FINANCIAL STATEMENT FRAUDS IN AN ORGANISATION: PROBLEMS AND SOLUTIONS

BRUNDA CHAVAN[1] **ARCHANA GANESH[2]** **CHANDRASHEKAR RK[3]**
B.Com F&A, Department of Professional Studies, Christ University, Karnataka, India

ANKITA AGARWAL[4]
Financial Analyst, Northern Trust

ABSTRACT

The recent business environment has pushed the top management of many organization into paying attention to, how to make financial statements of their organisation look better in order to attract investors by manipulating and window dressing the figures in their financial statement either by increasing or decreasing the figures depending on what they want to achieve at that moment using aggressive or creative accounting. This paper tries to identify such cases through case studies and discover what were the changes in policies took place after the same.

INTRODUCTION:

Accounting fraud is intentional manipulation of financial statement to create a fake presentation of a company's financial health .It involves an employee or account or the organization itself and is misleading to investors as shareholders. An organisation can falsify its financial statements by overstating its revenue or assets, not recording expenses and under-recording liabilities. Financial fraud is one of such accounting frauds where although it's less common, financial statement fraud can be the most damaging to a company. Overstating revenue, assets and earnings along with understating liabilities are the common activities found with this type of fraud. Enron and worldcomm are two major high-profile cases involving financial statement fraud.

Fraud has the capacity to undermine the confidence of stakeholders in an organisation and there is a strong connection between prevention of fraud and good corporate governance due to these the practice of manipulating the financial statements of companies to support their position.

Fraud with respect to auditing aspect and Consideration of such in financial reporting and the auditor's responsibility on reporting on fraud has always been an integral part of an audit of financial statements which should be carried out in accordance with the Standards on 2Auditing. ICAI has asked auditors to apply "professional skepticism" before confirming such cases to the government and take into account the measures already taken by the companies internally. (issued in the guidance note)

The current business environment, has pushed companies to such an extent where organization are paying attention to how to make the financial statement look better in order to attract investors or create a good picture of their companies, using aggressive accounting (Anumaka; 2007:1)

Fraud is classified into two categories:

* Fraud that is involving the manipulation of the accounts and records
* Fraud usually done internal members that is employees involving the theft, un-appropriation or embezzlement of companies' funds in the form of cash or its other assets. In this research paper, problems of financial statement fraud will be extensively assessed with its solution in relation to organization.

REVIEW OF LITERATURE

1. Data Mining techniques for the detection of fraudulent financial statements.

This paper explores the effectiveness of Data Mining classification techniques in detecting firms that issue fraudulent financial statements and deals with the identification of factors associated to the same. In using the task of management fraud detection, auditors could be facilitated in their work by using Data Mining techniques. This study shows the detective findings to usefulness of Decision Trees, Neural Networks and Bayesian Belief Networks in the identification of fraudulent financial statements. The input is composed of ratios derived from financial statements. The three models are compared in terms of their performances, procedures & activities.

(E, C, & Y, 2007)

2. Internal audit reporting lines, fraud risk decomposition, and assessments of fraud risk.

The main purpose of this research is to examine the effects of internal audit reporting lines on fraud risk assessments made by internal auditors when there is a shift of fraud risk. Significant importance has been placed on the of reporting lines in maintaining the autonomy of internal auditors, but the perceived benefits of requiring internal audit to report directly to the audit committee have not been sanctioned or systematically investigated. This finding runs counter to the anticipated benefits of requirements that the internal audit function report directly to the audit committee, and it reveals conflicts of interest and independence threats created by the audit committee itself. We also examine the effects of fraud risk decomposition on risk assessments made by internal auditors. We find that fraud risk assessment does not have the same effects on internal auditors as compared to the external auditors, and the effects of decomposition do not align with the expected benefits of decomposition.

(C.S., A.M, & J.M, 2010)

3. Financial Statement Fraud Detection: An Analysis of Statistical and Machine Learning Algorithms.

This study compares the performance of six popular statistical and learning models in detecting financial statement fraud under different assumptions of mis-classification costs of fraud firms with non-fraud firms. The results show, somewhat surprisingly, that logistic regression and support machines perform well relative to an artificial network, bagging, and stacking. Out of 42 predictors examined, only six are consistently selected and used by different classification algorithms: auditor turnover, total discretionary accruals, Big 4 auditor, accounts receivable, meeting analyst forecasts, and unexpected employee productivity. These looks forth the extend of financial statement fraud research and can be used by practitioners and regulators to improve fraud risk models.

