



EFFECT OF FORENSIC AUDITING AND INTERNAL CONTROL STRUCTURE ON AUDIT FEES CHARGED ON DISTRIBUTIVE FIRMS IN NIGERIA

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Abstract: This study focuses on the expected gaps between forensic auditing and internal control mechanism on the audit pricing of distributed firm in Nigeria. It examines the relationship between forensic auditing and audit fees charged by the auditors and reviewed the relationship between internal control structure and audit fees charged on distributive firm in Nigeria. Both primary and secondary data were used. In analyzing the data, Descriptive, Regression and Correlation analysis were used. Kendall's Concordance coefficient stood at 0.48 which meant that internal control structure influence audit fee charged on distributive firms at 48% with $p = 0.000$ at 5% level of significance. Correlation results ($p = 0.048 > 0.050$; $p = 0.027 > 0.050$) revealed that forensic auditing has relationship with audit pricing. It is recommended that management of these distributive firms strengthen their internal control system for a reduce risk level.

Keywords: Forensic auditing, internal control, audit fees, distributive firms

1.1 Introduction

According to International Standard Industrial Classification (ISIC), distributive trade consists of national entities which engage in trading and provision of visible/invisible goods. Firms that engage in distributive trade and services (distributive firms) account for a significant quantum of economic activities whether measured as a function of contributions to the Gross Domestic Product or share of total employment. Distributive firm activities involve food, livestock feeds, beverages, petroleum products, agricultural raw materials, paints, pharmaceuticals, tyre and tubes and plastic products. Others are cement, building materials, and hardware, steel and iron rods, wholesale and retail

establishment. However, internal control system is one of the important mechanism to distributive firm. Ayagre, Appiah-Gyamerah and Nartey (2014) opined that the effectiveness of an internal control system is a function of how flexible it interacts with itself and how adaptive it is with the organizations business processes. Internal auditing is expected to evaluate the soundness of its internal control policies to safeguard the company's assets, also determining the efficiency of its marketing strategies and reviewing compliance with company policies as well as governmental rules and regulations. The most notable differences between internal audits and forensic audit are the objectives of the tasks performed, certain similarities may be present, but the differences create a wide gap which justifies the need for

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specialization in forensic accounting & fraud detection. Forensic accounting on the other hand is more concerned in establishing the existence of fraud, determining the extent of damage or losses involved as a result of the fraud or crime, the gathering of sufficient evidence for use by the courts of law to come up with a fair and judicial ruling for indemnification and/or prosecution (Sarbanes-Oxley Act of 2002). Distributive firm are listed company which are mandatory to publish their financial statements for the awareness of shareholders and stakeholders towards the resource available and the development of the resources for decision making by the management and the investors, financial statements needs to be audited before published for credibility, accountability and transparency for the users. The engagement of auditing involves audit fees charged. Audit fees charged. Audit fees can be defined as the amounts of fees (wages) charged by the auditor for an audit task performed on the accounts of an enterprise (auditee). This implies that the basis for arriving at audit fee charged is basically on the contractual agreement between the parties which is premised on time put into audit process (El-Gammal, 2012)

1.2 Statement of the problem

Firms are seriously concerned about their existence, sustenance and continuity which are hinged upon consistent profitability. Audit fee, being a cost or charge on companies' fortunes, drains its profit and consequently affect capital accumulation, expansion, growth and diversification capabilities. Pricing of audit services have also occupied the concerns of many researchers to examine determinants of audit fee in the corporate environment (Al-Harshani, 2008). Distributive firm confronted with problems of internal control system integration and advancement due to the level of adaptation of the organization strategy and control in providing for environmental connectivity with their internal control structure. . The nature of these effects has become a misery that needs to be established as they

relate to the determination of audit fee in the distributive sector of Nigeria. Ideally, internal control mechanisms should naturally reduce external audit activities thereby reducing fee as claimed by previous researchers (Substitution theory), this claim has over the decades lack empirical generalizability. Hence, the need to determine how internal control structure relates with audit fee charged on Distributive Firms in Nigeria (DFN). Hence, forensic auditing in relation to this problem will serve as a deterrence or response to internal control deficiency of DFN towards the pricing system of audit and its equivalents. This research work establishes a gap of expectation on audit fees pricing on DFN.

