

Detection Techniques of Fraud in Accounting

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Abstract

The problem relating with the accounting fraud is that it has not stopped despite the numerous changes that have been made in legislation and strict controls by the internal and external auditors. Therefore, the aim of this paper is to assess strategies and techniques available to use for accounting fraud detection. Also, this paper aims to assess the impact of fraud, and the role of auditors and the media in combating this phenomenon. This research will be carried out using secondary data because it fits better the aim and purpose of the research. Data used derived from a range of sources that have a very high degree of credibility and reliability, and which have been carefully reviewed by other relevant bodies for accuracy and quality purposes. This includes databases and various publications. In addition, the data also stem from individual and group publications made by renowned scientific researchers who have solid expertise in their field of accounting. Narrative analysis is used to analyze the data in this paper. This research will conclude that techniques used for the detection of fraud in accounting and various strategies can positively influence the treatment of this phenomenon due to the alarm buzzer for possible fraud. However, vigilance is necessarily required to add all parties involved in the corporation through the use of different anti-fraud programs to stimulate the accountability of the management executives and employees through informants to fight this destructive phenomenon.

Keywords: fraud, technique, auditors, scandals, control, financial statements, auditing

1.0 Introduction

Because the financial statements are the basis for measuring the performance of a company, accounting fraud not only damages the confidence of investors, but also harms all management analyzes in regards to business performance.

Fraudulent activities in connection with the preparation and disclosure of corporate financial statements have received a significant amount of attention in the aftermath of the Enron scandal in the US. This scandal has left unimaginable consequences in the financial world and has had significant influence on the policies of oversight to avoid potential scams that may hit the market occasionally.

Financial statements fraud, however, are not isolated only in the corporate sector. Such can be found within the entrepreneurial subjects in all sectors of the economy, including line ministries and non-governmental organizations or non-profit.

Although there are some companies that investors consider to be very safe, trust in them has been shaken from a large number of financial frauds in US corporations. Large investment banks and independent public accountants have also been involved in these frauds. To ensure the business of the companies in question, investment banks have presented false tips to the public. Scams are also associated with increased earnings consulting services, which has led to increased conflicts of interest between the role of audit and advisory role

The problem in connection with the accounting fraud is that it does not stop despite the numerous changes that have been made in legislation and strict controls by the internal auditors and external. Therefore, the aim of this paper is to address strategies and techniques available to use for detecting accounting fraud. Also, this paper aims to assess the impact of fraud, and the role of auditors and the media in combating this phenomenon.

2.0 Literature Review

2.1 What is meant by fraud in the financial statements?

The American Institute of Certified Public Accountants (AICPA) defines fraud as an intentional act that results in an incorrect material statement to the financial statements. AICPA definition considers two categories of erroneous statements in financial statements (AICPA Auditing Standards Board, 2002). These include abnormalities arising from fraudulent financial reporting such as falsification of accounting records and false statements resulting from misappropriation of assets as asset theft or fraudulent expenses.

Definitions of financial statement fraud tend to be closed in the latter. The essence of these financial statements defines fraud as a deliberate attempt to mislead or misguide a person or a group of non-distort or give the amounts and disclosures in the financial statements (Rezaee, 2002).

Schemes commonly associated with fraud in the financial statement are as follows:

- Forgery, alteration, or manipulation of financial records, supporting documents, or business transactions.
- Deliberate material omission or misrepresentation of events, transactions, accounts or other important information from which financial statements are prepared.
- Intentional misuse of accounting principles, policies and procedures used to measure, recognize, report, and detect economic events and business transactions.

2.2 Causes of Financial statements fraud

Financial statements fraud reported recently and the fall in the stock market have shown the importance of the quality of financial reporting and auditing, as well as the meaning of what may have caused the occurrence of accounting scandals. The collapse of high profile companies like Enron and WorldCom, has left doubts on the effectiveness of corporate governance, financial reporting quality, and reliability of audit functions.

These alleged fraud financial statements have raised serious concerns about the effectiveness of corporate governance; integrity and ethical behavior of top executives, especially the Chief Executive and Financial Managers when they are being sued for 'cooking the books"; adequacy and effectiveness of internal controls; reliability of financial reports; quality audits; and authenticity of the stock markets.

Many factors have contributed to the latest scams. These factors are (1) lack of vigilant oversight functions (board of directors, audit committee); (2) management arrogant and greedy; (3) improper business conducted by senior executives; (4) ineffective audit functions; (5) soft regulations; (6) inadequate financial disclosures and less transparent; and (7) shareholders inattentive (Rezaee, 2005).

