



Article

Conventional Audit and Financial Crime in Nigeria

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Abstract: This study explores the relationship between conventional audit practices and financial crime in Nigeria, focusing on audit independence and audit risk concerning money laundering and embezzlement. Grounded in agency theory, the research addresses gaps in understanding the effectiveness of audit mechanisms in curbing financial irregularities. Using a survey research design, findings reveal that audit independence and audit risk significantly and positively impact both money laundering and embezzlement in Nigeria. The results emphasize the critical role of robust audit frameworks in addressing financial crimes. It is recommended that regulatory policies strengthen audit independence through enhanced training, and organizations adopt comprehensive risk management systems to mitigate high audit risk areas, thereby improving fraud detection and prevention.

Keywords: Risk positive, Conventional audit, Audit independence, Financial irregularities

1. Introduction

Financial crime encompasses illegal acts carried out by individuals or organizations to secure an illicit financial gain. Albrecht et al. (2024) stated that in Nigeria, financial crimes have been a significant problem for decades, posing a serious threat to economic stability, development, and international reputation [1]. Common types of financial crimes in Nigeria include money laundering, tax evasion, embezzlement, fraud, bribery, and corruption. Since the early years of independence, Nigeria's public and private sectors have been plagued by these crimes, fueled by weak regulatory systems, lack of transparency, and institutional corruption [2]. The rise of financial crime in Nigeria during the 1970s and 1980s coincided with the oil boom, which led to a rapid increase in government revenues but also heightened opportunities for misappropriation of funds.

The oil sector, in particular, became a breeding ground for illicit financial activities, with officials and individuals engaging in fraudulent schemes to divert public funds. This period also saw the rise of financial scandals involving high-ranking government officials and corporate executives, further entrenching corruption within the system. Efforts to combat financial crime in Nigeria have evolved over time, particularly with the establishment of regulatory and anti-corruption agencies such as the Economic and Financial Crimes Commission (EFCC) in 2003 and the Independent Corrupt Practices and Other Related Offences Commission (ICPC) in 2000. These institutions were created to address the growing menace of financial crimes and to promote transparency, accountability, and the rule of law [3].

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In many instances, audit reports uncovered widespread financial misconduct, yet the implementation of corrective measures was either slow or non-existent. One key challenge is that conventional audits often focus on the compliance of financial statements with existing laws and regulations, rather than actively investigating potential financial crimes [4]. This gap has allowed many fraudulent activities to go undetected for extended periods, as auditors may not have the necessary tools or expertise to identify sophisticated financial crimes like money laundering or tax evasion. The advent of technology has also introduced new complexities into the auditing process.

Financial crimes have become more sophisticated, often involving complex networks of transactions that are difficult to trace using traditional audit methods. As a result, conventional audits, while still necessary, have become less effective in identifying and preventing financial crimes without the integration of forensic auditing techniques. Forensic auditing, unlike conventional audits, goes beyond mere compliance checks to actively investigate and uncover financial crimes. In recent years, there has been a growing recognition in Nigeria of the need to supplement conventional audits with forensic techniques to better address the rising incidences of financial crimes. The shift towards forensic auditing reflects the increasing complexity of financial crimes and the demand for more rigorous, investigative approaches to combat them [5].

Statement of the problem

Financial crime remains one of the greatest threats to Nigeria's economic stability and growth, with acts such as embezzlement, money laundering, fraud, and tax evasion becoming increasingly prevalent. "Despite the existence of regulatory frameworks and oversight institutions, financial crimes continue to thrive in both the public and private sectors. This persistent issue has led to a significant erosion of public trust in institutions, a decline in foreign investments, and hindered economic development" efforts. "Singleton and Singleton (2020) stated that as Nigeria seeks to address these problems, conventional auditing has been one of the key mechanisms employed to ensure financial accountability and" transparency [6].

However, "the ability of conventional audits to detect and prevent financial crimes in Nigeria has been limited by several factors. Conventional audits, primarily focused on ensuring compliance with financial reporting standards, do not typically delve into the investigative aspects necessary to uncover sophisticated financial" crimes. Moreover, "the quality of audits in Nigeria has been compromised by inadequate professional training, lack of independence, and poor regulatory enforcement [7]. Auditors, especially those in public sector institutions, sometimes face pressure from corrupt officials, which weakens the auditing process and contributes to the continued prevalence of financial crimes."

