualified opinion expressed, with/ without quantification.	Legal determination of fraud and naming persons behind such frauds.
7.	Usage	Reports generated cannot be used for litigation	Reports generated can be used for litigation

Source: Vasudevan (2004)

### Theoretical Framework

#### The lending Credibility Theory

This theory suggests that the primary function of the audit is to add credibility to the financial statements. In this view the service that the auditors are selling to the clients is credibility. Audited financial statements are seen to have elements that increase the financial statement users’ confidence in the figures presented by the management (in the financial statement). The users’ are perceived to gain benefits from the increased credibility, these benefits are typically considered to be that the quality of investment decisions improve when they are based on reliable information.

### **The Theory of Inspired Confidence**

Limperg (1932) addresses both the demand and the supply for audit services. The demand for audit services is the direct consequence of the participation of third parties (interested parties of a company) in the company. These parties demand accountability from the management, in return for their investments in the company. Accountability is realized through the issuance of periodic financial reports. However, since this information provided by the management may be biased, and outside parties have no direct means of monitoring, an audit is required to assure the reliability of this information. With regard to the supply of audit assurance, Limperg (1932) suggests that the auditor should always strive to meet the public expectations.

### **Empirical Evidence**

Saxby, Ehlen and Koski, (2004) examined the relationship between financial services quality (i.e. audit, consulting, tax and financial statement preparation) and client satisfaction. The authors focused mainly on those services provided by CPA firms. Among the five dimensions of service quality (i.e. tangibles, reliability, responsiveness, assurance and empathy), only two dimensions (i.e. reliability and assurance) were found to be positively associated with clients' satisfaction. Butcher, Harrison and Ross, (2013) performed a study to assess the relationship between the audit quality attributes and the auditor retention. Focused on Australian state of New South Wales as there was prior research evidence on the satisfaction with audit service quality, the authors used 48 audit attributes to measure the audit quality. The 48 attributes were distributed over 7 categories include reputation, capability, assurance, independence, expertise, experience and responsiveness. Authors' findings indicated that only expertise and responsiveness to client needs are significantly associated with audit or retention. Despite that, the results of the above mentioned studies are different from one country to another in terms of the relationship between audit quality attributes and client satisfaction; there is some consensus on the role of audit quality attribute in enhancing the client satisfaction.

Cletus and Uwaoma (2014) also examined the relationship between forensic auditing and fraudulent practices in Nigerian public institutions. The population of the study consisted of the general managers and accountants of 12 public institutions in Nigeria. The data generated were statistically tested with the Pearson Product-Moment Correlation Coefficient. The findings suggest that both the proactive and reactive forensic auditing techniques have a negative significant relationship with fraudulent practices in Nigerian public institutions. Based on the above, it was recommended that: (1) The Economic and Financial Crime Commission (EFCC), the Independent Corrupt Practices Commission (ICPC), and other anti-corruption bodies in Nigeria should have, in their payroll, internal forensic auditors to supplement the duties of the internal auditors; (2) Forensic auditors should regularly undergo training and development programs to acquaint them with relevant knowledge and skills for effective forensic auditing; and (3) Forensic auditing should be made mandatory for public institutions by regulatory authorities rather than being voluntary.

The above empirics and some others which were not mentioned in this research work were not able to explore the influence of forensic audit drivers on quality of internal audit function which will establish the relationship between forensic audit and quality of internal audit function, hence the need to embark on this research. Our study builds on these studies by evaluating the influence of forensic Audit drivers on Quality of internal audit function in Nigeria.

### 3. Methodology

The study adopts survey research design to obtain data for the purpose of the study and covers medium scale manufacturing firms in the selected cities in South Western Nigeria with emphasis in Lagos and Ogun State. These two states have been selected due to their economic characteristics as commercial centres. The population for this study comprises stakeholders of forensic auditing in the sampled states including internal auditors of sampled firms, Forensic Accountants and other relevant stakeholder considered appropriate for the studies. A sample of 72 medium scale firms representing 10% of the total population of Lagos and Ogun state (723) was used as sampling frames for the study and chosen purposively in proportion of 60% and 40% for Lagos and Ogun firms respectively. Further 3 internal audit staff including internal auditors and assistant internal audit staff who are Chartered Accountants were used as respondents through purposive sampling procedure. Two hundred and thirty (230) copies of questionnaire were distributed while two hundred and sixteen (216) were returned. This makes a total 216 respondents from medium scale firms. Objective one on the relationship between forensic audit application and quality of internal audit functions was analyzed using correlation model while objective two on the influence of forensic investigation on quality internal audit functions was approached through regression model.