2.3 Cost and impact of fraud in the financial statements for businesses

The recent wave of corporate financial scandals has raised significant concerns about the effectiveness of corporate governance not only in the US but in all countries of the world. Usually there is a view that financial scandals and symptoms result from massive deficiencies in corporate governance. This view has made major changes, including the Sarbanes-Oxley Act, the new rules Securities Exchange Commission (SEC), and governance requirements adopted by stock exchanges such as NYSE and NASDAQ (Fich and Shivdasani, 2007).

Fraud in the financial statements continues to seriously affect economies in all countries of the world including developed countries and developing ones. Despite increased supervision, changes of laws, increased attention to the issue in question, fraud have not stopped. Damages from fraud in the financial statements account that damage the budget of United States of America (US) each year for an amount of \$ 572 billion. Therefore, fraud has become a popular area of investigation among accounting academics because of the size of losses.

Besides the direct impact on cheated corporations, financial statements fraud adversely affects the employees, shareholders and creditors. Fraud in the financial statements has broader negative indirect effects at the market participants ranging from undermining the reliability of corporate financial statements and confidence in financial markets, and resulting in higher premium risk and less efficient capital markets. Also, financial fraud leads to substantial valuation losses for investors for companies involved in scandals.

The research about the history of fraud and discovery is important because it adds to the understanding of fraud, which has the potential to improve the auditors and regulators to detect fraud directly or serve as a basis for future research fraud. Enhanced fraud detection can help deceived businesses, and their employees, shareholders and creditors to restrain costs associated with fraud. It can also help to improve market efficiency (Perols and Lougee, 2011).

2.4 Press as a watchdog for accounting fraud

Many experts in the field of accounting and academics stress the important role of the press in early identification of fraud in accounting. In this regard, the press functions as an invisible hand to monitor preventing fraud alignment and size. Accordingly, signals the relevant authorities and stakeholders to handle cases properly. Press role in terms of monitoring function for the accounting fraud is investigated by Miller (2006). In this study, the author finds that the press fulfills this role by retransmitting information from other information intermediaries such as analysts, auditors and those that have been sued taking the original investigation and analysis. Articles based on original analysis provide new information on markets and rebroadcast those allegations by other agencies do not. In accordance with the dual role of the press, the author finds that the press-oriented business is more likely to take the original analysis, while non-business magazines concentrate mainly on retransmission. Furthermore, the author infers that the press covers firms and scandals that will be of interest to a wide group of readers and situations that are lower cost to identify and investigate.

2.5 The Role of Internal Auditor

Internal auditors may not be useful for all types of businesses. This is a very professional work area and the skills of an internal auditor may not be suitable for all types of business organizations. Appropriate selection in the auditor position is a must for better results (Agarwal and Medury, 2014).

Many researchers have worked on the role of the internal auditor to detect and prevent accounting fraud. It also been noted that investors are expecting more from auditors to detect and prevent accounting fraud, but there are many gap between investor expectations and actual performance by the auditors (Epstein and Geiger, 1994).

Therefore, to avoid this issue, the study conducted by Agarwal and Medury (2014) discusses the effectiveness of the internal auditor to contain, to discover and prevent accounting fraud and so to combat this plague in the corporate sector. Therefore, they have come to the conclusion with the concept of the appointment of internal auditors by external actors to strengthen its independence and therefore its effectiveness to detect and prevent fraud in accounting.

3.0 Methodology

This research has been conducted using secondary data because it best suits the nature and purpose of the research. Data for this research derived from a range of sources that have a very high degree of credibility and reliability, and which have been carefully reviewed by other relevant bodies to carry out supervision of accuracy and quality purposes. This includes databases and various publications. In addition, the data also stem from individual and group publications made by renowned scientific researchers who have solid expertise in their field of research. Narrative analysis is used to analyze

the data in this paper.

4.0 Analysis

4.1 Fraud prevention and strategies for their detection

Accounting fraud has not stopped regardless the implementation of new regulations after the recent scandals in American corporations. Commission of fraud in the financial statements of corporations in the US high profile companies whose shares are publicly traded to take proactive roles by building strategies for the prevention and detection of fraud in the financial statements. According Rezaee (2005), some of the strategies that can be used are listed below

4.1.1 Review of the weakness of fraud

Reviews of fraud weakness should be conducted periodically and consistently. Corporations should consider the implementation of the deliberations of the weakness of fraud and fraud hotlines that can be used by the internals such as workers and auditors and outsiders including customers or suppliers to report fraudulent activities. Furthermore, corporations need to build adequate policies informants. After the Enron and WorldCom scandals, many other corporations in America like Coca Cola and Kodak have created offices for confidential reporting to informants including workers to hear about the affairs of accounting fraud charges.