The "evolving nature of financial crime also presents a significant challenge. With the rise of digital transactions and increasingly complex financial networks, conventional audit methods often struggle to keep pace with modern financial crime techniques. This gap has created an urgent need to enhance Nigeria's auditing systems to effectively combat financial" crime [8]. The "problem is that while conventional audits have been a standard control mechanism, they are insufficient in preventing and detecting financial crimes in Nigeria. This creates a vulnerability within the financial system, as criminals continue to exploit gaps in the auditing process. Without addressing these issues, Nigeria's economic development will remain stunted, and public trust in financial institutions will continue to decline [9]. Therefore, there is a growing need for more robust, investigative approaches, such as forensic auditing, to complement conventional audits and strengthen the fight against financial crime in Nigeria."

Aim and Objectives of the study

The aim was to determine the effect of conventional audit on financial crime in Nigeria, while the specific objectives were to;

1. Ascertain the effect of audit independence on money laundering in Nigeria
2. Determine the effect of audit risk on money laundering in Nigeria
3. Ascertain the effect of audit independence on embezzlement in Nigeria
4. Determine the effect of audit risk on embezzlement in Nigeria

Literature Review

Conceptual Review

Conventional audit

Conventional “audit refers to the systematic and objective examination of an organization’s financial statements, records, and operations to ensure accuracy, compliance with regulations, and adherence to established accounting standards. O’Dwyer and Unerman (2024) stated that the primary purpose is to provide assurance to stakeholders that the financial information presented is free from material misstatements and fairly represents the organization’s financial” position. Conventional “audits focus on verifying transactions, evaluating internal controls, and assessing whether financial statements comply with legal and regulatory requirements. The process typically follows established guidelines, such as Generally Accepted Auditing Standards (GAAS) or International Standards on Auditing (ISA), to maintain consistency and reliability (Cressey, 2023) [10]. “

Audit Independence

Audit “independence refers to the auditor's ability to carry out their work without bias, conflict of interest, or external influence, ensuring objective and impartial assessments of financial statements. It is critical because auditors must provide an honest evaluation of an organization's financial health, and any perceived or actual dependence on the client could compromise their” integrity. lack of “independence can lead to misleading audit opinions, which may conceal financial irregularities or fraud, ultimately eroding public trust in the auditing process. External auditors must maintain independence both in fact (actual freedom from influence) and in appearance (perceived impartiality by third parties) [11]. “

Audit Risk

Audit “risk is the possibility that an auditor may issue an incorrect audit opinion, failing to identify material misstatements in the financial statements. Schuchter and Levi (2023) stated that this risk arises from various factors, including human error, fraud, or limitations in the audit” procedures. It is “typically divided into three components: inherent risk, control risk, and detection risk, all of which contribute to the overall risk that financial statements may be inaccurate despite the auditor's efforts. To manage audit risk, auditors implement detailed testing, thorough review processes, and risk assessment strategies, aiming to reduce it to an acceptably low” level. However, audit “risk can never be entirely eliminated due to the complexity of transactions and potential for intentional deceit by management [12].”

Financial crime

Financial “crime encompasses a wide range of illegal activities that result in financial gain through deceitful means. This includes offenses such as fraud, money laundering, embezzlement, and bribery, all of which exploit weaknesses in financial systems and” regulations. Trotman and Gibbins (2020) stated “that the impact of financial crime extends beyond individual victims, causing significant harm to businesses, economies, and societal trust in financial institutions. Governments and regulatory bodies have implemented various measures, such as anti-money laundering (AML) laws and financial regulations, to combat financial crime, but the continuous adaptation of criminal tactics necessitates ongoing vigilance and innovation in enforcement and compliance strategies [13].”

