The Impact of Forensic Accounting on Financial Performance of Investment Firms

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This paper discusses the impact of task performance, fraud risk assessment and forensic accountants and auditors’ skills and mindsets in the profitability sectors and investment sectors. It also draws the attention of the users of public sector accountants and auditors such as the Economic and Financial Crimes Commission, the Independent Corrupt Practices Commission, Special Control Unit of Money Laundering. The objective of the study is to enhance the fraud risk assessment task performance in the Office of Auditor General and Accountant General through the effective use of skills and mindsets (forensic accountant and auditor), which will usher in the best corporate governance practices in the world in both public and private sectors. Thus, the study suggests performance measurement can be improved considering the impact of forensic accountant skills and mindsets on fraud risk assessment in the public and private sectors. Forensic accounting promotes financial performance by providing confidence in the financial markets. The proposed research is to investigate the various accounting scandals and eye-catching frauds, with the objective of exploring the role of auditing and forensic accounting. The study was inspired by the fact that accounting scandals and frauds still occur in the 21st century when auditing is massively performed to ensure transparency, reliability, and compliance with the generally accepted accounting principles. Attracting investors is the goal of global companies while providing the credibility, integrity of the financial statements and strength of the financial position and the reputation of the company.

Keywords: Forensic Accounting, Financial Performance, Investment Firms, Auditors’ Skills, Task Performance

INTRODUCTION

The sustainability of investment firms is highly dependent on the financial and accounting operations that relay the transparency, accountability, and profitability, which attracts investors (Bradford et al., 2016). In certain instances, firms may incur significant financial failure, lawsuits, and bankruptcy following accounting fraud involving manipulation of financial statements to imply excessive profitability. Despite the possible short-term economic benefits derived from accounting fraud, the outcomes for culpable firms involve a decline in financial performance, massive fines, and bankruptcy (Huber, 2017). For instance, the penalties imposed on Waste Management Scandal of 1998, Enron Scandal of 2001 and Tyco Scandal of 2002 demonstrate the final dangers of accounting fraud and the need for proper intervention measures (Huber, 2017). In this regard, forensic accounting is the ultimate solution that investment firms should practice to help avoid financial manipulations and related risks. The research paper explores the scope of forensic accounting and its impacts on the financial performance of investment firms.

METHODOLOGY

The research on the impacts of forensic auditing on the financial performance of investment firms adopts the systematic analysis methodology, which involves collecting and summarizing the empirical evidence from studies that fit the defined criteria. Since numerous studies have explored the topic, the criteria applied specified publications within the past five years up to 2018 and focused on the scope of investment firms. Therefore, the paper provides the primary findings from
the selected studies, as well as, the analysis of the validity or relevance of the results considering the risk of bias.

ANALYSIS

The emergence of modern technology in accounting has not only benefited firms in improving financial recording, analysis, and reporting but also enhanced the vulnerability to cyber risks. According to PwC's 2016 Global Economic Crime Survey, nearly 30% of firms in the Asian-Pacific experienced fraud instigated by cybercrime (White, 2016). The report also revealed that almost 43% of the cybercrimes attacked the financial information and accounting records (White, 2016). On the same note, various companies experienced frauds involving money laundering, assets misappropriation, bribery, manipulation of accounting records, and procurement among others. Therefore, the digital economy has facilitated the rise of illegal financial activities such as tax evasion, payroll fraud, data theft, asset misappropriation, and other accounting frauds (White, 2016). The PwC report is highly credible and relevant is linking the growing accounting technology to the challenges in financial reporting and processes.

Despite the illegal financial activities arising from the internal managerial decisions, stakeholder misconduct, or external attack, the impacts on financial performance are severe. According to White (2016), investment firms are vulnerable to risks of clients with financial irregularities and manipulations aimed at portraying high value. In this case, forensic accounting plays the risk management role through investigating and scrutinizing the financial information of all investors to detect the malpractices. As a result, forensic auditing is the solution to enhance the surveillance and investigation of all accounting records to detect and prevent related risks, which may affect the business reputation and fines that affect profitability.