### 4. Results and Discussion

#### 4.1. Test of Hypothesis I

The results of data analysis were displayed in Table 4.1. Correlation method of analysis was used to test the hypothesis Forensic application has no significant relationship with quality of internal audit function in medium scale firms in Nigeria. Table 4.1.0 shows the respondents' response on the forensic application relationship on quality of internal audit function in sampled medium scale firms. Table 4.1.1 show the significant of the variable used. From the table it shows that none of the variable has p-value greater than 0.05. This shows that all the variables were significant. Table 4.1.2 shows the model summary. From the table it shows R value of 0.697. This means that there is a strong and positive correlation between forensic application and quality of internal audit function in sampled medium scale firms. The coefficient of determination (R-square) means that variable used explained 48.9% variation. Since the p-value of 0.015 is less than 0.05, it means that the null hypothesis ( $H_0$ ) is rejected and alternative hypothesis ( $H_1$ ) accepted. Hence, it can be concluded that forensic application has significant relationship with quality of internal audit function in medium scale firms in Nigeria.

**Table 4.1.0: Forensic application relationship to quality of internal audit function in sampled medium scale firms in Nigeria**

	Strongly Agree (5)	Agree (4)	Neutral (3)	Disagree (2)	Strongly Disagree(1)	$\bar{X}$
Forensic application foster independence	25.7	65.1	4.8	1.8	2.6	26.9
Size of Forensic audit firm determines the quality of audit service rendered	77.6	16.2	-	1.8	4.4	30.9
Reputation of internal auditor determines the quality of audit function rendered in medium scale firms	84.1	8.1	3.3	4.4	-	31.2
Internal control settings in medium scale firms assist in forensic application	73.3	21.4	1.1	4.1		31.0
Response of medium scale firms to forensic application is impressive	9.6	13.6	1.8	58.5	16.5	16.0
Executive involvement in forensic application is evitable	20.2	11.8	0.7	59.2	8.1	18.6

Source: Authors computation, November,2019

**Table 4.1.1 Test of significance of variables**

Model	t	Sig.
Forensic application foster independence	-5.107	.000
Size of medium scale firm determines the quality of internal audit function rendered	2.516	.006
Reputation of internal auditor determines the quality of internal audit service rendered in medium scale firm	-4.748	.045
Internal control settings in medium scale firm assist in forensic application	8.089	.000
Response of medium scale firms to forensic application is impressive	-10.332	.000
Executive involvement in forensic application in medium scale firms is evitable	5.267	.003

Source: Author's computation, November, 2019

**Table 4.1.2: Model Summary**

R	R Square	Adjusted R Square	Sig.
.697 <sup>a</sup>	.486	.472	.015

Source: Author's computation

#### 4.2 Test of Hypothesis II

Regression analysis method was used to test hypothesis II that Forensic investigation has no significant influence on quality of internal audit function in medium scale firms in Nigeria. Forensic audit serves as the dependent variable while quality internal audit function is the dependent variable. The independent variables were forensic audit variables in medium scale firms. Forensic investigation relied on the independence of internal auditor in medium scale firms, Forensic application increases confidence in the quality of work undertaken by internal audit in medium scale firms, Size of medium scale firm determines the influence of forensic investigation on quality of internal audit function, forensic investigation influence quality of internal audit function in medium scale firms, your organization carry out forensic investigation when need arises, forensic investigation can help in reviewing existing internal control in medium scale firms, forensic investigation can help guarantee the safeguard of assets from unauthorized use in medium scale firms and forensic audit can guarantee strategic prevention of fraudulent activities in medium scale firms.

Table 4.2.0 shows the responses of the respondents on whether forensic investigation influence quality of internal audit function in medium scale firms.