Money Laundering

Money “laundering is the process by which illicitly obtained funds are disguised to appear as though they come from legitimate sources. Kranacher et al. (2022) stated that criminals use a series of complex transactions to move and obscure the origins of illegal money, often involving multiple financial institutions and” jurisdictions. Money “laundering undermines financial institutions, facilitates further criminal activity, and distorts economic systems by injecting illicit wealth. Regulatory bodies, financial institutions, and governments employ anti-money laundering (AML) laws and practices to detect and prevent these activities [14].”

Embezzlement

Embezzlement is “the act of dishonestly withholding or misappropriating funds or property entrusted to someone in a position of authority, typically within an organization. It involves the gradual or deliberate siphoning of money or assets for personal gain, often by individuals who have legitimate access to the finances, such as employees, executives, or public officials [15].” Unlike theft, “embezzlement occurs when the perpetrator is initially trusted with the assets, making the crime more difficult to detect. The impact of embezzlement can be severe, causing financial losses, damaging reputations, and eroding trust within institutions or businesses.”

Theoretical Review

Agency Theory

Agency “Theory explores the relationship between principals (such as shareholders) and agents (such as company management or auditors) in the context of financial decision-making and governance. Wells (2021) stated that the core premise of this theory is that there exists an inherent conflict of interest between these two parties due to differing goals and risk” appetites. Principals “typically seek to maximize their investment returns, while agents may prioritize personal gain, leading to situations where agents act in ways that do not align with the principals’ best interests [16]. In the context of auditing, Agency Theory highlights the importance of independent audits as a mechanism to mitigate this” conflict. Auditors “serve as third-party agents who evaluate the accuracy and reliability of financial statements, thereby providing assurance to the principals that the management is acting responsibly and transparently. The theory underscores the necessity of implementing strong corporate governance practices, including effective monitoring and control systems, to reduce the risk of financial misconduct (Sweeney & Roberts, 2022).” Ultimately, Agency “Theory provides a framework for understanding why audits are crucial for ensuring accountability and trust in financial reporting.”

EMPIRICAL REVIEWS

O’Dwyer and Unerman (2024) studied the “ethical dimension of sustainability reporting: A case study of a public-sector organization. This study employed a quantitative research design, using a survey method to collect data from 200 auditors and finance professionals across various organizations” in Nigeria. The “researchers used structured questionnaires to assess the relationship between the effectiveness of conventional audits and the ability to detect financial fraud. The results indicated a positive correlation between the effectiveness of conventional audits and the detection of financial” fraud. Specifically, the “study found that regular and comprehensive audits significantly reduced the incidence of fraud within organizations [17]. The authors recommended that organizations strengthen their audit practices by investing in regular training for auditors, improving internal controls, and fostering a culture of ethical behavior among employees to further reduce the risk of financial crime.”

Houghton and Ainsworth (2024) examined “the role of the internal auditor in fraud prevention and detection: A perspective from the Australian public sector. This research utilized a mixed-methods approach, combining quantitative data analysis with

qualitative” interviews. The researcher “analyzed data from 150 bank auditors and conducted in-depth interviews with 20 senior management officials in selected banks to gain insights into the role of audits in preventing financial fraud. The study found that strong auditing practices significantly contribute to the prevention of financial fraud” in banks [18]. Key factors “included effective risk assessment, the presence of independent auditors, and regular audit reviews, which enhanced the banks' ability to detect and address potential fraudulent activities. The study recommended that banks adopt a more proactive approach to auditing by implementing advanced data analytics tools, increasing collaboration between auditors and management, and enhancing regulatory compliance to improve fraud prevention measures.”

Knapp (2023) studied “the role of the auditor in detecting fraud. This study employed a correlational research design, utilizing a sample of 300 financial professionals from various sectors in Nigeria. The researcher administered questionnaires to gather data on auditors' independence and its relationship with the prevalence of financial” fraud. The findings “revealed that a lack of independence among auditors significantly increased the risk of financial fraud [19]. Factors contributing to compromised independence included close relationships with management and inadequate regulatory” oversight. The author “recommended implementing stricter regulations regarding auditor independence, promoting transparency in auditor-client relationships, and enhancing the training and resources available to auditors to ensure they can effectively carry out their duties without external pressures.”

