A TREAD INTO FORENSIC ACCOUNTING

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ABSTRACT

As the world progresses, business opportunities advance with the number of experienced and qualified entrepreneurs being on the rise. Despite there being highly educated and trusted people in several organizations, it is needless to say that there have been reported cases of fraud and malpractice. Strange and conflicting as it sounds, finding the truth often uncovers the unexpected. Looking at the bigger picture, this paper lists the types of misconduct that might be caused by system and regulatory weaknesses that are not robust, are unsafe, and can be infringed upon by potential players without being easily detected. These misconducts, once discovered, will have an adverse impact on the cycles of assignment, process, and documentation, including the quality of work and overall achievement of the objectives of an organization. 'Forensic Accounting' tracks and reviews records that have been reported, while at the same time seeks significant information from the records presented. Any doubtful information means a 'red flag' on financial irregularities and ethical violations of system by the perpetrator or fraudster. This paper presents some brief insights into challenges of an organization in terms of exposure to related risks, types of misconduct, brief review of literature, fraud models, red flags, as well as forensic accounting, and a recommendation for integrated forensic accounting framework.

Keywords: Forensic accounting, misconducts, risks, red flags, fraud models

INTRODUCTION

One of the challenges in any organization is mismanagement and misstatement causing distress and deterioration of the business. This may also mean misconduct and is defined as an implausible and planned behavior, inconsistent with the role that should be followed by the intention (Le, Shan, Chan, & Hu, 2014; Rabl & Kühlmann, 2008). Misconduct associated with self-esteem and mismanagement may lead to illegal behavior such as fraud, closure of illegal activities, and denying customer trust (DeFlaminis, Bryant, Cook, & Kirschbaum, 2014). Fraud and mistrust have been recognized as a global issue that can adversely affect the economy of a nation. Therefore, to keep a check and balance on such mismanagement, accounting evolved and extended its scope to include forensic accounting and forensic accountants' role. According to Jugurnath, Bissessur, Ramjattan, Soondrum & Seedoyal (2017), forensic accountants make valuable additions to corporate governance by creating a conducive working environment leading to fraud prevention, investigation of dubious cases and effective communication.

Forensic accounting gained its popularity in the late 1990s following the accounting and auditing scandal at Enron and WorldCom, and the subsequent downfall of Arthur Andersen (McMullen and Sanchez, 2010). These internal cases are widely recognized as the starting point of modern-day fraud and misconduct. Both cases received wide coverage in the global media, thus prompting a section of the Sarbanes-Oxley Act that added to a growing attention of financial fraud. According to Seda and Kramer (2014) the demand for forensic accountants in United States will increase in the future.

Similar corporate fraud cases were also reported in Malaysia in recent years. For example, Malaysian Airlines in the 1990's and 1MDB in 2000's[1]. According to Anwar (2008), companies were mostly direct victims of fraud and misconduct by management. In a subsequent study, Raziah, Roudaki, Clark and Norhayati (2010) noted that the number of reported cases of economic crime committed by company employees in Malaysia is higher than that reported for the Asia-Pacific region and for other countries around the world.

A review of the literature suggest that forensic accounting investigation largely focus on investigating elements of self-interest misconduct, fraud, and malpractice found in accounting practices. Drawing from this literature, various types of misconduct are summarized in Table 1.

[1] https://en.wikipedia.org/wiki/List_of_scandals_in_Malaysia

Table 1: Types of misconduct

Type	Brief Description
Patronage	Support, encouragement, and privileges or financial assistance provided from an organization or individual to another.
Nepotism	Favours to someone based on family relationships
Bribery	Giving money or rewards to change the recipient's actions.
Ghosting	A disguised entity for purposes of fraud and misappropriation
Kickbacks	In the case of buyers and sellers, a percentage or rebate is given or taken for or from someone in charge in the transaction to influence the buyer.
Front company	A company is established to protect a company from liabilities (debt). Subsidiary or shell company to parent company
Embezzlement	The dishonest reaction holds assets from a trusted person, for the purpose of changing / transferring those assets to one or more individuals.
Bid rigging	Tender collusion, where competitors compete together to obtain a commercial contract to a selected contractor only.
Collusion	An agreement between bidders limits open competition.
Fraud	A deliberate act is done to gain unlawful profits
Price fixing	Equal to bid fraud. Competitors conspire to set prices against competing in open markets.