According to Huber (2017), forensic accounting is a multi-discipline that combines accounting, auditing, and investigative skills to detect financial irregularities and recommend appropriate guidelines for the relevant parties. Huber enhanced the relevance of the study by exploring the various theories of fraud and dimensions of financial crimes. He argued that the fraud and financial crimes are complex, multifaceted, and interrelated. In other words, accounting frauds that affect the financial performance are linked to the personal drives of the perpetrator, organizational loopholes, political regimes, legal pitfalls, social and economic factors. In this regard, the satisfactory solutions require a multifaceted intervention such as forensic auditing, which detects fraud, as well as, the root-causes and other factors influencing the misconduct. Despite the broad use of forensic accounting in legal issues involving financial malpractices, companies could hire forensic accountants to oversee the accounting processes and provide favorable advice for improvement (Huber, 2017). Hence, forensic accounting promotes the financial performance of investment firms through mitigating irregularities.

Internal forensic accountants act as in-house consultants who audit the financial statements, oversee compliance with accounting standards and laws, as well as, quantifying the losses linked to the misconduct (Huber, 2017). The study by Enofe et al. (2015) revealed that forensic accounting enables firms to continually inspect the financial statements, detection of all intended or unintended frauds. The team studied the use of forensic accounting on corporate crime mitigation through statistical analysis of data collected from the Economic and Financial Crimes Commission, KPMG, Deloitte, and PwC subsidiaries in Nigeria. Enofe et al. (2015) revealed that 56.1% of the participants consider forensic accounting could complement auditing to mitigate the corporate crimes facing Nigerian investment firms.

Further, the study revealed that 66.7% of participants agreed that corporate crime mitigation strengthens corporate governance, which is the primary pillar for improved business performance and profitability. Through forensic accounting, institutions not only detect and prevent accounting fraud but also promotes ethical conduct, which enhances the overall productivity and stakeholders' satisfaction. Furthermore, companies with proper forensic accounting systems evade financial irregularities and make accurate investment decisions with limited risks. Therefore, prompt mitigation of fraud through forensic accounting promotes corporate governance and protects the firm from possible lawsuits, fines, and loss of shareholders’ trust; hence improving the financial performance (Enofe et al., 2015).

Forensic accounting also promotes financial performance through enhanced efficiency and prevention of financial reporting misconduct. According to Amiram et al. (2018), accounting fraud comprises all illegal activities arising from internal or external processes, but result in inaccurate financial reports to mislead investment decisions. Unlike the irregularities that may occur from minor errors or data manipulations, frauds involve proper planning and execution of illegal accounting tactics to gain massive profits (Amiram et al., 2018). Ponzi schemes, mega scandals, money laundering, assets misappropriation, bribery, and corruption are kinds of frauds that may affect the financial performance of investment firms.

Regardless of the nature, financial frauds and misreporting threaten the efficiency in the financial markets due to impartiality in information. For instance, an investment firm that uses manipulated financial reports to influence shareholders may affect the transparency codes of financial markets. In other words, investing in firms with false information impacts genuine firms and create misleading trends of investment and returns. However, firms culpable for accounting fraud in
the financial markets are vulnerable to long-term loss of reputational and shareholder's trust, the decline in revenue, and bankruptcy. Therefore, Amiram et al. (2018), proposes stringent forensic accounting as a viable solution to prevent financial reporting misconduct and evade the related risks that may affect profitability.

According to Somoye and Osho (2017), cited in Osho (2017), firms cannot operate without proper financing through external sources or internally-generated revenue. Either way, the appropriate management of funds is essential towards budgeting, procurement, and operations that translate into productivity and financial performance. According to the hypothesis of Osho (2017), the successes of the core financial system of the organization enhances the efficiency of operations and cost reductions, which, in turn, increases production and profits. The major processes in the financial system include management of ledger, budgetary resources, funds, cash, payment, accounts receivable and payable, as well as, cost management.

Nevertheless, failure to oversee proper reporting and management of these processes result in inefficiencies that affect operations and profits.

The research by Osho (2017) focused on the forensic accounting of Nigerian university financial systems and utilized the ex-post facto research design with descriptive and inferential statistics. Using financial and accounting data from 2005 to 2014 the study revealed that efficient financial management requires forensic accounting to oversee the processes and ensure transparency in all reports. Furthermore, through skilled forensic accountants working with relevant technology, a firm would not only enhance the efficiency in financial management and reporting but also prevent misconducts (Osho, 2017). On the same note, proper reporting and accounting promotes the investors' trust, builds a positive brand image, and efficiency in internal processes and investment. Therefore, forensic accounting is part of proper financial management and reporting, which constitutes the sources of competitive advantage and profitability.