1.3 Objectives of the study

This research aim on the following objectives:

- i. Examine the relationship between forensic auditing and audit fees charged on distributive firm in Nigeria
- ii. Examined the relationship between internal control and audit fees charged on distributive firm in Nigeria

1.4 Hypotheses of the Study

- i. There is no significant relationship between Forensic auditing and audit fees charged by distributive firm in Nigeria
- ii. There is no significant relationship between internal control and audit fees charged on distributive firm in Nigeria

2.1 Literature review

2.1.1 Diachronic analysis of audit fee

The evolution of audit services fees on regulated markets is characterized by no disclosure obligation on the audit fee by the client and the auditor. The auditing market and its audit fees is a subject studied both in developed (US, Australia, Canada) and emerging economies (Hong Kong, Malaysia, Singapore). Hay (2006) considered in the mentioned meta-study that audit fees determinants are: customer size, the overall audit risk, and complexity of the client, customer profitability, owners of the company, and the degree of competition of market share. El-Gammal (2012) investigated the determinants of audit



fees in Lebanon by studying the views of external auditors and client's representatives (accountants, financial controllers and internal auditors) about the factors that determine audit fees and provide evidence whether these factors are related to audit firm characteristics or the audit client characteristics. AICPA (2009), see audit fees as sums payable to the auditor for the audit services offered to the auditee. Audit firms have to consider cautiously cost and benefit that will arise from the discharge of their services to decide their audit fees, the aspects regarding audit fees are extensively analyzed from point of view of the effects the different fees levels may have on the auditors' independence. Audit fees charges are considered to be related with the level of risk embedded in audit assignment. Litigation against the auditor could be costly and the investors could engage in litigation against auditor to recover any loss arising from auditor's negligence (Menon & Williams, 1994). It is therefore suggested that audit fees should reflect a cap that recognizes different level of risk across clients engagement (Simunic & Stein, 1996 and Seetharaman et al. 2002). The study of Pratt and Stice (1994) notice that auditors mostly evaluate the expected value of liability loss in audit fees charges on engagement. This shows that there are connections between the audit that requires forensic management and fees charged

2.1.2 Internal control

Internal control mechanism and practices have impact on audit fee of organization positively or negatively in spite of the minimum fee position stipulated by regulatory bodies. Steward and Munro (2007), stated that external auditor relies on an effective internal control but do not reduce their audit testing. Moreover, time and effort saved due to the presence of effective internal control balance with time spend for more meetings with client managers and partners and so, it has significant relationship with audit fee charged. Zhang, Zhou and Zhou (2007) pointed that firm's internal control is under the purview of its audit committee which not only plays

an important monitoring task to ensure the quality of financial reporting and corporate accountability.

Hoitash, Hoitash and Bedard (2008) affirms that the degree of risk determines the effort required by the auditor in a particular engagement which may also result in the premium on fees charged for likely litigation. The study further discovered that risky clients are more likely to have internal control problems that could lead to misstatements in financial reporting.

