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IS IT POSSIBLE TO ELIMINATE FINANCIAL ACCOUNTING FRAUDS?

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Abstract:-The radical changes in the globalization have impacted the economies of many countries. In current economic scenario, every organization regardless of its location, size, nature of business is affected by fraud in some or the other way. Financial accounting fraud detection (FAFD) mechanism has become a vital and an upcoming topic of great importance in the field of academics, research and industries. Today the failure in the internal auditing system of the organisation in detecting the accounting frauds has led to the use of focused procedures to identify the accounting frauds in organization. This is collectively known as Forensic Accounting. The main aim of this article is study the reasons why fraud occurs in financial accounting, the role of an auditor and his responsibilities in Fraud detectionand to identify the possibilities to eliminate the fraud.

Keywords: Mistake, Fraud, Cookie-Jar Accounting Practices, Auditor, Coercion.

INTRODUCTION

Fraud is an intentional act meant to induce another person to part with something of value, or to surrender a legal right. It is a deliberate misrepresentation or concealment of information in order to deceive or mislead. It affects many organizations, regardless of size, location, or industry. Financial accounting fraud detection (FAFD) is emerging buzzword with great relevance in the field of research and academics Industrial institutions. Inappropriate methods adopted in internal auditing system of many organizations have led to the use of specific and specialized procedures to detect fraud in the financial accounting were it is suspicious of occurrences of fraud. Accounting organization hasrecourse to a new system known as Forensic Accounting.

The Association of certified Fraud Examiners, (ACFE) in one of its study, suggested that fraudulent financial statement accounts incidents occur approximately 10 % in most of the white collared crimes. Instants of misappropriation of assets,hipped sales figures, improper expenditure records, ignored liabilities and hidden corruption are likely to occur at a higher frequency have been reported. Yet the financial impact of these mentioned crimes is comparatively less.

Theincident of financial statement fraud occurs in various forms. It is important to understand that if once unreliable accounting practices are instigated, infinite inappropriate and manipulation systems can be exploited , whereby it is easy to maintain and project a sustainable appearance in the business. The common approach of overstating revenues can be projected by misreporting future expected sales, devaluing expenses by capitalizing operational expenses, by undermining asset values in terms of net worth and ignoring to calculate depreciation values, meddling with balance sheet figures and fraudulent disclosures about customer transactions and structured finance deals etc.

Here where the role of Cookie Jar accounting practice emerged, an alternative substitute to financial statement fraud. It is a practice by which firms or companies will devalue the revenue in a specific or a particular accounting period and preserve them as a reserve or a surplus for the future tenure which anticipates worst performances in business. Such practices ideally remove the appearance of unpredictability from the operations. In the most recent case, a big computer giant showcases the practice of cookie jar accounting that happened in July 2010 agreed to pay a sum of $ 100 million as penalty to the Securities and Exchange Commission (SEC). SEC Alleged allegations werethat it used cookie jar reserves. Hence it is better to know about the difference between Mistake and Fraud.

DEFINING A "MISTAKE"

"Any error or fault that occurs from a substandard judgment, carelessness or incomplete knowledge can be called as a Mistake."

According the Law of Contract – A mistake is an erroneous conviction about certain true or facts.

According to the Criminal law- A mistake is a defensive tool against the criminal charges that are based on the ignorance of facts.

DEFINING "FRAUD"

The Association of CertifiedFraud Examiners describes fraud as "a misrepresentation or dishonesty made or individuals knowingly that such misrepresentation is made with an intention to create certain unauthorized benefits to the individual himself or the business entity or to the third party.

The Black's law Dictionary defines fraud as "a known misrepresentation of the true and the suppression of material facts to induce other to act to his or her disadvantage.

Accounting fraud can be interpreted as the misrepresentation or a modification in the records of accounts to get a favorable financial advantage and increase the net income and boost the sales figure of a business. This conceals any financial obstacles faced by the company.

Some of the more common reasons why people commit financial statement fraud include:

- To encourage investment through the sale of stock.
- To demonstrate increased earnings per share or partnership profit interests, thus allowing increased dividend and distribution payouts.
- To dispel negative market perceptions.
- To obtain financing, or to obtain more favorable terms on existing financing.
- To receive higher purchase prices for acquisitions.
- To demonstrate compliance with financing covenants.
- To meet company goals and objectives.
- To receive performance-related bonuses.