According to Bhasin (2016), forensic accountants are increasingly engaged in the public sector, insurance firms, government agencies, and banks among others, to aid in investigations and reveal the culprits in financial fraud. Bhasin (2016) aimed to investigate the perspectives and prospects of forensic accounting including its contributions to the future of organizations. Of the diverse functions of forensic accountants, Bhasin (2016), revealed that the forensic reports and recommendations forwarded to the litigation team have essential roles. In this regard, the findings and reports of forensic accounting often reveal the loopholes or approaches to committing accounting frauds and the culpable parties (Bhasin, 2016). In addition to the legal directives to implement the recommendations of forensic accounting, organizations have the initiative to learn from the findings and improve financial management and reporting.

Furthermore, forensic accountants create a business environment with regulatory measures and investigative standards that discourage involvement in the fraud. Therefore, investment firms could implement improvement recommendations from forensic accounting to enhance transparent accounting practices that eliminate losses and inefficiencies, while promoting stakeholders' satisfaction and financial performance.

Forensic accounting promotes financial performance by providing confidence in the financial markets. The study by Kizil and Kaşbaşı (2018), investment decisions made using inaccurate financial statements discourages shareholders and market trust. The due researched to investigate the various accounting scandals and eye-catching frauds, with the objective of exploring the role of auditing and forensic accounting. The study was inspired by the fact that accounting scandals and frauds still occur in the 21st century when auditing is massively performed to ensure transparency, reliability, and compliance with the generally accepted accounting principles.

In different jurisdictions, public oversight bodies, independent auditing firms, and internal auditors are established and empowered to enhance the supervision of financial management and reporting processes (Kizil and Kaşbaşı, 2018). However, despite the stringent accounting regulations, laws, and oversight functions, various accounting malpractices still emerge. As a result, Kizil and Kaşbaşı (2018), explored the contributions of forensic auditing in the improvement of financial reporting that enables investors to make decisions based on accurate information. The study revealed that forensic accounting incorporates the functions of auditors, accountants, and internal control to detect frauds, corruption, misreporting, and malpractices in the private sector. Similarly, transparency and efficiency achieved in the accounting processes result in improved reliability in internal controls and positive public image of the organizations; these contribute to increased investments and financial performance.

According to the study by Emmanuell et al. (2018), forensic accounting has a relationship with the integrity of financial statements, which is a major pillar for earning the investors trust and confidence. The integrity of financial statements relates to the accuracy, quality, and transparency in recording and reporting the business transactions and internal control processes. Despite the lack of guarantee that integrity in financial reporting may translate into higher investment or profitability, the lack of integrity poses catastrophic risks when unveiled. In this regard, Emmanuell et al. (2018) investigated the relationship between forensic accounting and integrity in financial statements through surveying professional accounting bodies in Nigeria. The group gathered data from 321 participants and multiple regressions applied to test the hypotheses.
The study revealed that nearly 23% of the integrity of financial statements (IFS) is attributed to forensic accounting techniques. Similarly, the inclusion of forensic accounting techniques in the financial management and reporting systems improves the efficiency in the internal control functions, which translate to the overall organizational productivity, cost reduction, and profitability. Through creating or integrating forensic accountants, the business enhances the oversight and integrity employed in managing the financial statements. Unlike other studies that handle forensic accounting as a whole, Emmanuel et al. (2018) classified their research into specific elements of forensic accounting to enhance accuracy and clarity. The group revealed that forensic accounting incorporates diverse functions including fraud prevention, detection, investigation, auditing, litigation, mediation, and computer-assisted reviews. In this regard, an organization could utilize forensic accounting for diverse purposes including non-litigatory investigations used as proactive measures to prevent fraud/scandal.

Therefore, forensic accounting is a proactive approach for investment firms to evade the malpractices and frauds in financial management and reporting.