2.1.3 Forensic auditing

Forensic auditing is an aspect of forensic accounting that applies auditing, accounting and investigative skills to situations that have legal consequences, however, forensic auditing integrate modern digital techniques and changed the way the fraud examiners conduct investigations. It is methods internal auditors use to plan and complete the work and the approaches the external auditors take to assess risk and perform audits. Albrecht, Albrecht and Dunn (2001) depict forensic investigation as the use of specialized investigative skills in carrying out an enquiry conducted in such a manner that the outcome will have application to the court of law. In this emerging economic scenario, forensic auditing has geared the investigation attitude of incidents of cybercrimes and frauds. AICPA emphasized that auditors faced with difficulty while conducting their verifications, investigations & audits work due to lack of applicability of a single/uniform method like digital analysis, electronic evidence collection, data mining and computer forensics for the same. Indeed, forensic auditing use computer-based fraud detection involves a plethora of different technologies, methodologies and goals. Forensic Auditing lies on the critical evaluation so as to detect the various types of computer frauds. A forensic audit is a detailed engagement which requires the expertise of not only accounting and auditing procedures but also expert knowledge regarding the legal framework. A forensic auditor is required to have an understanding of various frauds that can be carried out and of how evidence needs



to be collected. Therefore, the importance of forensic auditing in discovering fraudulent act in any organization cannot be overemphasized (Akenbor & Ironkwe 2014 and Zachariah, Masoyi, Ernest & Gabriel 2014). Onodi, Okafor, and Onyali (2015) affirm that forensic investigative skills are necessary to expose and ascertain the incidence of fraudulent financial act in organization.

2.1.4 Forensic Audit and Fees Charges

Some past accounting research suggests that the auditors are regarded as heavy fees chargers by investors (Schwartz & Menon 1985 and Memon & Williams 1984). It has been noticed that auditors put forth their fees based not only on volume but risk involved in the engagement (Sinunic & Stein 1996 and Seetharaman, Gul & Stephen 2002). The auditors are bound to evaluate the clients risk possibilities and build this into the fees charged.

Hoitash et al (2008) affirm that the auditors efforts in audit engagement is a function of risk involve in it. The auditor will be ready therefore to charge a risk premium on any risky engagements to cover probable risk of litigations. Pratt and Stice (1994) confirm that the auditor evaluates the liability loss component to charge their fees. Grambling, Schatzberg, Bailey and Zhang. (1998) discover that auditors assess client risk for risks adjust fees.

2.1.4 Main Elements of a Forensic Audit

Each forensic accounting assignment is unique and accordingly the actual approach adopted and the procedures performed would be specific to it. However, in general, many forensic audits would include the following steps:

- i. Meet with the client
- ii. Perform a “conflict check”
- iii. Perform an initial investigation

- iv. Develop an action plan
- v. Obtain the relevant evidence
- vi. Perform the analysis
- vii. Prepare and present the report

2.1.5 Distributive firms in Nigeria

National Bureau of Statistics (NBS) in Nigeria affirmed that distributive trades (DTIS) are the only channels through which goods and services available for consumption reach the final consumers. Based on the NBS official statistics, firms that involved in distributive trade and services (distributive firms) in Nigeria are classified under the codes ranging from 4901-4965 depending on the type of business they engaged in. Some of the businesses identified by NBS are as follow; food, livestock feeds, beverages, petroleum products, agricultural raw materials, paints, pharmaceuticals, tyre and tubes and plastic products. Others are cement, building materials, and hardware, steel and iron rods, wholesale and retail establishment and so on. Presently, the NBS is the only agency which data-bank firms that engage in distributive trade and services in Nigeria. Coming from this background information, it is crystal clear that selected firms for this study met the criteria set for the distributive firms by both the ISIC and NBS.

3.1 Methodology

This study used both primary and secondary sources of data, quantitative and adopted stratified random sampling technique was adopted. Population for this study consisted of sixty-nine (69) distributive firms out of the entire 159 companies listed on Nigerian Stock Exchange (NSE, 2018). This study covered a period of 10 years (2007-2016).



Table 3.1 List of Sampled Firms based on the Sampling Techniques adopted.

