

## MANAGEMENT INVOLVEMENT AND THE RELEVANCE OF FORENSIC INVESTIGATIONS OF SELECTED FINANCIAL INSTITUTIONS IN CROSS RIVER STATE

**ASUQUO, AKABOM ITA, Ph.D;**

*Lecturer I. Department of Accounting, Faculty of Management Sciences, University of Calabar, Nigeria*

**AKPAN, ANIEFIOK UDOH; Ph.D;**

*Lecturer II. Department of accounting, Faculty of Management sciences, University of Calabar, Nigeria*

### ABSTRACT

*Fraud and corruption are issues of great concern to management of any organization due to their devastating effects on the system. This study examines management involvement and the limit of forensic accounting as means of preventing the issues. To conduct the study, some relevant literatures were reviewed and a well validated questionnaire was developed and administered to the study population through sampling. Data obtained were analysed using frequency distribution, and Pearson Product Moment Correlation. The result from the test of the study hypothesis revealed that organization profitability does not depend on management involvement in forensic investigation and that forensic accounting gives credibility to the financial report of a firm. Based on these results, recommendations were made that senior management board and audit committee for the internal audit's function be thoroughly equipped to identify fraudulent records and the services of forensic accountants should be engaged so as to maintain the credibility of a firm's financial report.*

### INTRODUCTION

The growth of the private and public limited liability companies and large increase in the number of investors owning shares and the separation of ownership from control of companies have called for regular auditing of corporate financial reports. The objectives of the ordinary audit of financial statement by the independent auditor according to the American Institute of Certified Public Accountants (AICPA, 1993) is the expression of an opinion on the fairness or otherwise in all material respect financial position, results of operation and its cash flows in conformity with generally accepted accounting principles.

However, modern organized frauds are sophisticated. Therefore, there is urgent need to respond to this changing criminal threat and the skills of accountants and legal experts are needed to combat the corporate ill, this has aroused the need for forensic accountants. Forensic accountants refers to a certified public accountant who performs an orderly analysis of financial reports of firms in an attempt to obtain the truth which is used to form an expert opinion (Crumbley, 2006).

In the past decade, we have witnessed a number of major accounting scandals causing many to speculate that management was guilty of financial statement fraud. This is indeed a significant problem and so, management must be actively involved in forensic investigations in order to effectively detect the fraudulent activities before they evolve into scandals. The large increase in the number of financial frauds reported and subsequent business failures have led to the need for management to be involved in forensic investigations in order to concentrate on preventing and detecting such fraud. The detection of error and fraud is the responsibility of the management of the organization through institution of adequate internal control appropriate to the organization (Udoayang and James, 2004). Therefore, it is up to management of any firm to deliver effective control of an organization's operations and financial reports by actively getting involved in forensic investigations as this will go a long way in ensuring accurate financial reports and revealing the organization's profitability as well as increasing management integrity. Also, for management to be fully aware of the limit of such investigations.

In recent times, there has been a significant increase in the number of organizations that collapsed and even more cases of financial fraud and deceit. These events have certainly served to help erode the public's confidence in corporations and other organizations on how well they are managed and controlled. This has necessitated the need for forensic accounting investigations and indeed management involvement

in such investigations as they are often blamed for the failure of businesses and accused of fraud and mismanagement.

#### **UNDERSTANDING FORENSIC ACCOUNTING PRACTICE:**

Forensic accounting can be traced as far back as 1817 to a court decision. According to Coenen (2005), forensic accounting involves the application of accounting concepts and techniques to legal problem. It demands reporting where the accountability of the fraud is established and the report is considered as evidence in the court of law or in the administrative proceeding (Joshi, 2003). It provides an accounting analysis suitable to the court, which will form the basis of discussion, debate and ultimately dispute resolution (Zysman, 2004).

Forensic accounting broadly is a mixture of accounting, finance, law, computerization, ethics and criminology, with focus on prevention and detection of financial frauds and conduct of investigation to undertake and assist in litigation support to book the wrong doers. Forensic accounting looks at the accounting in a wider perspective rather than in different segments such as data entry, record keeping, preparation and finalization of accounts. This field of accounting is not limited to the correctness of accounts; it encompasses accounting, investigative accounting, investigative audit and litigation support. Forensic accounting is the integration of accounting, auditing and investigative skills (Zysman, 2004).

