

## Fraud Free Financial Report: A Conceptual Review

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**Abstract** *The study reviewed the key factors that enhance the quality of financial reports with emphasizes on Accounting Standards, Corporate Governance, Audit Committee, Whistle blowing, Internal Control, Audit Quality, Efficient Capital Market, Management Performance and Forensic Accounting Education in this order. Empirical evidences from extant literature revealed that these factors have influence on the quality of financial reporting. Hence it is recommended that they should be given careful attention by SEC, corporation players, financial analysts and individual investors in determining the quality of financial reports for viable investment decisions that drive economic growth.*

**Key words** Financial report fraud, financial report quality, corporate governance, audit quality, efficient capital market, management performance, and forensic accountant education

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### 1. Introduction

The 21<sup>st</sup> century is an era where materialistic postures drive both corporate and personal life in the society. These materialistic tendencies deflate corporate wellbeing, and put enormous pressure on personal resources in a manner that create insatiable hunger for more economic resources to sustain an individual modern social status as against the 18<sup>th</sup> century values such as integrity, probity and good character in general terms.

This contemporary menace has snowball into pressure for fraudulent activities in the corporate world, even in our entire society. This cannot be over emphasized looking at the view of Osisima (2012) in Nenyiaba and Okoye (2015) that Fraud is systemic. Fraud has stultified growth and national development and subverted the national and corporate values and norms. Any remedial measure that does not address core and ingrained character defects in leaders and followers, even corporate players will not attract great success. Fighting fraud requires a strong accountability framework and integrity system, and a new generation of national and corporate leaders.

As an import from the above assertions, the key players in actualizing strong accountability and integrity system in the corporate world and the leadership in all of us need reawaking through the development of fraud free intellectual mindset via education, learning and practice. By so doing, we can achieve corporate reporting devoid of manipulation informed by fraudulent intents. Due to the markets and business globalization, geographical expansion and the greater demand for information and transparency among investors, stakeholders and society in general as aftermath effects of recent corporate scandals involving financial report manipulations, market agents have developed keen interest in the quality of financial reporting being the main source of knowledge on company strategic operations. In view of Jonas and Blanchet (2000), financial reporting is not an end in itself rather the sanctity of the process of generating this report, including disclosure of the company's transactions, information about the selection and application of accounting policies and knowledge of the judgments made based on extant accounting rules, regulations and standards.

Financial report by a company has become essential issue for any market participant, as it reduces information asymmetries between managers, investors, regulatory agencies, society and other stakeholders, and also helps in assessing the economic performance and condition of a business as well as a

guide in making economic decisions. Fraudulent financial report impairs sound economic view in making viable investment decision which erodes the confidence of investors in the economy and in turn impairs economic growth of any nation. Therefore, one of the main questions arising of recent is how do we enhance a fraud free financial report. This paper intends to review factors that can help in maintaining corporate sanity with special reference to enhancing quality financial reports.

## **2. Literature review**

### **2.1. Financial report fraud**

Fraudulent financial report has myriad of definition, but the common thread is that fraudulent financial report involves intentionally misleading or omitting disclosures in financial reports in an attempt to deceive financial report users, most especially external stakeholders. Talking of fraud in context of financial reporting, we are probably describing wrongdoings that would not ordinarily be seen as fraudulent in the strict legal sense. However, to be a fraud, the wrongdoing must be deliberate and intentional. It usually involves falsification, alteration or manipulation of material financial information contained in the records; material, intentional omissions or misrepresentations of events, transactions, accounts, or other significant information from which financial statements are prepared; deliberate misapplication of accounting principles, policies, and procedures used to measure, recognize, report, and disclose economic events and business transactions; or, intentional omissions of disclosures or presentation of inadequate disclosures regarding accounting principles and policies and related financial amounts (Jeremy, 2005).

For the purposes of this paper, financial report fraud is being discussed in corporate context; a context that affect confidence in the financial system, corporate governance, accounting and auditing profession, and stock market. The perspective is beyond 'internal fraud' or various types of dishonest conduct in corporate world. This is actually about projecting a false state of affairs on a large scale and in a very public context.