S/N	Category/Companies	Share Capital as @ Dec, 2016. (N'000)	Average Capital as @ Dec, 2016. (N'000)
A	Category A – Consumer Goods		
1	Cadbury Nigeria Plc.	939,101	1,766,345
2	Dangote Flour Mills Plc	2,500,000	1,766,345
3	GuinnessNig. Plc.	725,944	1,766,345
4	Nestle Nig. Plc.	396,328	1,766,345
5	Nigerian Brew Plc.	3,964,551	1,766,345
6	PZ Cussons Nigeria Plc.	1,985,238	1,766,345
7	Unilever Nigeria Plc.	1,891,649	1,766,345
B	Category B – Industrial Goods		
8	Ashaka Cement	184,231	509,828
9	Portland Paint & Product Nig. Plc.	200,000	509,828
C	Category C – Natural Resources		
10	Multiverse Mining & Exp. Plc.	2,130,969	816,364
11	Thomas Wyatt Nig. Plc.	110,000	816,364
D	Category D – Oil and Gas		
12	ConoilPlc	346,976	1,033,694
13	Eterna Plc.	652,072	1,033,694
14	Forte Oil Plc.	655,314	1,033,694
15	OandoPlc	3,411,177	1,033,694
E	Category E – Conglomerate		
16	A.G Levetis Nigeria Plc.	1,323,645	4,625,562
17	Transnational Corp. of Nigeria Plc	20,323,996	4,625,562
18	U.A.C.N	960,432	4,625,562
F	Category F – Healthcare		
19	Fidson Healthcare Plc.	750,000	503,369
20	Glaxosmithkline Consumer Nig.Plc.	478,351	503,369
G	Category G – Agriculture.		
21	FTN Cocoa Processors Plc.	1,100,000	627,391
22	Livestock Feeds Plc.	1,000,000	627,391
23	Presco Plc.	500,000	627,391

Source: NSE (2017).



3.1.1 Model Specification

Model 1:

$$AFEE_{it} = \beta_0 + \beta_1 IASIZE_{it} + \beta_2 IAQUALI_{it} + \beta_3 IAFIN_{it} + \beta_4 IAOP EFF_{it} + \beta_5 IACOMP_{it} + \varepsilon_{it} \dots (3.1)$$

Where: b

IASIZE – Strength of internal audit staff

IAQUALI – Percentage of internal audit staff having professional accounting/auditing qualifications

IAFIN – Actual time spent on financial statement by staff of internal audit department

IAOP EFF - Internal audit time spent on operational efficiency and effectiveness review including Internal Control

IACOMP - Internal audit time spent on assessing compliance with company policies, procedure and statutory requirement

Model 2:

$$FEE_{it} = \beta_0 + \beta_1 AFT_{it} + \beta_2 AABV_{it} + \beta_3 CAATs_{it} + \beta_4 DASA_{it} + \varepsilon_{it} \dots (3.2)$$

AFEE - Audit fee charged on distributive firms

AFT- Analysis of financial transactions

AABV- Auditing of assets and business valuations

CAATs- Computer Assisted Auditing Tools

DASA-Deductive Analysis on Statement of Accounts

Where β_0 represent the constant for audit fees regression equation (Fixed audit costs component)

β_1 - β_5 represent the respective correlation coefficient's of the independent variables.

ε_{it} – represents the error term of the model.

4.1 Results and Discussion

4.1.1 Analysis of the effect of Forensic Auditing on audit fees charged

The total numbers of respondents were N-59, among the variables considered for forensic auditing: Auditing of Assets and Business Valuations (AABV) which has standard deviation of 1,138, followed by Analysis of Financial Transactions (AFT) with standard deviation of 1,110. Computer Assisted Auditing Tools (CAATs) with standard deviation of 1,017, while Deductive Analysis on Statement of Accounts (DASA) also has Standard deviation of 0.866. This descriptive analysis indicated that AABV, AFT, CAATs and DASA is important tools for forensic auditing. The correlation analysis was used to ascertain the direction of relationship between AFEEs and FA variables of this study.