Forensic accountants investigate and document financial fraud and while collar crimes such as embezzlement, allegation of fraud, estimated loses, damages of assets and analyses of complex financial transactions. Their engagements are usually geared towards finding where money went how it got here, and who was responsible for getting it there. They are trained to look beyond the numbers and deal with business reality of situation (Zysman, 2004).

#### **THE TECHNIQUES IN FORENSIC ACCOUNTING**

The conventional accounting and auditing with the help of different accounting tools like ratio technique, cash flow technique, a standard statistical tool for examination of evidence are all part of forensic accounting. In cases involving significant amounts of data, the present day forensic accountant has technology available to obtain or source data, sort and analyze data and even quantify and stratify results through computer audit software applications and various other techniques.

APS II(2002), identified that some of the techniques involved in forensic accounting are:

- (1) Computer Assisted Audited Tools (CAATs): are computer programs that the auditors use as part of the audit procedures to process data of audit significance contained in a clients information systems, without depending on him. CAAT helps auditors to perform various auditing procedures such as: Testing details of transactions and balances, identifying inconsistencies or significant fluctuation, sampling programs to extract data for audit testing etc. Forensic accounting software comes in two different varieties namely: data extraction software and financial analysis software. Data extraction software is designed to conduct spreadsheet analyses on all the company's computer database records such as accounts receivable, payments to vendors, payroll and purchasing. Unusual inconsistent fluctuations are then detected and investigated. Financial analysis software uses monthly quarterly, or annual financial statements, and benchmarks the "ratios" between different accounts such as billings by revenues or supply cost as a percentage of revenue.
- (2) Data Mining Techniques: it is a set of computer assisted techniques designed to automatically mine large volumes of data for new, hidden or unexpected information or patterns. Data mining techniques are categorized in three ways: data mining techniques are categorized in three ways: discovery, predictive modeling and deviation and link analysis. In discovery, it discovers the usual knowledge or patterns in data, without a predefined ideas or hypothesis about what the pattern may be, that is without any prior knowledge of fraud. In predictive modeling, patterns discovered from the database are used to predict the outcome and to guess data for new value items. In deviation analysis, the norm is found first, and then those items are detected that deviate from the usual within a given threshold (to find anomalies by extracted patterns).

- (3) Benford's Law: It is a mathematical tool, and is one of the various ways to determine whether variable under study is a case of unintentional errors or fraud. On detecting any such phenomenon, the variable under study is subject to a detailed scrutiny. The steps of Benford's law are simple, once the variable or field of financial importance is decided, the left most digit of variable under study extracted and summarized for the entire population. The summarization is done by classifying the first digit field and calculating its observed count percentage. Then Benford's set is applied. A parametric test called the Z-test is carried out to measure the significance of variance between the two populations, that is, Benford percentage numbers for first digit and observed percentage of first digit for a particular level of confidence. If the data confirm to percentage of Benford's Law, it means that the data is Benford's set, there is 68% (almost  $2/3^{\text{rd}}$ ) chance of no error or fraud. The first digit may not always be the only relevant field, Benford has given separate sets for  $2^{\text{nd}}$ ,  $3^{\text{rd}}$ , and for last digit as well. This law also works for combination numbers, decimal numbers and rounded numbers. The advantage of Benford's law is that, it is not affected by scale invariance and is of help when there is no supporting document to prove the authenticity of the transactions.
- (4) Theory of Relative Size Factor (RSF): It highlights all unusual fluctuations, which may be routed from fraud or genuine errors. It is measured as the ratio of the largest number to the second largest number of the given set. In practice there exists certain limits (e.g. financial) for each entity such as customer, employee, vendor etc. These limits may be analyzed from the available data if not defined. If there is any stray instance of single transaction that is way beyond the normal range, then there is a need to investigate further into it. This theory helps in better detection of anomalies. In this method, the records that fall outside the prescribed range are suspected of errors or fraud. However, these records or field need to relate to other variables or factors in order to find the relationship, thus establishing the truth.
- (5) Ratio Analysis: Like financial ratios that give indicators the financial health of a company, data analysis ratios reports on the fraud health by identifying possible symptoms of fraud. The three commonly employed ratios are:
  - (i) The ratio of the highest value to the lowest value (max/min)
  - (ii) The ratio of the highest value to the second highest value (max/max 2); and
  - (iii) The ratio of the current year to the previous year.