Fraud in financial reporting is based on conscious intent and effort of the perpetrator (directors, auditors, employees etc.) to wrongfully present the reality for personal or corporate gains. Therefore, "fraudulent reporting only refers to intentional misrepresentation, including omissions of amounts purposely designed to mislead the users of the financial reports" can be reflected as: manipulation, forgery, counterfeit or alteration of records or supporting documentation, misstatements or omissions regarding transactions or information, intentional misapplication of accounting principles related to values, classification or manner of presentation of information, fictitious entries records (towards the end of the year) to manipulate operating results or achieve other objectives, improper adjustments of the assumptions and changing in judgments used to estimate account balances, omissions, advances or delays in recognition of transactions that occurred during the reporting period, concealment or non- disclosure of facts that could affect the amounts recorded in the financial statements, engaging in complex transactions designed to distort the entity's financial position or performance; changing the records or conditions of significant transactions. Revenue dilapidation (revenue coming from unwarranted claims or diverting income), theft of physical assets or intellectual property, payments to fictitious suppliers, without the entry of goods or services, use of assets in personal interest (including also personal loan guarantees), false records to cover the deficit are other schemes of financial report fraud. These abuses are often minor and are usually committed by employees, although sometimes, the managers themselves are involved in such activities. Misappropriation of assets may also include expenses incurred for illicit purposes, in the form of bribery, for corporate undue advantage. Having set those parameters, the psychology becomes very interesting because the likelihood of detection becomes so high that the conduct looks deeply irrational. However, sometimes perpetrators become convinced that they are surrounded by a sufficient number of insiders and external advisers that they will never be detected. It is at this point, that financial report fraud becomes systemically dangerous. This is where the United States found itself in the Enron/WorldCom days and this is why the Sarbanes-Oxley legislation was passed so hastily.

### **2.2. Financial report quality**

High quality information disclosed in financial reports influence the market efficiency in that it helps stakeholders when making investment, credit, and resource allocation decisions (IASB, 2008). Though, both

FASB and the IASB emphasize the importance of high quality financial reporting, one of the key problems is how to measure quality (Beest *et al.*, 2009). The evaluation of the quality of financial reports involves choices between determining elements, since financial reports are context specific (Dechow and Dichev, 2002; Schipper and Vincent, 2003). Perceived quality of financial reports differs among users of financial information since they have different preferences. In addition, even within a user group different users may perceive the usefulness of information in different ways given its context. Thus, measuring quality of financial reporting is made difficult due to context and user specificity (Botosan, 2004). The measurement of the quality of financial reporting depends on attributes affecting the quality of financial reports, such as earnings management, financial restatements, and timeliness (Barth, Beaver and Landsman, 2008; Cohen, Krishnamoorthy and Wright, 2004). There is no generally accepted single measure of financial reporting quality in the recent time. The various tools and techniques for measuring various attributes that are perceived to influence financial reporting quality are used to evaluate the overall quality of financial reports. Beest *et al.* (2009) enumerates a non-exhaustive classification of methods most widely used in prior literature to evaluate financial reporting quality such as accrual models, value relevance models, specific elements in the annual report, and methods that help in modeling the qualitative characteristics.

Accrual models and value relevance only focus on information disclosed in financial statements to assess financial reporting quality (Healy and Wahlen, 1999). The quality of earnings is directly related to the quality of discretionary accruals. Higher discretionary accruals suggest lower quality earnings, while lower discretionary accruals suggest higher quality earnings. That is why the quality of financial reporting depends to a large extent on discretionary accruals. Context specific research papers are not able to assess financial reporting quality (Cohen *et al.*, 2004). Due to the fact that a single proxy cannot cover all aspects of financial reporting quality, most researchers use more than one method to measure the quality of financial reporting to achieve comprehensive measurement that could withstand academic scrutiny.

### **3. Enhancing a fraud free financial report**

The recent financial scandals involving big corporations gave rise to probing the essence of corporate governance, and brought to derision the accounting and auditing profession. This has motivated researchers to focus on the factors that determine/enhance quality financial reporting. This tends to review and establish interconnection among some of the strong factors that enhances quality of financial reporting.