The correlation coefficients (0.015, 0.031, 0.015, and 0.022) revealed that AFEE has positively correlation with AFT, AABV, CAATs and DASA. Correlation coefficients (0.027, 0.044 0.011) revealed that AFEE have relationship with AABV, CAATs and DASA. Correlation coefficients (0.045 and 0.012) estimated that there is correction with AFEE at 0.05 level of significant. Finally AFEE has correction (0.890**) with CAATs at Significant level of 0.01. **I.**

For the Pearson Correlation: The result ($p = 0.048 > 0.050$) purview that forensic Auditing have positive relationship with and audit fees charged. **II. For the 1-tailed correlation:** the result ($p = 0.027 > 0.050$) estimated that was appropriate statistical evidence that forensic auditing can reduce the auditor charges on audit engagement

Table 4.1: Descriptive statistics



Descriptive Statistics	N	Rank	Minimum	Maximum	Mean	Std. Deviation	Variance
Relative Size Factor Analysis (TRSFA)	59	14	1	3	1,89	,835	,697
Computer Assisted Auditory Tools (CAATs)	59	15	1	4	1,87	1,017	1,035
Ratio Analysis (RA)	59	6	1	4	2,23	,800	,640
Benford's Law	59	7	1	4	2,22	,753	,566
Data Mining	59	8	1	4	2,20	,930	,864
Laboratory Analysis of Physical and Electronic Evidence (LAPEE)	59	**1	1	4	2,73	1,091	1,191
Analysis of Financial Transactions (AFT)	59	*2	1	4	2,67	1,110	1,232
Confidential Sources(CS)	59	9	1	4	2,19	,930	,864
Public Document Reviews and Background Investigations (PDRBI)	59	5	1	4	2,37	1,116	1,244
Physical and Electronic Surveillance (PES)	59	10	1	4	2,12	,888	,789
Interviews of Knowledgeable Persons(IKP)	59	13	1	3	1,92	,741	,550
Deductive Analysis on Statement of Accounts (DASA)	59	12	1	4	2,05	,866	,750
Investigative Ability/Intuitiveness on Legitimate Business (IALB)	59	11	1	3	2,08	,694	,481
Organize an Unstructured (OU)	59	*4	1	4	2,42	,946	,894
Auditing of Assets and Business Valuations (AABV)	59	*3	1	4	2,48	1,138	1,295
Valid N (listwise)	59						



Table 4.2: Matrix Correlation Analysis

	AFEE	AFT	AABV	CAATs	DASA
AFEE	1.000				
AFT	0.015**	1.000			
AABV	0.031*	*0.027	1.000		
CAATs	0.015**	0.044**	0.045**	1.000	
DASA	0.022**	0.011*	0.012**	0.890**	1.000

Note: ** P < .01, * P<.05.

Table 4.3: Correlation analysis

Correlations		AFEES	FA
Audit Fees (AFEES)	Pearson Correlation	1.000	.048
	Sig. (1-tailed)		.027
	N	59	59
Forensic Auditing (FA)	Pearson Correlation	.048	1.000
	Sig. (1-tailed)	.027	
	N	59	59

4.2 Descriptive Analysis of Internal Control Structure and Audit Fee charged

The table 4.4 showed the analysis of the result that assesses the relationship between internal control structure and audit fee charged on distributive firms in Nigeria. It revealed that the highest total score (Sum) is 822 and the highest mean score is 5 in the statement “Internal audit effort complements the extent of external audit effort thereby reducing external audit fee. Whereas the lowest mean score is 1.1101 in the statement “Firms require periodic review of internal control mechanism for better efficiency”. Similarly, in standard deviation, the highest value is 1.12550 in the statement “Size is one of the factors influencing external audit fee in Nigeria distributive firms” and the lowest is with the value 0.31372 in the statement “firms require periodic review of internal control mechanism for better efficiency”.