Using ratio analysis, a financial expert studies relationship between specified costs and some measure of production such as units sold, direct labour hours. For example, to arrive at overhead costs per direct labour hour – Total overhead costs might be divided by total direct labour hours.

### **THE ESSENCE OF FORENSIC ACCOUNTING INVESTIGATION IN AN ORGANIZATION**

Forensic accounting involves the use of professional accounting skills in matters involving potential or actual civil or criminal litigation, including but not limited to, generally acceptable accounting and audit principles, the determination of lost profits, income, assets, or damages, evaluation of internal controls; fraud and any other matter involving accounting expertise in the legal system. This branch of accounting requires, along with the knowledge of the subject, a knack for investigating, strong communication skills, presentation skills, knowledge of the law of the land, ability to collect evidence and also the confidence in proving the fraud in the court of law by presenting evidence (Abot, Park and Parker, 2000).

The essence of forensic accounting lies in the ability of experts in the field to discern facts from fiction in order to maintain a credible testimony. Survey results indicted that this skill was rated as one of the most important proficiencies. Forensic accountants apply their unique expertise to an array of diverse assignments. As a results, they are employed by governments. They work for agencies such as the federal Bureau of investigation, internal revenue service in United States. In Nigeria, one agency that has engaged the services of forensic accountants is the Economic and Financial Crime Commission (EFCC). Through this commission, high profile cases involving people like Joshua Dariye, Tafa Balogun and Emmanuel Nwude, whom with two others are facing prosecution for defrauding a Brazilian bank to the tune of N36 billion have been prosecuted. (Balarabe 2005). Forensic accountants in this role look for signs of suspicious financial activity and fraud by individuals and businesses.

Forensic accounting helps to keep a check on the various corporate frauds that are committed. This branch of accounting ensures that the businesses operate ethically and well within the morals that are required while doing business. Consequently, experts in the field are often hired or employed by large organizations as they provide guidance to these organizations when evaluating potential business transactions. Forensic accountants assess a company's true worth during a merger or acquisition ensuring that a purchaser is knowledgeable of a target firm's financial situation and value, while simultaneously searching for suspicious accounting activity. Also, the practical and in-depth analysis that a forensic accountant brings to a case helps to uncover underlying problems in a business. They have the ability to comprehend the internal control systems of corporations and to assess the risks (Albrecht and Romney, 1986).

Forensic accounting is a field of specialization that has to do with the provision of information that are meant to be used as evidence especially for legal purposes. Experts in the field (Forensic Accountants) investigate and document breaches of contract, crimes such as embezzlement, and investigate allegations of fraud as well as professional negligence. They provide these services for corporation, attorneys, criminal investigators and the government. (Coenen, 2005). Their skills are useful in situations relating to personal injury, product liability, contract disputes, fatal accidents, libel or matrimonial disputes. The involvement of a forensic accountant at the beginning of the litigation process often acts as a catalyst of bringing proceedings to an early termination and in curtailing unnecessary legal costs. Also, they (forensic accountants) testify in court (expert witness). The expert witness testimony of forensic accountants has forced businesses to restructure, and large sum of money to be paid in damages, people have on occasion even gone to jail.

Finally, the essence of forensic accounting lies in experts knowledge of psychology which helps them to understand the impulses behind criminal behaviour that motivate and encourage financial deception. Forensic accountants also possess interpersonal and communication skills which aids them in disseminating information about a company's ethics. Razaee, Crumbley and Elmore (2006) surveyed opinion of practitioners and academics regarding the importance, relevance and delivery of forensic accounting education. The results indicate that the demand and interest in forensic accounting will continue to increase.

## **MANAGEMENT INVOLVEMENT IN FORENSIC ACCOUNTING INVESTIGATION**

In many recent corporate scandals, managers have been accused of hiding or distorting key accounting information to pursue corporate expansion plans and continue to extract benefits of control, in spite of their companies unsound financial position. These events have certainly served to help erode the public's confidence in corporations and other business organizations and how well they are managed and controlled. The capability of boards, management and both internal and external auditors to effectively safeguard their organization or clients is often questioned or met with some degree of skepticism by key stakeholders, shareholders, customers, creditors etc. While this set of people would like "think" things are under control, it is up to the management of organizations, who are in charge of the day to day operations to deliver effective control of an organizations operations and financial reports. They can effectively achieve this by engaging the services of forensic accountants and also, actively participating in forensic accounting investigations. Forensic accounting is the best ever growing areas of accounting that helps in enhancing the chances of success in day to day life of corporate firms by surmounting all the vexing and critical problems faced by management of business organizations. (Owojori and Asaolu, 2009).

