

Improving Stakeholder Management through Detection of Accounting Frauds

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ABSTRACT

Stakeholder management is a key to continuous survival of companies. The welfare of various stakeholders like shareholders, creditors, bankers, employees and so on, is linked to the financial well- being of the organization. Financial well- being can more often than not, be threatened by occurrence of accounting frauds

Accounting Fraud examination is fast emerging as a profession all over the world. This research paper proposes to undertake an exploratory research into the theoretical framework for accounting fraud examination and provide insights into a couple of accounting frauds in India and abroad. Both primary as well as secondary data will be used to support incidents cited in this research paper.

The paper would offer its conclusions based on certain broad observations learnt from examining accounting frauds.

1. Introduction

Stakeholder management is a key to continuous survival of companies. The welfare of various stakeholders like shareholders, creditors, bankers, employees and so on, is linked to the financial well- being of the organization.

Financial well- being can more often than not, be threatened by occurrence of accounting frauds. Accounting Fraud examination is fast emerging as a profession all over the world. This research paper is aimed at highlighting the use Accounting Fraud examination as a tool to improved stakeholder management.

1.1. Accounting Frauds

Accounting frauds can be described as the use of clandestine methods of siphoning away funds of the organization through seemingly correct accounting practices.

The example of Sathyam Infotech can be cited to explain the statement given above. While the company purported to discharge its salary obligation to its employees, a considerable sum of money was purloined away in name of salaries paid to ghost employees.

2. Objectives of the Study

- I. To understand how accounting frauds are classified
- II. To take a preliminary search on quantum of accounting frauds that have occurred across the world based on Published information.
- III. To describe two cases of accounting frauds and record findings on causative weaknesses in the accounting policies.

3. Research Methodology

The researcher proposes to review the conceptual framework of accounting fraud detection and correlate a few

real incidents of accounting frauds into the same for better understanding of the concept and application of accounting fraud examination. The researcher proposes to use both primary as well secondary sources of data in the attempt to explain the concept in question.

4. Review of literature

The researcher undertook a study two basic resource materials namely:

1. Report to the Nations- 2018 issued by Association of Certified Fraud Examiners
2. "Fraud" – The monthly Magazine released by ACFE which gives periodical inputs on accounting frauds that are reported all over the world

The occurrence of the accounting frauds termed as Occupational frauds and the Fraud tree that are presented in the foregoing paragraphs are sourced from the resources stated above.

5. Limitations of the Study

The study is limited by the factor of secrecy of information which prevents companies from sharing exact information which in turn limits the availability of Empirical data.

6. Occurrence of Accounting Frauds

Accounting frauds arising out of occupational advantage are broadly classified into the following categories:

- **Asset Misappropriation**
- **Corruption**
- **Financial statement Fraud**

The 2018 report tabled by the Association of Certified Fraud examiners captioned as report to the nations reports the following figures:

Table 1. Categories of Occupational Frauds & Median Loss Values

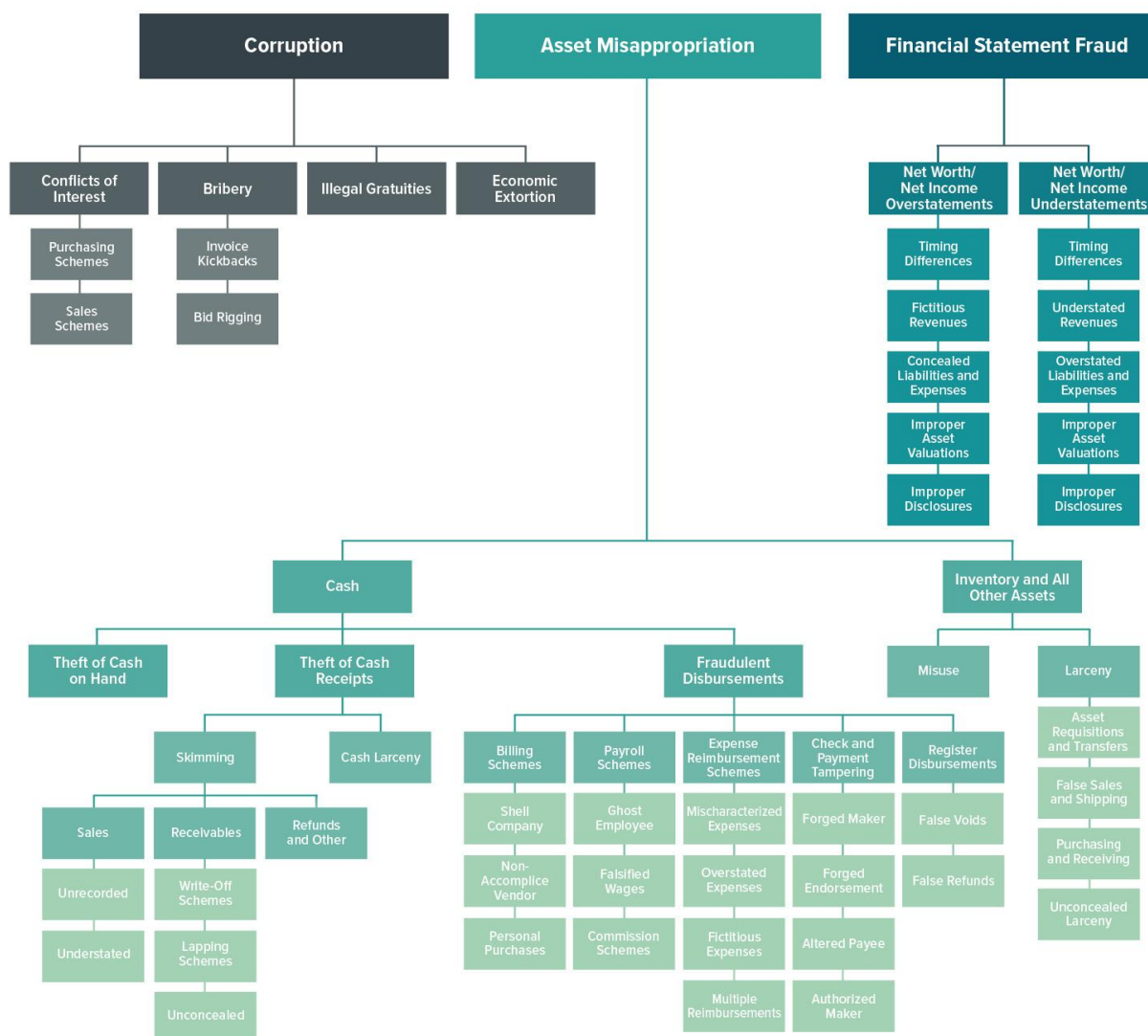
Category of occupational fraud	Median loss value in US \$	Percentage of cases
Asset Misappropriation	\$114000	89%
Corruption	\$250000	38%
Financial statement fraud	\$800000	10%