Table 4.4: Descriptive Statistics

	N	Min.	Max.	Sum	Mean	Std. Dev.	Variance



Firms require periodic review of internal control mechanism for better efficiency.	218	1.00	2.00	242.00	1.1101	.31372	.098
Size is one of the factors influencing external audit fee in Nigeria distributive firms.	218	1.00	5.00	441.00	2.0229	1.12550	1.267
Compliance with companies' policies, procedure and statutory requirements need to be assessed periodically.	218	1.00	3.00	337.00	1.5459	.54325	.295
Review of operational efficiency and effectiveness is a major determinant of internal audits time.	218	1.00	3.00	304.00	1.3945	.52615	.277
Number of Internal Audit staff determines the extent of work completion strength.	218	1.00	3.00	292.00	1.3394	.52090	.271
Qualifications of internal audit staff also determine the extent of work completion strength.	218	1.00	4.00	381.00	1.7477	.82898	.687
Internal audit effort complements the extent of external audit effort thereby reducing external audit fee.	218	2.00	5.00	822.00	3.7706	.78150	.611
Valid N (listwise)	218						

Source: Author's Computation (2018)

4.3 Analysis of the relationship between Internal Control Structure and Audit Fee charged on Distributive Firms in Nigeria.

The Kendall's Concordance is specifically use to test for objective two. Table 4.5 for the Kendall's analysis shows that Kendall's Concordance coefficient (Kendall's W) obtained was 0.48 which meant that internal control structure and audit fee charged on distributive firms is Nigeria have strong concordance, so, it can be stated that the relationship that exist between internal control structure and audit fee charged is 48% and the significant value of calculated result obtained is 0.000 ($p < 0.005$) at 1% level of significance. Therefore, based on the foregoing analysis, the null hypothesis which stated that

there is no significant relationship between internal control structure and audit fee charged on distributive firms in Nigeria is rejected, while the alternative hypothesis which stated that there is a significant relationship between internal control structure and audit fee charged on distributive firms in Nigeria is accepted.

Table 4.5: Kendall's Concordance Test

Total	218
Kendall's W	.485
Test Statistics	634.307
Degrees of Freedom	6



Asymptotic Sig	.000
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Source: Author's Computation (2018)

5.1 Conclusion and Recommendations

This study examined the effect of forensic audit and internal control structure on the audit fee charged of the distributive firms in Nigeria. This study used both primary and secondary sources of data and stratified random sampling technique was adopted to select sixty-nine (69) distributive firms out of the entire 159 companies listed on Nigerian Stock Exchange over period of ten years. The result revealed that both forensic auditing and internal control structures has a connection with audit fees charged on distributive firms in Nigeria. This finding is in congruence with the study of Pratt and Stice (1994) and Hoitash et al (2008). It is recommended that the internal control structures of distributive firms are strengthen to reduce level of risk that could lead to premium audit charges.

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APPENDIX

Communalities of the Variables

Communalities	Initial	Extraction
Relative Size Factor Analysis (TRSFA)	1,000	,831
Computer Assisted Auditory Tools (CAATs)	1,000	,938
Ratio Analysis (RA)	1,000	,622
Benford's Law	1,000	,794

Data Mining	1,000	,613
Public Document Reviews and Background Investigations (PDRBI)	1,000	,947
Interviews of Knowledgeable Persons (IKP)	1,000	,922
Confidential Sources (CS)	1,000	,835
Laboratory Analysis of Physical and Electronic Evidence (LAPEE)	1,000	,813
Physical and Electronic Surveillance (PES)	1,000	,932
Analysis of Financial Transactions (AFT)	1,000	,886
Deductive Analysis on Statement of Accounts (DASA)	1,000	,876
Investigative Ability/Intuitiveness on Legitimate Business (IALB)	1,000	,740
Organize an Unstructured (OU)	1,000	,692
Auditing of Assets and Business Valuations (AABV)	1,000	,934

Extraction Method: Principal Component Analysis