#### **3.1. Accounting standards**

The aim of the drafters of accounting standards is to facilitate the provision of financial information about entities that will enable investors, analysts, creditors and the entities themselves to make informed decisions about resources allocation. Accounting standards are essentially about disclosure and, in many respects, are at the heat of market efficiency. Clearly, while accounting standards assists preparers of financial statements by providing a framework within which to construct the statements, their prime objective is to assist users of the statement to make meaningful assessments about the financial position and performance of an entity. Users of financial statements range from directors to investors, financial analysts and or credit rating agencies. Quality financial reporting, which is essential to investors' confidence, can only be achieved if it is underpinned by relevant and extant accounting standards. As the detail of financial reporting requirements is increasingly being left by legislation to be filled in by accounting standards, the importance of accounting standards is becoming accentuated. Accounting standards facilitate both the efficient operations of individual business entities and contribute to the efficient operation of capital markets. At the firm level, accounting standards improve the accountability of individual business enterprises and their managements to investors, creditors and other stakeholders (Asuquo, 2013). By promoting quality reporting, accounting standards assist the management of a business entity to maximize the wealth of the entity and to put in place effective and efficient corporate governance arrangements. At a broader level, accounting standards are central to the provision of accurate, transparent, reliable and quality information to the market as a whole.

Therefore, the broader the accounting standards, the qualitative the financial reports, though, dubious corporate players do deviate from extant accounting standards to roll out unrealistic financial

information informed by fraudulent intent. The quality of financial reports depends on the extent of compliance with or deviation from accounting standards. This assertion is in line with the objectives of IASB as contained in its constitution: To formulate and publish in the public interest, accounting standards to be observed in the presentation of financial statement and to promote their world wide acceptance and observance; to work generally for the improvement and harmonization of regulations of accounting standards and procedures relating to the presentation of financial statements; and to contribute to the development and adoption of accounting principles that are relevant, balanced and comparable internationally and to encourage their observance in the presentation of financial statements.

### **3.2. Corporate governance**

Corporate governance is the mechanism, process and practice by which companies are governed and controlled. The rate of accounting scandals occurrence recently has raised many criticisms about the financial reporting quality (Agrawal and Chadha, 2005). The involvement of companies such as Enron, Worldcom, Sunbeam, Parmalat etc. in accounting frauds has eroded the investors' confidence in the quality of financial reporting. Therefore, there is a need for strong good governance structure in order to prevent failure in financial disclosure with minimum threshold for improved financial reporting quality (Petra, 2007). The relationship between corporate governance and financial reporting quality has been critically analyzed in developed countries (Klai and Omri, 2011). Previous researchers placed emphasis on governance mechanisms such as concentrated shareholding, board independence, director shareholding and auditor reputation. Good corporate governance is a corporate set-up that leads to maximization of shareholders wealth legally, ethically and on a sustainable basis while ensuring equity and transparency to all stakeholders (Murthy, 2006).

Empirical evidences of the link between corporate governance and financial reporting quality. Chen, *et al.* (2006) examined the effects of ownership structure and boardroom characteristics on corporate financial fraud in China. Their results from univariate analyses show that ownership and board characteristics have influence on fraud. However, using a bivariate probity model with partial observability they demonstrate that boardroom characteristics are important, while the type of owner is less relevant. In particular, the proportion of non-executive directors, the number of board meetings, and the tenure of the chairman are associated with the incidence of fraud. Therefore, the personalities that make up the board members, the percentage that is non-executive directors, the number of board meetings held, and the tenure of the chairman determine the extent of compliance with the corporate governance code in a manner that will guarantee the sanctity of corporate engagement, accounting records and financial reports.

Jiang *et al.* (2008) studied the link between corporate governance and earnings quality. Their results suggest that only firms in the highest category of corporate governance experience significantly improved quality of earnings. They concluded that corporate governance is negatively associated with small earnings which imply that firms with weak corporate governance are more likely to manage earnings in order to meet or surpass analyst forecasts.

Connelly *et al.* (2012) investigated effect of ownership structure and corporate governance on firm value in Thailand. They find that Tobin's  $q$  values are lower for firms that exhibit deviations between cash flow rights and voting rights. They also find that the value benefits of complying with "good" corporate governance practices are nullified in the presence of pyramidal ownership structures, raising doubts on the effectiveness of governance measures when ownership structures are not transparent. Finally, they posited family control of firms through pyramidal ownership structures can allow firms to seemingly comply with preferred governance practices but also use the control to their advantage. Dimitropoulos and Asteriou (2010) investigated the effect of board composition on the informativeness and quality of annual earnings. Their data analysis over a period of five years (2000–2004) revealed that the informative quality of annual accounting earnings is positively related to the fraction of outside directors serving on the board, but it is not related to board size. Additionally, firms with a higher proportion of outside board members proved to be more conservative when reporting bad news but on the contrary they do not display greater timeliness on the recognition of good news. They further indicate that firms with a higher proportion of outside directors report earnings of higher quality compared to firms with a low proportion of outside directors.