Management involvement in Forensic accounting investigations can only be successful where there is team working between the management teams and the forensic accountants or investigators. Teamwork is critical not only at project kick off, but also throughout each phase of the engagement. Early discussions of management teams with forensic accountants or investigators will allow for timely clarification of individual roles and responsibilities, engagement issues, strategies and timetables. As new facts are surfaced and unexpected circumstances developed, strategies and time tables must be modified. There is need for team members to sufficiently communicate and work together as conflict and confusion may arise and this will result in negative results. Project leaders should be nominated and under their directions, the team is hopefully brought together to form a United group, with each team member working towards common objectives and motivated to carryout his or her individual role. The quality of

the team work that exists between both groups during the engagement is the determining factor of the degree of success that will result in the project (Apostolou, Hassell, Webber and Summer, 2001).

In ensuring a successful forensic investigations within their organizations, management have a primary responsibility to prevent and detect fraud. "Most frauds, embezzlement and thefts of corporate assets may not be discovered in the course of routine financial auditing." (Udoayang and James, 2004). According to Zysman (2004), management can effectively detect and prevent fraud in two ways:

- By creating the right environment in an organization, by making the right hiring choice, recruitment of quality personnel and disseminating a well understood code of conduct.
- Eliminating opportunities for fraud by installing a good system of internal controls with physical control of assets, proper authorization, segregation of duties and proper documentation. However, inspite of all good intentions, fraud does occur and then the forensic accountant is called into the picture. Here, they complement efforts of management in reducing fraudulent activities and installing fraud proof internal control system within the organization.

One premise of forensic accounting is to look for indications of abnormal occurrences in the company's accounting and financial reporting systems. By following a forensic accounting mindset of "keeping within the lines" management will develop a good understanding of their company's business processes, information and financial reporting systems. It is a mind and skill set that is relevant to top managers and probably the internal audit within the organization. Having a forensic accounting orientation will help management to design steps for verification of data and also provide managers the opportunity for identifying possible fraud (Mehta and Tarun, 2007).

Finally, conducting forensic audit by forensic accounting investigators that is closely monitored by management helps them to be proactive in reducing the company's transaction processing risk, help them perform audit type procedures on a routine schedule. Timely performance of audit type procedures (that is, continuous monitoring) can help management to be more effective in helping them identify and resolve potential internal control breakdown quickly and thoroughly (Mehta and Tarun, 2007).

#### **THE LIMIT OF FORENSIC ACCOUNTING INVESTIGATIONS IN AN ORGANIZATION**

Forensic accountants play a critical role in an investigation of suspected financial scandals and misappropriation of assets. It is their job to bring independence and credibility to these investigations. However, there are limits to these investigations as those in this field face a host of challenges in their line of work. Challenges come when forensic accountants have to be resourceful in fact finding solutions and information gathering to prove that fraud effectively existed (Bell and Carcello, 2000). Challenges come too when there is a gap between what the client expects and what the forensic accountant can deliver. For this reason, before signing an engagement, a forensic accountant must make sure that his or her client knows that there is a possibility that fraud will not be found or that fraudster tactics will not be uncovered as a result of an investigation. However, the true challenge for forensic accountants is seeing beyond financial records (Bell and Carcello, 2000).

#### **THE LIMIT OF FORENSIC ACCOUNTING ARE SUMMARIZED AS FOLLOWS:**

- (1) **Equipment:** Ideally a forensic investigator should have access to all the equipment and accounting tricks to commit complex fraud. Therefore, they need state of the art facilities not only to uncover fraud but to carry out investigations and other services. However, experts in this field do not have access to this equipments due to its high cost and budgetary limitations.

Forensic accountants need to be able to dig deep into a company's computer system as culprits behind these crimes use computers. Without the proper equipments, that process can prove to be very difficult. To facilitate the presentation, collection, analysis and documentation of evidence, they need to acquire specialized software and computer hardware. These are of the many new equipments that allow the investigators to recover detected files, crack encryptions or codes and extract and sort data (Church, Macmillan, & Schneider (2001). Most of forensic accountants simply cannot afford such equipments and technologies especially in developing countries.