Adapted from 2018 Report to the nations from ACFE

7. The Fraud Tree

The diagram given below represents the various ways in which accounting frauds can occur under the various categories:

FIG. 4 Occupational Fraud and Abuse Classification System (the Fraud Tree)



Source: Report to the Nations- 2018 by ACFE

It must be realized that starting point of accounting fraud prevention is to recognize the methods of fraud occurrence. A recognition of frauds helps in identifying the susceptibility of one's accounting system to losses on account of embezzlement which in turn would help one to design accounting firewalls.

8. Understanding Accounting Frauds through Case Studies

While the need to prevent accounting frauds is well understood, prevention is achieved best by understanding the knowhow and do how of accounting frauds.

The researcher proposes to use the case study tool to understand about accounting frauds. The case that is described in the foregoing paragraphs is from the personal experience of the researcher who was part of the Fraud Detection team in an organization (names changed).

The Gift Scheme Fraud:

SXL was a Joint venture company which was engaged in the manufacture of home appliances. It had a network of over 400 dealers. Mumbai represented its biggest network of dealers comprising about 25% of its total dealer network.

There was a branch head and three sales executive, an accounts officer and a service engineer who manned the branch operations.

The sales officers' uses to collect checks from the dealers and the accounts officer used to deposit the checks in a collection account (one way accounts receiving deposits but no local payments). The collections used to be credited by a branch transfer to the cash credit account of the company operated from Chennai

There was a separate current account for the branch into which the branch imprest cash would be funded by the HO. The account was operated at two levels viz. 1. Up to Rs.10000 by the upon the Joint Signatures of Accounts officer/Service Engineer 2. Beyond Rs. 10000 jointly signed by the Branch Head and the Accounts Officer.

The Company in order to speed up the sales Collection process entered into a banking arrangement with a leading private international bank to discount the checks on deposit and credit the proceeds to the Central Cash Credit account through the Collection account.

It was here that things started going wrong for the company. The Accounts Officer would pick up some random individual checks (received on bill-to-bill basis) and present them as a second lot of checks to the banker for discounting. The discounted payment received as check form the discounting banker would be deposited not in the collection account but in the current account. The realized amount would then be withdrawn from the current account in smaller sums (within the drawing power of the AO/SE)

It was at the instance of the Senior Accounts Manager at the central office the fraud was finally discovered after one year, who detected the fraud by connecting two factors namely that the bank statement of the current account was never sent with the periodical reports and also by looking at the consistent outstanding of old dues from various dealers while new sales dues were regularly collected.

He took forward the initiative of writing to the partner bank directly asking for a statement of account of checks discounted and paid. The statement showed that over 1 year as much as Rs. 75 lakhs had been discounted and not accounted for. A visit to the company's banker in Mumbai proved that all these Gift checks were deposited into the current account and withdrawn.

The company lodged a formal inquiry process and threatened arrest of the Accounts Officer and the service engineer who fearing arrest and disgrace for the families surrendered as much Rs.50 lakhs. However the company had to write of a loss of about Rs.25 lakhs which could not be recovered from the miscreants. The branch manager who was oblivious to the whole fraud was sacked for poor supervision.

Analysis of the Fraud:

The following points would highlight the accounting failures in the system:

1. An appropriate accounting system of confirmation of closing balances was not kept in place and the central accounting system had placed an over-reliance on the branch accounting system.
2. The same failure was highlighted in another dimension of the scam wherein the central accounts team had applied to the partner banker for information only as an exception and not as a matter of course.
3. Periodic reconciliation of accounts was not done during the year but left for year-end auditing process.
4. Lack of realization, that embezzlement of funds from the bank account is not necessarily linked to financial limits of check signing powers

To sum up the accounting system of the company was a reactive system capable of only receiving financial information and accounting the same. It had not provided for itself, given the wide sprawl and spread of its business operations, a proactive capability to detect accounting frauds

9. Consequences to the Stakeholders

The after effects of an accounting fraud cannot be overstated. An embezzlement leads to loss of funds which would have to be discharged in favor of either the external or internal liability-holders.

It is to be remembered that shareholder value management happens not merely from profit and wealth maximization but also from efficient collection and management of funds.

10. Conclusion

Intensive Training on recognizing possibilities of accounting frauds and implementing a robust, pro-active accounting system are the only possible ways of reducing and eliminating accounting frauds

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References

1. Report to the nations – 2018 Global study On Occupational Fraud and Abuse