Cornett, McNutt, and Tehranian (2009) examined whether corporate governance mechanisms affect earnings and earnings management at the largest publicly traded bank holding companies in the United States. They find that CEO pay for performance sensitivity (PPS), board independence, and capital are positively related to earnings and that earnings, board independence, and capital are negatively related to earnings management. They also find that PPS is positively related to earnings management. Finally, they assert that PPS and board independence are positively related and the relationship is bidirectional. While both PPS and board independence are associated with higher earnings, their results indicate that more independent boards appear to constrain the earnings management that greater PPS compels.

### *3.2.1. Other corporate governance mechanism*

#### *3.2.1.1 Audit committee*

It is a statement of fact that there is no consensus on the definition of audit committee that may be found in regulations, reports, surveys and research studies. We do have different definitions posited by various regulations and authors.

Audit Committee means a committee (or equivalent body) established by and amongst the board of directors of an issuer (a company) for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer (US Securities Exchange Act of 1934; SOX Section 404, 2002). Each member of the Audit Committee of the company shall be a member of the board of directors of the company, and shall otherwise be independent. It expected of every public company to have, and certify that it has and will continue to have, an audit committee of at least three members, each of whom must; be independent according to Rule 4200(a)(15); meets the criteria for independent set forth in Rule 10A-3(b)(1) under the Act (subject to the exemptions provided in Rule 10A-3(c); not have participated in the preparation of the financial statements of the company or any current subsidiary of the company at any time during the past three years... (Final NYSE CG Rules, Section 303A (7) (a)): Audit committee is a committee of the board normally comprises of non-executive directors with no operating responsibility in the financial management. Its basic tasks are to review the financial statements, the effectiveness of the company's accounting and internal control system, and reviewing the findings of the external auditors, and to make recommendations as appropriate on the appointment and remuneration of the external auditor.

An audit committee is a committee of the board of the directors established to give additional credence regarding the quality and reliability of financial information contained in the financial report present by the board. An audit committee of a company may be broadly defined as a committee of the board of directors, composed largely of non-executive directors, set up to oversee, review and monitor the financial reporting process and the external audit activities. An audit committee is an organized standing committee of the board composed mainly of non-executive directors with an audit oversight responsibility. These definitions state that the audit committee is a sub-committee of the board of directors; and confine the definition mainly to the composition and the key responsibilities of audit committees. These definitions emphasize the composition of the audit committee by the participation of independent directors with the professional abilities to perform the key responsibilities of financial reporting, audit and internal control.

In summary, all definitions of the audit committee tend to emphasize two attributes of its composition, namely independence and financial expertise, as well as its responsibility. Therefore, since the audit committee's independence and financial expertise of competence are the key factors that determine its performances, any serious regulatory attempt should have specific requirements related to these factors, and different levels of regulatory requirements may result in different levels of supervisory performance. Hence, the quality of financial report of any jurisdiction depends on the levels of supervisory performance of its audit committee reflecting through composition, independent and expertise of the committee.

Empirical evidences show that independent of audit committee has influence on the quality of financial report. Beasley (1996) researched the relationship among independent directors of audit committee(s) and concurrent financial manipulation, and he observed that those companies with a higher percentage of independent directors with an established audit committee(s) have lower percentages of

financial manipulation; whereas the companies which had not set up audit committee(s) had higher records of fraudulent financial reporting.

Tsai (2009) carried out a study to examine whether audit committee expertise and independence have relationship with earnings management of the firms in question. It finds that earnings management (discretionary accruals) is negatively related with the independent directors on audit committee. Tsai reports that the higher of independent directors divided by the total number of board of directors leads to lower earnings management. This reveals that higher levels of independence can lead to more effective supervisory functions, hence, high quality financial reporting.

Kao (2009) in his study divided the quality of accounting information into conservative accounting, stability, timeliness and continuity, in order to have set up in 2008 of an audit committee of listed prospective cabinets. The result showed that the independence of the audit committee and conservative accounting information quality led to a smooth and continuous positive relationship in terms of timeliness. This study's results show that the independent directors of the audit committee can improve the corporate governance environment, and effective assistance and supervision of the company's financial reporting process, hence, high quality financial reporting.