LITERATURE REVIEW

London & General Bank Case (1895): It was suggested that the job of an auditor is to determine and bring out the true financial position of a company at the time of conducting an audit. He should take reasonable care, a bit skillful in ascertaining the facts, making enquiries and investigations while examining the books of accounts. An auditor should remember that he is only presenting the financial position of the company and not playing a role of as an insurer or guarantor that the books do correctly show the records. He needs be honest and ethical while dealing with any company's financial accounting records.Hooks, Kaplan, and Schultz (1994) suggested that in order to deter fraud, an open communicative environment is required. A Whistle blowing practice is to be put in practice to prevent fraud and make an earlier detention in any case.Summers and Sweeney (1998) discussed that there are a number of financial characteristics in predicting fraud. In their research they stated that a company with fraudulent intention will show a higher level of inventory, increased sales and having higher return on assets in comparison with non-fraud companies.Charles Lundelius (September 2011) in his article on Detecting Financial fraud in the world of IFRS suggested that Financial reporting fraud involves modification of financial statements. This is practiced mostly by the top officials at the management resulting in fraud. these are the tools that managers obtain to make some gain.Wells (2011) sees fraud as different from error, which refers to "unintentional misstatement or omissions of amount or disclosures from an entity's accounting records or financial statements.

OBJECTIVES OF THE STUDY

1.To identify the reasons why fraud occurs in financial accounting.
2.To understand the role of an auditor and his responsibilities in Fraud detection.
3.To know the possibilities in elimination of fraud in financial accounting.

RESEARCH METHODOLOGY

The study is a type of documentary research based on the secondary data. The study is focused on collecting information from the existing literature. Many Books, encyclopedias, newspapers, journals, magazines, conference proceedings, and reports have been looked into to understand and prepare this study.

1.REASONS FOR OCCURRENCE OF FRAUD

The most widely accepted model developed by famous criminologist, Dr. Donald Cressey, in his research is fraud triangle. It is a model where people explain why they commit fraud in the first instance. He described such people as "Trust Violators".

The following are the reasons for the occurrence of fraud-

FRAUD TRIANGLE

1. Financial pressures: The individual has unshareable financial problem (may be it is personal or professional)-That he is unable to solve with his resources. So he is committing an illegal act. Ex: Drug addiction or gambling, or need to meet productivity targets at work etc.,
2. Opportunity: Many a times, people commit white collar crimes to maintain their social status. Ex: To acquire expensive cars or houses or to live a leisure life etc.,
3. Rationalization: They are the first time offenders with no criminal activities in the past.These offenders perceive themselves as honest and ordinary people who are trapped in a set of bad situations. Subsequently, these fraudsters must justify the crime to themselves in way that makes it asuitable or defensible act. It is known as accidental fraud.

FRAUD DIAMOND

Wolfe and Herman son offered the "Fraud Diamond" to the Fraud Triangle. It is the fourth side was added. The primary contribution of the fraud diamond is that the capabilities to commit fraud are explicitly and separately considered in the assessment of fraud risk. By doing so, it moves beyond viewing fraud opportunity largely in terms of environmental or situational factors, as has been the practice under current and previous auditing standards. Apart from financial pressure, opportunity and rationalization, a new aspect “Capability” was introduced. It states that in reality people will not commit a fraud even if all the three above mentioned elements are strongly present. For an offender to commit a fraud, it mostly depends on his personality trait, which is a deciding factor for him whether he will or not to go ahead with the fraudulent act.

Kranacherexplains in his “MICE” concept of motivation behind the fraud. According to him, ideology, ego, entitlement, coercion and the urge for money are the major and primary factors that are responsible for motivating an offender to commit fraud. Retaining the original fraud triangle, he speaks of another side called “Opportunity” and adds criminal mindset and arrogance as two new sides of the attached triangle.