(Source: Brown & Loosemore, 2015; Transparency International, 2005)

LITERATURE REVIEW

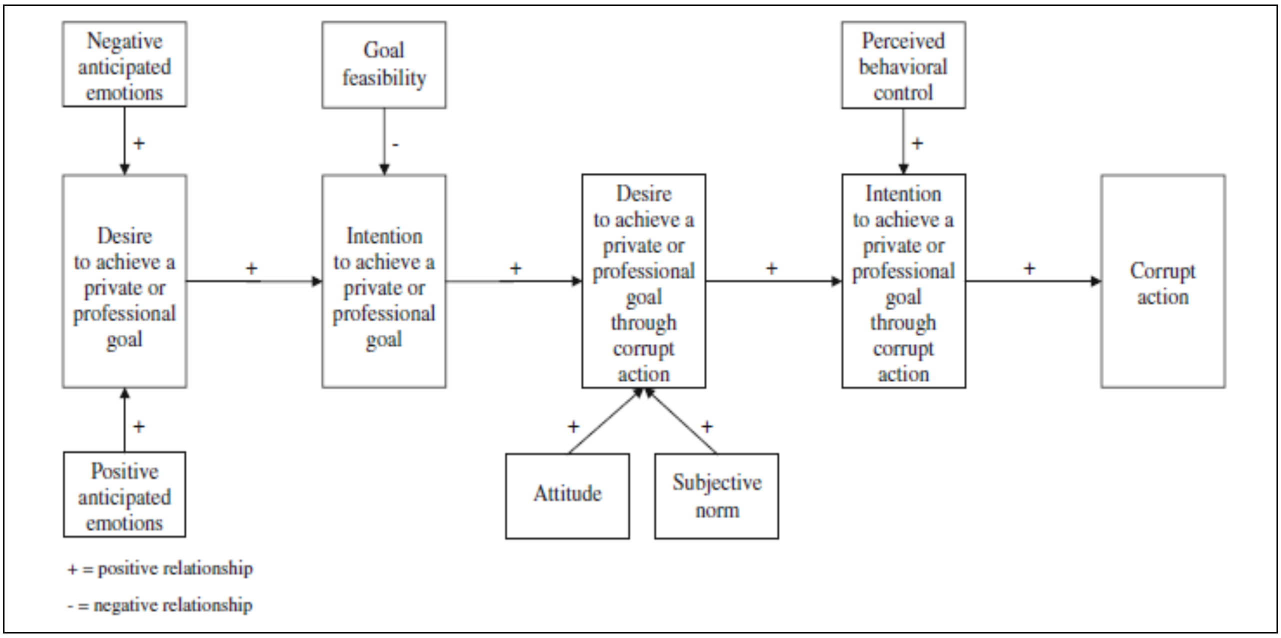
This section provides a brief review of selected literature from recent years, where several studies have been conducted in order to assess the potential causes and impacts of certain fraud cases. In general, cases of misappropriation may put an industry in jeopardy. Recent studies conducted on developing countries include Shan, Chan, Le, Xia, & Hu (2015), Le et al. (2014), Mohamed Nor Azman, Dzulkalnine, Hamid, & Bing (2014), Buys & Roux (2013), Mohd-Nordin, Takim & Nawawi (2013), and Callistus, Felix, Ernest, Stephen, & Andrew (2011).

Human behavioral factors play a significant role in determining whether a person is doing something and whether they are doing the job properly and according to the rules, or vice versa. Models for fraudulent behavior and abstraction from past studies (Dorminey, Fleming, Kranacher, & Riley, 2012; Rabl & Kühlmann, 2008; Cressey, 1950), such as the 'Fraud Triangle' model, have been used to explain why the parties may engage in fraud and misconduct.

In an effort to find the sources of these fraudulent cases, Rabl and Kühlmann (2008) argued that the motive of a person engaging in this negative behavior is based on motivational, emotional, and cognitive aspects. They use the 'Causal Model of Corrupt Action' as in Figure 1. They relate the desires and intentions of inducing individuals to meet their own needs and goals. Due to industry characteristics involving several phases, potential exposure to fraudulent activities may occur due to someone's own instinctive reaction, behavior, and attitudes (Otusanya, 2011; Stansbury, 2005). Research by Mohd-Nordin et al., (2013) used the study by Rabl and Kühlmann (2008) to examine the industrial environment in Malaysia.