### **3.2.1.2. Whistle blowing**

Whistle-blowing is the disclosure by staff or insiders within an organization the illegal, unprofessional, illegitimate and fraudulent practices of organization's employee or employer to an authorized persons or organization that may be able to effect action (Near and Miceli, 1995). Whistle-blowing is veritable corporate governance, financial and internal control mechanism that help to prevent and deter economic leakages, abuse of office and fraudulent financial practices.

Sarbanes-Oxley Act of 2002 (section 4) developed a guideline on the process of whistle-blowing that would guide financial institutions in their internal operations. It is expected that this policy will lead to high quality of financial reporting in the banking industry and by extension the entire corporate world. Also, organizations are expected to act within the capacity of the policy to take full benefits of the policy in both short and long run.

Mice *et al.* opines that whistle-blowing has received attention in recent times because it has led to financial transparency of most financial institutions. They believe that whistle-blowing has reduced the incidence of fraud in workplaces. A survey conducted by Association of Certified Fraud Examiners in 2010 revealed that whistle-blowing has reduced fraud by 48% in most financial institutions globally. The survey revealed that whistle-blowing has led to transparency in the financial reporting process of most financial institutions in the world.

The independence of financial reporting was probed due to recent corporate scandals which underscore one of the whistle-blowing objectives; to ensure that financial information is free from undue interference, so as to ensure its independence. Whistle-blowing implementation has improved to a large extent the independence of financial reports from undue influence which has enhanced its quality.

Lewis and Uys (2007) reveal that the ultimate goal of whistle-blowing is the stakeholders. Their study demonstrates that the importance of whistle-blowing is to make financial statements robust and add value to organization's stakeholders. This value addition reflects in the quality of decision that could be made with the information contained in financial reports. The tripartite essence of whistle-blowing as import from above; the transparency, independence and value orientation of financial reporting process, have great influence on the quality financial reporting.

### **3.2.1.3. Internal control system**

Committee of Sponsoring Organizations (COSO, 2013) defined internal Control as a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance.

Certified American Institute of Public Accountants (AICPA) posited that internal control comprises the plan of organization, coordinate methods and measures-adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and encourage adherent to prescribed managerial, operational, accounting and reporting policies.

According to the Government Regulation No.60 (2008), Internal Control System is a process that is integral to the actions and activities carried out continuously by the management and all employees to provide reasonable assurance on the achievement of organizational goals through effective, efficient, and reliable financial reporting system, safeguarding the assets and ensuring compliance with state laws and regulations. In other hand, Boynton *et al.* (2006: 326) states: Internal Control safeguards assets against unauthorized acquisition, use, and disposition. This implies that the internal control safeguards assets against illegal use or misappropriation that can prompt fraudulent financial reporting. Under AU 319 and COSO, internal control consists of five parts which are control environment, risk assessment, control activities, information and communication, and monitoring.

### **3.3. Audit quality**

Audit quality has been recurring concept under the scope of auditing. However, there still no consensus on its universal definition. Having reviewed contemporary audit quality research journals and papers issued by regulatory bodies, its definition can be classified into two broad categories - direct definition and indirect definition. Definitions fall into the 'direct' category if the authors define audit quality without recourse to any proxies such as auditor's quality, reputation, etc.; all the rest of the definitions are treated as 'indirect', especially when proxies are used and the theory is built on some research results and findings, or the definition implicitly implied from the contents (Bing *et al.*, 2014).

#### **3.3.1. Direct Definition**

The most widely used definition of audit quality is by DeAngelo (1981), stating that "the quality of audit services is defined to be the market-assessed joint probability that a given auditor will both discover a breach in the client's accounting system, and report the breach". Many researchers then used this double approach to further define audit quality with details in competence and independence, while others adopt it as a foundation to identify other audit quality attributes. For instance, Seyyed (2012) explains further that audit quality could be a function of the auditor's ability to detect material misstatements and reporting the errors. Together with other similar definitions, they all emphasize on two of the most important aspects of audit quality, namely auditor ability or auditor effort which bothers on competence, and auditor independence. In essence, this plethora of definitions is mainly about the auditors' quality.

Other researchers in defining audit quality focuses on the accuracy of the information reported by the auditors. Titman and Trueman (1986) suggest that high audit quality would improve the reliability of financial statement information and allows investors to make more precise estimate of the firm's value. Schauer (2002) also posits that "a higher quality audit increases the probability that the financial statements more accurately reflect the financial position and results of operations of the entity being audited". In other words, audit quality is reflected in the quality of accounting information disclosed which is a measure of financial report quality.