2. **Evolution:** As culture and technology changes, so too does crime. Forensic experts must keep up with the evolution of their field. For instance, before now there was not much need for forensic accountants, but due to the high rate in business failures, collapse of companies, fraud and financial deceptions, corporate scandals, misappropriation of company's assets, etc, there is a strong demand for forensic accountants and investigators as they possess a high level of expertise required to analyze present day complicated financial transactions and events, detecting and preventing fraud as well as giving evidence in court (expert witness) and settling disputes in an organization. Discoveries in medicine and chemistry can lead to new investigative tools that allow forensic experts to catch more criminals by uncovering even more evidence (Neal-Litherland, 2010).
- (3) **Limited Time:** Forensic investigators do not always have enough time to properly investigate crimes according to catseypi.com. There is always pressure exerted on the forensic accountant or investigator because of clients deadlines. Additionally, many types of evidence, e.g. computer data may have a short lifespan, necessitating quick collection and analysis before vanishing or becoming too damaged to be useful. The longer the evidence sits and the more damaged it becomes, the harder it is to resolve the crime.
- (4) **Expensive and Time consuming:** Wallace (1991) stated that the forensic accountant must have the ability to review a large volume of documentation ranging from the more usual accounting records and management information systems to memos, correspondence and other less obviously financial data to extract the key issues. This process is tedious and time consuming as it involves the experts or forensic investigator going through the entire financial reports of an organization to find out the figure that would uncover fraud. Also, the complexity of these investigations is usually a strain on a company's resources.

A forensic investigation is significantly more expensive and time consuming than regular audit work, whereas a financial audit is a sampling activity that does not look at every transaction, a forensic investigation focuses on a specific aspect of the books and may examine each item. According to Pionier (2004), "while the average accountant is trying to make everything add up, a forensic accountant is performing a detailed financial analysis to find out why everything does not or should not add up."

Lorraine Horton, an expert in the field of Forensic accounting says that in investigative accounting, "you are looking for one transaction that will be the key." The one transaction that is a little different no matter how small the difference and that will open the door" (Wolosky, 2004). It therefore means that forensic accounting is not only time consuming and expensive, it is very tedious.

This study was therefore carried out to examine how management participation in forensic investigation can reduce mismanagement, fraud, collapse of business organizations and also to be intimated on the limits of such investigations and develop strategies to tackle them.

## RESEARCH QUESTIONS

The following research questions guided the operation of the study:

- (i) Does financial statement depict errors?
- (ii) Is forensic accounting practice a solution to the problems of mismanagement and corporate fraud?
- (iii) Will active management participation in forensic investigations ensure a reliable and credible financial reports.

How does relevant accounting standards affect forensic investigations?

## RESEARCH METHODOLOGY

### Research design

The research designs for this study were both descriptive and survey designs.

### Population of the study

The population affected by this study were the top, middle and lower levels of staff of ten financial institutions in Cross River State – Nigeria.

### Sampling Technique and Sample Size

To enable the researcher obtain the relevant data for this study, a purposive sampling technique was adopted, whereby five financial institutions were purposively selected out of a population of ten. Questionnaires developed for the study were then administered to four staff from each of the five institutions selected.

### INSTRUMENTATION

The technique adopted in obtaining relevant data for this study relied mostly on well validated questionnaire which was constructed and administered across the study population. Data were also collected from published journals, texts, newspapers, annual reports, and internet materials.

### RESULTS AND DISCUSSIONS

(i) A test was carried out to show whether organizations' profitability depends on management involvement in forensic investigation thus;

Table 1: Variables showing management involvement in forensic investigation and average profits of selected financial institutions.

Variable	Score	Frequency	X (Score x frequency)	Average profit ₦000,000
Strongly agreed	4	12	48	11,819.00
Agreed	3	6	18	18,677.00
Strongly disagreed	2	1	2	41,287.20
Disagreed	1	1	1	16,397.60

Source: Field survey, 2011.

Table 2: Correlation values for assessment of relationship between organization profitability and management involvement in forensic investigation.