4.1.2 Good and vigilant corporate governance

Corporate governance should have well-defined roles and accountability to all stakeholders for management and financial performance, including the board of directors, audit committee, management's top, internal auditors and external. While the primary focus in the past to stop fraud in the financial statements has been to the external auditors, nowadays to prevent any possible fraud all leading corporate bodies should be involved in this process conform to the roles and responsibilities that always have in long-term interest of shareholders.

4.1.3 Vigilant audit committees

Future audit committees necessarily are expected to be guardians of the interests of their investors. Recent scandals alert big corporate challenge to improve the supervisory functions and practices of their audit committees. These challenges will provide opportunities to improve corporate governance and financial reporting quality always in the best interest of investors and the financial community. The entire body of the audit committees must be independent enough financially to make difficult questions and in an effective way to oversee internal controls of businesses, the process of financial reporting, and audit functions.

4.1.4 Programs for fraud prevention

Corporations should work to design programs to prevent financial statement fraud, set up policies and procedures appropriate for the oversight of all financial chain involved in corporations, to communicate policies and procedures for all staff fraud, enforce policy compliance in practice and periodically independently monitor their impact on the prevention and detection of fraud in the financial statements. The programs in question should apply legal accountants, researchers, internal auditors, lawyers. Furthermore, it is essential to clarify that these programs will apply indiscriminately to all workers of lower level to those in the highest levels of of management chain (Rezaee, 2005).

4.2 Fraud detection techniques

Using various techniques for detecting accounting fraud is a very important process to avoid timely financial statements irregularities and to stop potential scandals by various manipulators involved in this process. According to Zhao and Kapoor (2011), until today it is estimated that in most cases the methods that are used most frequently are: regression, decision tree, neural networks, the networks' Bayesian " and supported vector machines.

1. Regression

Regression methods for the detection of fraud is estimated to be the most used method so far. Transformations of variables in regression models were also studied in the context of fraud detection. A study that was done in Greece from data of 76 companies, half of which have been involved in the fraud affair, while the other half was not. In this study were used 10 financial variables and multi-variable logistic regression to identify relationships among the factors associated with financial statement fraud. The total of ten financial reports net profit to total assets, the ratio of total debt to total assets, financial concern, the ratio of inventories and sales, and the ratio of working capital and total assets are used for examination of possible forecasts financial fraud. Results show that companies with high inventories in relation to sales, high debt to total assets, lower net profit to total assets, lower working capital to total assets and high financial stress are more likely to manipulate financial statements.

2. Decision Tree

The objective of decision trees is the classification that separates observations into groups and multiple mutually exclusive choosing correctly attributes to share best sample. This method is used to predict the hidden problems in the financial statements considering the following six variables: Quick assets to current liabilities, the market value of equity to total assets, total liabilities to total assets, and interest payments to income before interest.

3. Neural Network

Neural networks are another technique used successfully to detect financial fraud. This technique assumes no independence of an attribute and is able to process data related and is a suitable alternative for problems where some assumptions regarding the regression are not valid.

4. Bayesian networks

Bayesian networks method usually are used to describe the statistics of a particular user and statistics of different scenarios of fraud. Bayesian networks can be used to prove the probability of fraud by considering the behavior of the users of financial statements.

5. Supported Vector Machines (SVM)

SVM builds a linear model to assess a decision function using class boundaries based non-linear support vector. Also, SVM is based on the structural principle of minimizing the risk, which means that this type of classifier minimizes the peak of the current risk while the other minimizes classifier empirical risk. Using this technique can help internal auditors and external who must allocate limited resources audit to make appropriate decisions during the fraud warnings. Its application extends to taxes, banking, creditors, regulators and agencies (Pai et al., 2011).

The techniques mentioned above have proven to be effective in detecting fraud in the financial statements. However, they are not without limitations. While these techniques have been developed for predictive modeling fraud discoveries in the financial statements, they are not developed enough in terms of the impact assessment of possible fraud.

5.0 Conclusion

Accounting fraud pose a critical issue in the protection of the global financial market. Overall frauds are related to the review of accounting records, falsification of transactions, and the misuse of accounting principles. Also, frauds have a devastating effect on the economy in general, to the shareholders of the company and to the employees.

Recent scandals of fraud that have affected various corporations in the US have led to a review of the rules and directives of stricter financial supervision in terms of reporting and financial statements and the opening of information to interested parties. However, these changes have not managed to stop and destroy this phenomenon.

The techniques used for the detection of fraud in accounting and various strategies can positively influence the treatment of this phenomenon due to the alarm buzzer for possible fraud. However, vigilance is necessarily required to add all parties involved in the corporation through the use of different anti-fraud programs to stimulate the accountability of the management executives and employees through informants to fight this destructive phenomenon.

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