In the same vein, another set of definitions concentrates on the degree to which the audit conforms to applicable auditing standards. Government Accountability Office (2003) defines a high-quality audit as an audit "in accordance with generally accepted auditing standards to provide reasonable assurance that the audited financial statements and related disclosures are presented in accordance with generally accepted accounting principles and are not materially misstated whether due to errors or fraud". Furthermore, it is suggested that audit quality is the probability of detecting audit failure, disciplining auditors and incentivizing them to constrain managerial opportunism, which is a reflection of strict compliance with auditing standards. However, it is found that most literatures we read have been contented to approximate or even equate audit quality with the quality of auditors. However, there are some exceptions. Manita and Elommal (2010) suggested that audit quality should be measured in terms of audit process quality, and that the studies on audit process should put emphasis on examining different stages of the audit process. However, they also suggest that the indicators of audit process may not be as obvious as those of auditors.

#### **3.3.2. Indirect Definition/Implied Definition**

Many indirect definitions are associated with the independence and competence of auditing, following the basis developed by DeAngelo. According to Francis and Yu (2009), higher quality audits are

inferred by the auditor's likelihood of issuing a going-concern audit report and accuracy of the report in predicting client bankruptcy, and the degree to which client's evidence earnings management behavior". Besides, it is suggested by Mansouri *et al.* (2009) that audit quality is positively related to audit independence. But he also points out if there is lack of competence; the auditors may rely on management representation of the client's, which may impair their independence. Hence audit quality, auditor independence, auditor competence and financial report quality should be positively related. Hence, the quality of auditing is the quality of reporting direction and information risk reduction for all stakeholders.

Firm size and reputation is another proxy for defining audit quality. This type of definitions uses auditor's characteristics to explain what audit quality is since both size and reputation can reflect auditor's competence and independence to some degree. It is commonly suggested that audit quality is positively related to firm size and specialization. DeAngelo (1981) once states that "larger auditors, as captured by membership among the Big N, tend to provide higher quality audits. In later theoretical and empirical researches, it is confirmed that firm size is closely associated with audit quality.

Audit quality can also be inferred from earnings quality, as high quality of audit minimize the extent of earnings management and enhances the informativeness of financial reports. According to Balsam *et al.* (2003), audit quality has a positive relationship with the quality of financial reporting, which can be proxies by earnings quality. If the quality of earnings is high, the informativeness and usefulness of earnings would be correspondingly high, hence the accuracy of the information disclosure in the financial report.

### **3.4. Efficient capital market**

The primary role of the capital market is allocation of ownership of the economy's capital stock. In general terms, the ideal is a market in which prices provide accurate signals for resource allocation, that is, a market in which firms can make productive investment decisions, and investors can choose among the securities that represent ownership of firms' activities under the assumption that security prices at any time "fully reflect" available information. A market in which prices always "fully reflect" available information is called efficient market (Fama, 1970). Available information in this context is talking about full disclosure which is the hallmark of quality financial reports. Therefore, efficient capital market will have strict listing requirements and market regulations that can engender quality financial reportage.

Efficiency of capital market may involve examination and monitoring of the determinants of cost of equity, cost of debts, investment efficiency, investor behavior, investor protection, investment decision making, analyst forecasts and firm valuation with respect to accounting information, fundamental analysis and the value relevance of financial reporting. Hence, efficient capital market sets a minimum threshold of qualitative factors for measuring the quality of financial reporting.

Empirical studies using indirect measures of disclosure document reveals that a firm's disclosure quality is positively associated with capital market valuation benefits (Welker, 1995), and, in particular, is inversely related to its cost of capital (Botosan and Plumlee, 2002). Suffice to say, efficient capital market and quality financial reports is a two sides of a coin.

### **3.5. Management performance**

Management performance is a function of management efficiency while management efficiency is measured by the management's capability of minimizing input usage in the production of output (Hahn, 2008). In the other hand, management efficiency is the manager's ability to manage its limited resources in order to achieve company goals (BadavarNahandy, 2008). Efficient management of organization resources reduces net operational costs with an increasing effect on the net earnings which is a measure of management performance. Therefore, when management performance proxy by earnings increases naturally due to management efficiency, the drive for aggressive earning management through unnecessary discretionary accrual will be done away with, hence, the quality of financial report remains sacrosanct.