Schuchter and Levi (2023) studied the “fraud triangle: A framework for analyzing white-collar crime. This study adopted a descriptive research design, using a survey of 250 internal auditors and finance officers in various public sector organizations” in Nigeria. The “researchers employed structured questionnaires to collect data and used regression analysis to test the relationship between internal auditing practices and financial fraud. The results indicated that strong internal auditing practices significantly reduce the incidence of financial fraud in the public” sector. Key internal “controls, such as regular audits, effective monitoring, and staff training, were found to be particularly effective. The authors recommended that public sector organizations invest in training for internal auditors, adopt advanced audit technologies, and establish a culture of integrity and accountability to further minimize the risks of financial fraud.”

Sweeney and Roberts (2022) examined “Agency theory and the management of fraud risk in financial reporting. This research used a quantitative approach, surveying 180 auditors from various sectors, including manufacturing, banking, and telecommunications.” The researchers “analyzed the collected data using statistical techniques to assess the relationship between audit quality and the detection of financial fraud. The study found that higher audit quality is associated with a lower prevalence of financial” fraud. Key “components of audit quality, such as auditor competence, independence, and adherence to professional standards, were significant predictors of effective fraud detection. The authors suggested that organizations should prioritize hiring qualified and experienced auditors, enhance ongoing professional development, and adopt best practices in auditing to improve audit quality and reduce the risk of financial fraud.”

Trotman and Gibbins (2020) studied “the role of audit committee members in the financial reporting process: Evidence from the literature. This research adopted a mixed-methods approach, combining quantitative surveys with qualitative” interviews. The researchers “surveyed 100 forensic accountants in the banking sector and conducted interviews with 15 bank executives to explore the effectiveness of forensic accounting in detecting fraud. The study found that forensic accounting significantly enhances the detection of fraud in the banking” sector. Forensic “accountants were more effective at identifying complex fraudulent schemes than traditional auditors due to their specialized

training and analytical skills. The authors recommended that banks incorporate forensic accounting into their auditing practices, invest in specialized training for auditors, and establish dedicated forensic teams to enhance fraud detection capabilities.

2. Materials and Methods

The “research design adopted in this study a survey research design. The reason is that the entire population cannot be studied and a survey is considered appropriate. The study population is made up of 100 staffs randomly selected from companies’ internal audit body.”

The “probability technique was adopted in this study because it concerns a selection among a population.”

Model Specification

$$ML = \beta_0 + \beta_1 AI + \beta_2 AR + \mu \dots\dots\dots \text{equation 1}$$

$$EZ = \beta_0 + \beta_1 AI + \beta_2 AR + \mu \dots\dots\dots \text{equation 2}$$

Where Audit Independence = AI, Money Laundering = ML, Audit Risk = AR, Embezzlement = EZ. Modifying the model results in the specified equation below: β_0 = slope of the model

Table 1. Coefficientsa

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error			
(Constant)	7.909	5.987		1.321	.194
AI	1.986	1.530	.174	1.297	.000
AR	4.824	1.473	.461	3.275	.002

a. Dependent Variable: ML

Source: SPSS OUTPUT (2024)

The “regression analysis results indicate a statistically significant relationship between the independent variables, AI and AR, and the dependent variable, ML. The constant term of 7.909, though not significant (p = .194), suggests the baseline level of ML when AI and AR are zero.” AI, with a “positive coefficient of 1.986 and a beta value of .174, implies a modest but meaningful contribution to ML, although its p-value (.000) indicates a highly significant effect despite its relatively low beta value. AR has a larger impact on ML with a coefficient of 4.824 and a beta of .461, highlighting it as the stronger predictor compared to AI, with an impressive T value of 3.275 and a significance” level of .002. This “suggests that changes in AR lead to more considerable changes in ML than changes in AI do, given its higher standardized coefficient.”