2.THE ROLE OF AN AUDITOR

Any Chartered Accountant under the Chartered Accountants Act 1949 is eligible to become an Auditor. According to the Act, a person can be appointed as an auditor to examine the books of accounts of a company registered under the provisions of Companies Act and submit a report to the stakeholder and shareholders of a company. He is eligible to examine the annual reports,ie profit and Loss account statements, balance sheet or any other financial statements.

Auditors Role and Responsibilities:

Let us throw light on the recent and most noted multi- crore scam done by renowned IT Company in India where the chairman misrepresented the company’s balance sheet and brought the responsibility of the auditors under scrutiny.

The main purpose of an auditor in accounting is to analyse, review and verify a company's financial records, systems, controls and present an opinion about the company's financial statements. These help the company to understand the financial position of the company and its future operations.

Ethically an auditor should statically provide a clarity and effectiveness of the accounting policies and put that in clear framework. He should be like a watch dog rather a blood hound for money. He should only present the fact on the financial statements. Hisduty is not to advice the shareholders or directors of a company.

The duties of the financial auditors mostly depend on the terms and conditions of the Articles and the statutory provisions made. The following are duties of an auditor

1.They prepare reports for the members.
2.They certify the statutory report.
3.Their duty is to certify profit and loss account statements and the prospectus of the company.
4.They play an important role by assisting in the investigations of the company regarding finance.
5.They declaration the solvency of the members when the company is voluntary winding up.
6.An auditor should correspond in writing with the previous auditor.

3.ELIMINATION OF FRAUD IN FINANCIAL ACCOUNTING

Financial frauds are the vital challenges in the modern business environment. When the corporates engage themselves in such practices, they design to hide or maneuver the accounts. This demoralizes the quality, integrity, reliability and transparency of the financial reports and process endangering the objectivity and honesty of auditing profession. There is a need to possibly make incentives to eliminate fraud in the financial statements. The following measures can be looked into towards detecting or eliminating fraud-

1)Creating a right culture and adopting ethical manners:

It is the responsibility of the senior or top level management to create a culture in the business environment and let all its employees know that fraud in any manner will not be tolerated. They need to examine each and every financial record in the light of transparency, conduct themselves in an ethical manner, expecting the same from their employees and work in an ethical environment.

2)Encourage and Adopt effective whistleblower program:

It is rightly said "prevention is better than cure". Companies should adopt an effective whistleblower program in place. A proper practice should be adopted to uncover the fraud that may affect the financial report systems or records before it starts.

3)Eagle eye on frequent auditor changes.

The COSOTC (Committee of Sponsoring Organizations of the Tread way Commission) prepared an analysis of fraudulent financial reporting occurrences between 1998 and 2007 and found that 26% of the firms that experienced fraudulent reporting happened in either the year of the fraudulent reporting or in the year just prior to change of an auditor. It is better to avoid frequently changing the Auditor.

4)Careful about extraordinary or complex transactions.

Specifically questionson extraordinary transactions, either positive or negative, that offset results from operations. One significant gain that would offset a bad year of results may be used to improve the bottom line.

5)Frequent check on accounts receivable.

Revenue manipulation, a common form of financial fraud, will often affect receivable balances. Investigation of outlier activity in receivables, basis for uncollectible accounts, and receivable data in comparison to industry standards can help identify potential financial reporting problems.

6)Careful about swings in assets or liabilities.

Manipulation of revenues or expenses will often involve unexplained swings in assets and liability balances. There should always be a logical explanation for significant changes in balance sheet.

CONCLUSION:

The term Fraud in financial statements is evident from the age old period. The ancient and the most well-known economist and minister in the dynasty of King Chandra Gupta, Shri Koutilya or Chanakyareferred about fraud in his book 'Ardha Sastra". His stated that a change is required in an individual's attitude in order to eliminate fraud from the organization and the society. Financial statement fraud weakens the confidence of the market participants and capital markets, in the consistency of financial information and as a consequence makes the capital markets less efficient. In the bigger picture it undesirably affects the nation's economic growth and prosperity, resulting in destroys the career of individuals involved in financial statement fraud and incurs huge litigation costs. Subsequently it results in economic losses and bankruptcy and a company engages itself in financial statement fraud. Hence It is important to make honest efforts by the individuals involved in preparing financial statement to be transparent and practice ethics. Hence these preventive measures will help in elimination of Fraud.

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