Table 4.2.1 shows the model summary. From the table it shows the coefficient of determination (R-square) means that out of the total variation in the dependent variable, Forensic investigation influence quality of internal audit function in medium scale firms, and the independent variables explained 79% of the variation. The Durbin-Watson confirms that autocorrelation does not exist since the value is approximate to 2. Table 4.2.2 shows the significance of the independent variables. From the table it indicates that all the

variables were statistically significant since their p-value is less than 0.05. Table 4.2.3 show the p-value of 0.000 which less than 0.05, Hence, it can be concluded that forensic investigation influenced quality of internal audit function in medium scale firms.

**Table 4.2.0: Forensic investigation influence on quality of internal audit function in medium scale firms**

	Strongly Agree (5)	Agree (4)	Neutral (3)	Disagree (2)	Strongly Disagree(1)	$\bar{X}$
Quality of internal audit function in medium scale firms can be guaranteed by forensic investigation	73.2	24.3	0.4	2.2	-	31.4
Forensic investigation can be compromised in medium scale firms	19.5	80.5				28.2
Forensic investigation relied on the independence of internal auditor in medium scale firms	73.9	6.3	1.1	9.2	9.6	28.5
Forensic investigation increases confidence in the quality of work undertaken by internal audit in medium scale firms	53.7	28.7	1.8	11.8	4	27.7
Size of firms determines the influence of forensic investigation on quality of internal audit function in medium scale firms.	37.9	24.6	2.2	18	17.3	23.1
Forensic investigation influence quality of internal audit function in medium scale firms	30.9	46	1.5	17.3	4.4	25.5
Your organization carry out forensic investigation when need arises	44.8	21.6	0.4	14.6	18.7	24.1
Forensic investigation can help in reviewing existing internal control in medium scale firms	36	23.2	1.5	22.8	16.5	22.6
Forensic investigation can help guarantee the safeguard of assets from unauthorized use in medium scale firms.	59.6	10.7	0.4	14.3	15.1	25.9
Forensic investigation can guarantee strategic prevention of fraudulent activities in medium scale firms	61	16.2		6.6	16.2	26.8

Source: Author's computation

**Table 4.2.1 Model summary**

	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
	.550	.534	.79435	2.071

Source: Author's computation

**Table 4.2.2 Coefficient of estimates**

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	3.475	1.108		3.136282	.002
Quality of internal audit function in medium scale firms can be guaranteed by forensic investigation	1.132	0.093	0.068	12.172	.015

Forensic investigation can be compromised in medium scale firms	0.862	0.187	-0.121	4.60963	.045
Forensic investigation relied on the independence of internal auditor in medium scale firms	0.372	0.049	-0.086	7.59184	.013
Forensic investigation increases confidence in the quality of work undertaken by internal audit in medium scale firms	0.632	0.054	0.624	11.7037	.000
Size of firm determines the influence of forensic investigation on quality of internal audit function in medium scale firms	0.17	0.047	-0.093	3.61702	.001
Your organization carry out forensic investigation when need arises	0.116	0.0391	0.022	2.97401	.006
Forensic investigation can help in reviewing existing internal control in medium scale firms	0.78	0.051	0.104	15.29412	.010
Forensic investigation can help guarantee the safeguard of assets from unauthorized use in medium scale firms	0.14	0.039	-0.055	3.58974	.005
Forensic investigation can guarantee strategic prevention of fraudulent activities in medium scale firms	0.358	0.039	0.077	9.179487	.019

Source: Author's computation

**Table 4.2.3. ANOVA Regression**

		SS	df	MS	F	Sig.
	Regression	198.623	9	22.069	34.974	.000
	Residual	162.795	258	.631		
	Total	361.418	267			
Source:						
Author's						
computation						

Note :  
SS = Sum of Square  
MS = Mean Square

## 5. Conclusion and Recommendations

Based on the findings and analysis carried out, it can be concluded that forensic audit has significant relationship with quality of internal audit function in medium scale firms and it influenced the quality of internal audit functions.

Based on the findings and conclusions, the following recommendations were made:

- i. Medium scale firms need to employ quality forensic analyst.
- ii. Medium scale firms need to make use of modern- day technology to aid the forensic application and investigation.

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