In line with the literature, the dimensions that can lead to deviant behavior are culminated into a causal model as shown in Figure 1. Among the factors that cause fraudulent acts are the desire, intentions, attitudes, and negative behaviors.

Figure 1: A causal model of corrupt action

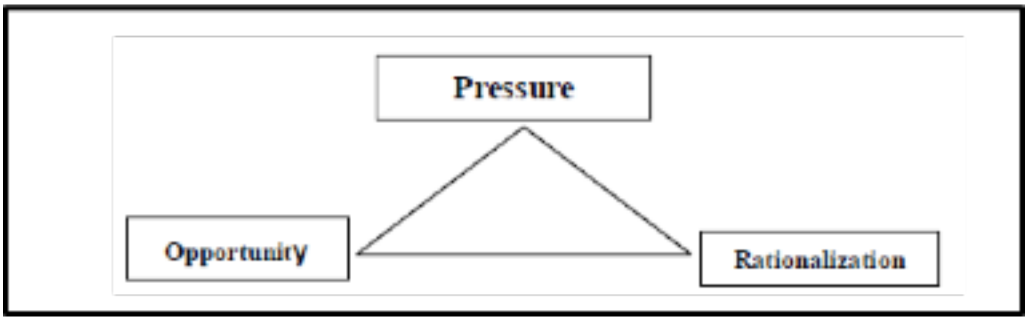


(Source: Rabl & Kühlmann, 2008)

As in Figure 1, Rabl and Kulmann (2008) argue that the contributing factors to fraudulent acts are based on desire and intention. The figure also indicated that the desire to achieve a private or professional goal depends on the positive and negative emotions, and this in turn is transformed into intentions to achieve the goal. The intentions to achieve a goal largely depends on perceived behaviour control (PBC). PBC is assumed to reflect past experiences and anticipated impediments as well as obstacle. Hence, the stronger an individual's intention to perform the particular behaviour, the greater will be the outcomes of PBC. Although the factors indicated are expected to relate to fraud behavior, individual emotions and mental status nevertheless seemed to be within one's control and action (Brown & Loosemore, 2015; Buys & Roux, 2013; Mohd-Nordin et al., 2013).

Inter-relationships of causality can be further refined using the 'Fraud' model as mentioned previously.The Fraud Triangle originally developed by Cressey (1950) and revised by Kassem and Higson (2012) identified three factors (incentive, pressure, and rationalization) that causes an individual to commit fraud. Repeated financial issues that lead to violations of laws and regulations can affect these three fraudulent motives. It happens with the intent to take advantage of possible positions and beliefs of individuals involved in the organization.

Figure 2: Fraud triangle



(Source: Kassem & Higson, 2012)

Figure 1 suggests that the motive to commit fraud may be driven by the pressures influencing the individual, by rationalization, or by sheer opportunity (Vona, 2008). In the era of circulation, many researchers believe that behavior that an individual does not intend may be influenced by other factors that are vastly more significant than what is shown in Figure 2. Other models are given and as shown in Table 2.

In the context of an industry, Abdul-Rahman, Wang & Mohamad (2015) contends that the challenging and complex environment in the industry exposes the parties to high-risk activities. This is consistent with the argument by DeFlaminis et al. (2014). He points out that due to its own industry characteristics involving 'free-flowing money' and unlimited transactions compared to other industries; it has created potential risks to companies in which the perpetrator may take the opportunity to implement their fraudulent behavior.

FRAUD MODEL

With strong laws, controls and mechanisms as well as stringent rules under management's responsibility and care, it is frustrating that cases of global financial collapse and collapse of businesses are happening among large and respected organizations in the world such as Enron, Satyam, Bernie Mandoff Scandal, Worldcom and others. These cases are often used today as lessons so that history will not repeat in other existing organizations. Table 2 provides some insights into fraud models, according to the references indicated.