Dada (2014), argued that corruption, bribery, and embezzlement of funds are the core issues that have vastly affected the corporate industry in Nigeria. While most cases of corruption are linked to political functions and public institutions, investment firms are often involved in managing the proceeds and even used as avenues to launder bribes and loot. However, despite most corruption cases in Nigeria affecting public firms, the overall impact on the economy affects the performance of all stakeholders in the marketplace. In this regard, Dada (2014), utilized a survey design to gather reliable empirical data for testing the hypothesis that forensic accounting could lower corruption, bribery, and embezzlement cases. Through regression analysis, he revealed that primary forensic accounting functions including fraud detection and prevention, have a significant impact in reducing corruption. Based on the findings, organizations should establish forensic accounting departments to oversee all the internal control practices and prevent fraud, bribe, or embezzlement instigated by external or internal stakeholders. Furthermore, operation in a corruption/bribe-free environment promotes the business relationships and stakeholders’ confidence, which in turn, builds brand reputation, market share, and financial performance.

According to Eyisi and Ezuwore (2014), fraudulent financial activities constitute inadequate corporate governance, which has resulted in business collapse and loss of investors resources. In an investment firm, corporate governance is essential in ensuring proper management of financial resources, maximizing shareholders’ wealth, and attaining sustainable profitability. In this regard, Eyisi and Ezuwore (2014), conducted a theoretical investigation into the roles of forensic accounting in ensuring the implementation of corporate governance functions related to financial management and reporting. The study revealed that forensic accounting positively influences accountability, oversight functions, and corporate governance functions. The presence of forensic accountants and auditors ensures constant scrutiny of all financial reports, oversight, and investigation, which results in stringed repercussions upon detecting fraudulent activities (Eyisi and Ezuwore, 2014). Furthermore, other professionals in charge of financial management and reporting are influenced to exhibit and ensure maximum ethical practices, which develop the overall corporate governance in the organizations.

Therefore, through forensic accounting, investment firms enhance corporate governance, which attracts more investors and improves efficiency for better productivity and revenue.

The basic skills, ethical values, and traits of an employee have a direct influence on the performance and relationship with other stakeholders (Salleh and Ab Aziz, 2014). Employees with favorable personality traits and moral values prioritize on respect for others, preservation of organizational resources, corporate governance, and positive relationships among others. Based on this assumption, Salleh and Ab Aziz (2014), performed an empirical study to explore the perceptions of users on the traits, skills, and ethical values of forensic accountants, and how they influence organizational performance and profitability. While performing the forensic accounting functions including investigation, auditing, evidence gathering, reporting, and litigation, specific skills are necessary to ensure precision, accuracy, problem-solving, attention to detail, and objectivity (Salleh and Ab Aziz, 2014). Similarly, forensic accountants should possess adequate skills for critical thinking, deductive analysis, investigative flexibility, communication, and legal knowledge. Therefore, the interaction between these core skills may influence the quality of forensic accounting and the associated financial benefits to the firm.

Using self-administered survey questionnaire, Salleh and Ab Aziz (2014), gathered data from three stakeholder groups of forensic accounting including investment firms (42.5%), professionals (42.7%), and academicians (15.8%) in Malaysia. The team used descriptive statistical analyses and ANOVA tests to analyze the data; overall, the stakeholders in public sector value analytical, ethical, detail-oriented, confident, and evaluative traits in that
order. The ANOVA tests also revealed a lack of statistically significant variation in the skills, attributes, or ethical values that the three stakeholders prefer in forensic accountants (Salleh and Ab Aziz, 2014). The findings from this study imply that stakeholders such as investment firms consider specific traits and values as must-have qualities for forensic accountants. In this regard, institutions whose forensic accountants possess the core skills and values, have a higher potential to prevent accounting malpractices and fraud; this results in better investor relationships and profitability.

CONCLUSION

The systematic analysis of empirical evidence from diverse studies aimed to explore the impacts of forensic accounting on the financial performance of investment firms. Using five-year-old studies, the research revealed that the growth of technology had influenced the emergence of accounting frauds such as money laundering, assets misappropriation, bribery, corruption, and manipulation of accounting records among others. However, forensic accounting combines the investigation, litigation, auditing, and financial reporting skills to detect and prevent frauds. Similarly, it promotes corporate governance, mitigation of accounting irregularities, quality financial reporting practices, improved internal control, and shareholders’ trust. Therefore, through these achievements, forensic accounting promotes the performance and profitability of investment firms.

REFERENCES