### **3.6. Forensic accounting education**

The primary objective of financial reporting is to provide high-qualitative financial reporting information concerning economic entities, primarily financial in nature, useful for economic entities to



achieve useful economic decision making (FASB, 2008; IASB, 2008). In line with this objective, it was argued that analysts, investors and management have deployed dozens of forensic indices that aid the forensic accountant in assessing the probability of performance index manipulation by a suspect company observing that because the financial statement are the responsibility of company's management. Transactions can be structured to best achieve a desired accounting result by reporting key financial transactions to the company's advantage (Enron, World Com, Cadbury Plc and so on). It was further argued that the quality of a company's earnings is one facet of an investigation that is often overlooked in the financial forensic process.

The recent widely reported cases of fraudulent financial reporting also points to the need to revamp the current trend of quality assurance approach on financial statements through forensic accounting education. The process has heralded a new era demanding total disclosure of facts that would enable financial statement play the key role of educating and informing existing and potential investors on the true financial position of any organization, hence the study of forensic accounting. Kasum (2009) defines forensic accounting as the application of specialized skills to stumble upon evidence of economic transaction. It is an integration of accounting, auditing and investigation skills. Ramaswamy (2007) submits that forensic accounting is an accounting analysis that can uncover possible financial reporting manipulations that is suitable for presentation in court.

Forensic education is also further necessitated by the present knowledge deficiency in the area of forensic audit that can actually impact on the quality of financial reports. The most important course objectives in Forensic education which include-fraud detection, investigation and prevention, identification of internal control of firms and providing education on pervasiveness of and the causes of fraud and white-collar crime and techniques for identifying fraud red flags need to be reinforced in our curriculum to aggressively address the knowledge deficiency in both practitioners, academicians and students with a view to reverse the ugly incidence of fraud characterized by the significant changes in the business environment posed by globalization, technological advancement and high profile financial scandals ( Zango, 2012).

#### **4. Importance of quality financial reporting**

The importance of quality financial reporting can be viewed from both deterrent perspective and incentive perspective. The deterrent perspective is more common, in the light of recent corporate scandals which took accounting and auditing profession to the cleaner: Enron, Worldcom, Tyco, Parmalat, Adelphia...etc. From this perspective, high quality financial reporting help to crystallize such scandals, with its attendant economic, social and profession costs. The negative consequences of these scandals were not limited to investors and employees but also the accounting and audit profession, even, the entire world economy outlook. These scandals send a very strong signal of the negative effects of fraudulent accounting and reporting. There is also the other side of the coin: the incentive perspective. Good accounting and reporting system are conducive to both financial sector development and private sector developments, which in turn spur economic growth in sustainable manner.

The connection between high quality financial reporting and financial and private sector developments take several dimensions which are: (1) through strengthening the domestic financial architecture and reducing the risk of financial market crises and their associated negative economic impacts. (2) By contributing to foreign direct and portfolio investment and helping to mobilize domestic savings. (3) By facilitating smaller scale corporate borrowers' access to credit from the formal financial sector by lowering high costs of information and borrowing. (4) By allowing investors to evaluate corporate prospects and make informed investment and voting decisions, which results in a lower cost of capital and a better allocation of resources. Financial reporting is also a gauge for market based monitoring, which allows shareholders and the public at large to assess a company's management performance, and thereby promotes the active development of stock markets. (5) By supporting economic integration both regionally and globally.

Hence, a quality corporate financial reporting system should not be viewed as the core objective for its own sake, as it is much more than that: it is the bedrock of a well-functioning market economy and a robust financial system ([siteresources.worldbank.org/importance of quality financial reporting](http://siteresources.worldbank.org/importance%20of%20quality%20financial%20reporting)).

## 5. Conclusions

The study reviewed the key factors that enhance the quality of financial reports with emphasizes on Accounting Standards, Corporate Governance and some of its mechanism such as Audit Committee, Whistle blowing and Internal Control system, Audit Quality, Efficient Capital Market, Management Performance and Forensic Accounting Education in this order. Empirical evidences from extant literature revealed that these factors have influence on the quality of financial reporting. Hence it is recommended that they should be given careful attention by SEC, corporation players, financial analysts and individual investors in determining the quality of financial reports.

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