Table 2: Fraud models

Model	References	Brief description
Triangle of Fraud Action	Albrecht, Turnbull, Zhang, & Skousen, (2010) and Albrecht, Albrecht, & Albrecht (2006)	Three elements for fraudulent action: (1) Act (Act) - the implementation and the manner of fraud such as malpractice, "check kiting", or misstatement and material financial reporting. (2) Concealment - hiding fraudulent acts, including falsifying journal records, falsifying bank statement adjustments, or destroying evidence and related files. (3) Conversion - the process of converting unprofitable / profitable profits into something that can be used by fraudsters as if it were lawful and halal including money laundering, cars and home assets.
Fraud Diamond Model	Wolfe and Hermanson (2004)	Four features that can be observed in committing fraud: (1) Position of having authority and function within the organization (2) Capacity to understand and exploit accounting systems and internal control weaknesses. (3) Individual beliefs will not be detected and if caught can be easily overcome. (4) The ability to tackle the pressure by doing evil actions.
MICE	Dorminey, Fleming, Kranacher and Riley (2012) and Ramamoorti (2008)	Four factors that motivate offenders or fraudsters: (1) Money - money stolen or involved in fraudulent action to meet their own goals (2) Ideology - justifying their fraudulent action by claiming something is not wrong, and/or is even consistent with their responses and beliefs. (3) Coercion - occurs when individuals are directly and/or indirectly attracted to fraudulent schemes, but these individuals may be whistleblowers and witnesses. (4) Ego - Individuals who do not want to lose their rank, reputation and status in the presence of their community and family members.

RED FLAGS AND FORENSIC ACCOUNTING

Red flags for the most commonly reported financial statements are sales growth and unpredictable profit growth, undisclosed accounting records, internal control problems, and personal issues of organizational leadership, as well as risk management behaviors. Agarwal and Cooper (2017) studied the effects of accounting fraud cases to senior officials of an organisation including the financial officers and external auditors.

For the purpose of scrutinizing accounting and financial reporting data, among the methods that can be used in forensic accounting are as follows:

i. Analyze net consumer value between net income and expenditure (net worth analysis)
ii. Ratio analysis of either vertical or horizontal format
iii. Trend analysis
iv. Direct and non-direct method
v. Money laundering and withdrawal methods from bank accounts
vi. Net worth analysis

In summary, an integrated and robust framework titled 'Integrated Forensic Accounting Framework' is proposed, as given in Figure 3. This framework comprises of important elements that will support forensic accounting. There are basically three layers:

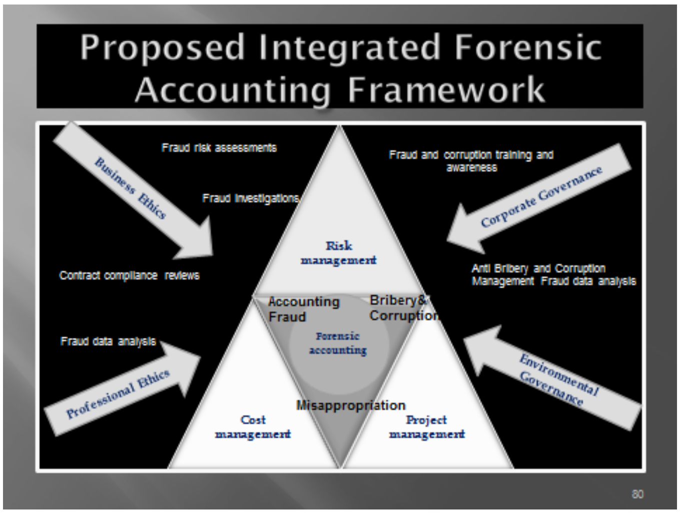
i. The first layer involves Risk Management, Cost Management and Project Management.
ii. The second layer includes factors such as business ethics, professional ethics, corporate ethics, corporate governance, and environmental management.
iii. The third layer is the forensic accounting environment and application involving a robust and effective solution to any misconduct.

CONCLUSION

Overall, based on past literature as indicated above and the framework suggested as indicated by Figure 3, it can be seen that forensic accounting may help eradicate the outcome of misconduct, along with the fraud models as given. The integrated forensic accounting framework encapsulates the necessities for both forensic accounting and fraud model to function in the real world. The proposed framework, however, needs to be tested to ensure that it can detect any and all possible violations of the codes, standards and rules. Thus, the proposed framework forms part of a potential area for future research. The findings from future research can significantly contribute to knowledge and also provide significant input to policy makers.

It is hoped that this paper contributes to initial knowledge in the field of forensic accounting, perhaps as an eye opener for the importance of forensic accounting in order to analyze malpractice and mismanagement, with an emphasis on examining accounting data and identifying red flags. This paper is however limited to selected literature to provide a brief fundamental route for a momentary understanding of forensic accounting with a sense of approaching a fraud model as a mechanism to address fraud cases. Readers are advised to study existing cases and more literature in order to obtain better understanding.

Figure 3: Integrated forensic accounting framework proposal



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