X	Y (₦,000,000)	X <sup>2</sup>	Y <sup>2</sup> (₦,000,000)	XY
48	11,819	2304	139688761	567312
18	18677	324	348830329	336186
2	41287.2	4	1704632884	825744
1	16397.6	1	268881285.8	1002470
<b>Total</b>	69	88180.8	2633	2462033260

$$r = \frac{n\sum xy - \sum x \sum y}{\sqrt{n\sum x^2 - (\sum x)^2} \sqrt{n\sum y^2 - (\sum y)^2}}$$

$$= \frac{4(1002470) - 69(88180.8)}{\sqrt{4(2633) - (69)^2} \sqrt{4(2462033260 - (88180.8)^2)}}$$

$$r = -0.59988,$$

$$\text{where } t = \frac{r\sqrt{n-2}}{1-r^2} = \frac{0.73}{1-0.59988^2}$$

Then using the two tailed test at 5% significant level, the critical value of t is 2.92; meaning that the calculate t-value of -0.73 is less than the critical t-value of 2.92.

Therefore, we could say that the organization's profitability does not depend on management involvement in forensic investigation.

- (ii) A test was also carried out to determine whether the credibility of financial report depends on forensic accounting as follows:

Table 3: Correlation values on responses showing if credibility of financial report depends on forensic accounting

Variable	X	Y (₦,000,000)	X <sup>2</sup>	Y <sup>2</sup> (₦,000,000)	XY
Strongly agreed	15	12	225	14	180
Agreed	4	5	16	25	20
Strongly disagreed	0	2	0	4	0
Disagreed	1	1	1	1	1
<b>Total</b>	<b>20</b>	<b>20</b>	<b>242</b>	<b>174</b>	<b>201</b>

$$r = \frac{n\sum xy - \sum x \sum y}{\left[ \sqrt{n\sum x^2 - (\sum x)^2} \right] \left[ \sqrt{n\sum y^2 - (\sum y)^2} \right]}$$

$$= \frac{4(201) - (20)(20)}{\left[ \sqrt{4(242) - (20)^2} \right] \left[ \sqrt{4(174) - (20)^2} \right]}$$

$$= \frac{404}{409.88}$$

$$= 0.9857$$

$$r = 0.9857,$$

$$\text{where } t = \frac{r\sqrt{n-2}}{1-r^2} = 8.27$$

Then using the two tailed test at 5% significant level, the critical value of 152.92, showing that the calculated value of t is greater than the critical value. Hence, we inferred that the credibility of financial report depends on forensic accounting.

## DISCUSSION

Following the empirical analysis carried out in (1) above, it was revealed that organization profitability does not depend on management involvement in forensic investigation, implying that there are other factors such as high quality of product and services offered to customers, efficiency of operations, etc. may contribute immensely to achieving profitability in an organization as found out non-empirically.

Again, with regards to the second test which revealed that the credibility of financial report depends on forensic accounting, we can say, that use of forensic accounting in assessment of financial statement of a firm provides assurance as to their fairness and dependability and conveys to the users (management, employees, owners, etc) that such reports are reliable.

## CONCLUSION

Forensic accounting is the best ever growing area of accounting that enhances the chances of success in day to day life of corporate firm by surmounting all the vexing and critical problems of the corporate field. The importance of the forensic accountants' role in the detection of fraud cannot be overemphasized. With the public need for honesty, fairness and transparency in reporting increasing exponentially, there is a great demand for the skills and services provided by forensic accountants. Armed with the combination of skills, these financial detectives are today important assets to modern legal teams.

As more and more companies look for forensic accountants and professional organizations offer certifications in the areas, it is becoming evident that the forensic accountant has a skill set that is very different from an auditor or a financial accountant.



## RECOMMENDATIONS

Based on the findings of this study, the following were recommended for possible action by any business organization that wants to prevent fraud by taking advantage of the function of forensic accounting: (i) Management of firms should engage the services of forensic accountants and be actively involved in forensic investigation carried out in their organizations so as to maintain the credibility of any financial report issued. (ii) There should be an open communication and understanding between senior management, internal auditors, employees and forensic investigators. (iii) The government should develop interest in forensic accounting and accountants, for monitoring and investigation of suspected and confirmed corruption cases. (iv) Finally, practicing accountants should work towards specialization and possibly establish firms for forensic accounting practice only.

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