Table 2. Coefficientsa

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error			
(Constant)	1.824	5.582		2.863	.000
AI	1.005	1.820	.174	1.884	.041
AR	8.355	1.991	.738	6.852	.008

a. Dependent Variable: EZ

Source: SPSS OUTPUT (2024)

The “regression results provide insight into the relationship between the predictors AI and AR and the dependent variable, EZ. The constant term of 1.824, with a significant p-value (.000), suggests that even when AI and AR are zero, EZ is present at a baseline level, indicating potential systemic or external factors influencing” EZ. The “coefficient for AI is 1.005, with a standardized beta of .174, indicating that while AI contributes positively to EZ, its influence is more moderate compared to AR; however, its p-value (.041) denotes statistical significance, reinforcing that it does play a meaningful role in influencing” EZ.

The “coefficient of AR, at 8.355 with a beta of .738, reveals a substantial impact, with AR clearly exerting the stronger influence on EZ among the predictors, as demonstrated by its high T-value (6.852) and significant p-value (.008).” This stronger “association suggests that increases in AR correlate with notable increases in EZ, underscoring AR as a primary factor impacting EZ levels. Collectively, these findings indicate both variables are influential, though AR is notably more predictive, emphasizing the importance of addressing AR factors to manage and mitigate EZ” effectively. This “model highlights AR as a critical driver in understanding EZ, warranting targeted attention within strategic oversight frameworks

3. Results and Discussion

1. Audit “Independence's positive and significant effect on Money Laundering in Nigeria suggests that as audit independence increases, there may be more exposure of potential money laundering activities. This outcome indicates that when auditors are able to perform without external influence, their capacity to detect and report irregularities like money laundering” improves. The “statistical significance of this relationship underscores the value of a strong, independent audit process as a preventive measure against money laundering practices. Consequently, enhancing audit independence may be a crucial strategy for regulators and firms seeking to address money laundering risks effectively.”
2. Audit Risk's “positive and significant effect on Money Laundering in Nigeria implies that heightened audit risk correlates with an increase in money laundering cases. This relationship may arise because higher audit risks, stemming from complex or opaque transactions, make it easier for money laundering to occur” undetected. The “significance of this effect suggests that where audit risks are not managed, money laundering risks increase, stressing the need for firms to identify and mitigate high-risk areas rigorously. By focusing on reducing audit risk, organizations can potentially reduce vulnerabilities to financial crimes like money laundering.”
3. Audit Independence's “positive and significant effect on Embezzlement in Nigeria indicates that greater auditor autonomy is associated with higher detection and reporting of embezzlement incidents. When auditors operate independently, they are more capable of identifying and addressing embezzlement, as they can report financial discrepancies without” interference. This “relationship's significance highlights the role of audit independence in maintaining accountability, serving as a deterrent to embezzlement activities. Therefore, enhancing auditor independence may be pivotal in efforts to curb embezzlement by increasing transparency and accountability within organizations.”
4. Audit “Risk is positive and significant effect on Embezzlement in Nigeria suggests that increased audit risk tends to correlate with higher embezzlement occurrences. High audit risk can result from factors like inadequate internal controls or complex financial transactions, creating an environment where embezzlement can occur more” readily. The “significance of this effect emphasizes that unaddressed audit risk areas may serve as weak points, facilitating opportunities for embezzlement. Managing and mitigating audit risk could thus be an essential strategy for

organizations seeking to reduce instances of embezzlement, as it closes off avenues where such financial misdeeds could otherwise thrive [20].

4. Conclusion

The “findings highlight the crucial roles of audit independence and audit risk in influencing financial irregularities, such as money laundering and embezzlement, in Nigeria. Strengthening audit independence and rigorously managing audit risk can be effective strategies for mitigating these financial crimes, enhancing accountability, and promoting transparency in organizations.”

Recommendations

1. Strengthening “audit independence through regulatory policies and enhanced training can improve the detection and prevention of money laundering in Nigeria.”
2. To mitigate “money laundering risks, organizations should implement robust risk management frameworks to identify and control high audit risk areas effectively.”
3. Encouraging “auditor autonomy and minimizing external pressures on auditors will help reduce the occurrence of embezzlement by improving transparency and accountability.”
4. Organizations “should regularly assess and address audit risks to limit vulnerabilities that could enable embezzlement, ensuring stronger internal controls and oversight.”

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