(perols, 2011)

4. Finding Needles in a Haystack: Using Data Analytics to Improve Fraud Prediction.

Developing models to detect financial statement fraud involves challenges related to (1) the rarity of fraud observations, (2) the relative abundance of explanatory variables identified in the prior literature, and (3) the broad underlying definition of fraud. Following the emerging data analytics literature, we introduce and systematically evaluate three data analytics pre-processing methods to address these challenges.

(Perols, Bowen, & Zimmermann, 2017)

5. Fraud detection: Intentionality and deception in cognition.

Fraud detection is made difficult in part due to the fact that most auditors have relatively little experience with it. We elaborate the issue of what kind of knowledge supports the easy flow of financial statement fraud detection by examining the more general information processing problem of detecting a deception. We define deception as a process in which a deceiver has intentionally manipulated an environment so as to elicit a misleading representation in a target agent .We develop a theory of guiding facts that the deceiver and the target use for constructing and detecting deceptions. Drawing on the literature in several fields we identify specific strategies and tactics for creating a deception. We use the strategies and tactics for creating a false pre-tense to propose what the knowledge that would lead to the detection of financial statement fraud be like based on a proposed hierarchy of the deceiver's goals. We compare the proposed detection knowledge with the knowledge base of a computer model of financial statement fraud detection task that was successful in solving several real fraud .We also compare programmes of the detection knowledge proposed in our theory with the know how employed by several experienced auditors who performed the task of concurring partner review on one of the fraud cases successfully analysed and interpreted by the model.

(P.E., S., & K, 1993)

RESEARCH DESIGN:-

STATEMENT OF THE PROBLEM

In current times, fraud has been discovered to pose a big threat on organizations. It is a big business risk which can incur a very big cost leading to a lot of problems of which one of them might be loss of confidence of shareholders and the public on the company. Fraud is big business risk which if not prevent in the initial stage, it will have a very big negative impact on organizational performance.

For our respective research paper we will be looking into the following accounting cases that took place post 2000.

Case studies	Public or private sector	Large cap or mid cap	Reason
Satyam case	Private sector	Mid cap	To analyse corporate governance
Coal gate case	Public sector	Large cap	To find the impact of policy ,and implementation of legislation after allocation of coal blocks
Punjab national bank case	Public sector	Mid cap (moved out from NSE presently)	To analyse the corporate governance

OBJECTIVE OF THE STUDY

The major purpose of this research paper is the assessment of the problems of financial statement fraud in the organizations with solution to the same. Areas like reason for fraud, types and implication of costs of fraud shall be dealt. Since auditors are to express their opinion on the financial statement of a company as to true and Fairview of such statement, the internal auditor's role in the prevention of fraud will be looked into in addition understanding the changes in accounting and auditing policies that took place post scam.

TOOLS OF ANALYSIS USED:

1. ***CREDITWORTHINESS***:

The judgment and analysis of the current and future ability of an entity to repay their debtors, and propensity to honor debt obligations as agreed. Factors affecting creditworthiness are credit history, credit rating, and character of the entity.

2. ***CASH MANAGEMENT***:

The Cash Management refers to collection, outlay and the management of cash in such a way that liquidity of firm is maintained. In other words, it is with organising the cash flows within

and outside of the firm and making decisions with respect to the investment of surplus cash or borrowing cash from outside for funding the deficit.

3. ***INTERNAL AUDIT***:

Internal auditing is an independent, objective assurance and consulting activity constituted for addition of value and improvement in effectiveness of an organization's operations. It enables an organization to achieve its objectives by providing a systematic, disciplined approach to examine and improve the efficiency of risk management, control and regulation.

4. ***SHARE PRICE INDEX***:

Measurement of a part of the stock market. It is calculated from the prices of selected stocks usually using weighted average method. It is a tool used by investors and finance managers to analyze the market, and to compare the return on certain investments

LIMITATIONS OF CONDUCTING RESEARCH ON ACCOUNING SCANDALS OF INDIA ARE:

1. ***Difficulty in finding the extent of the period for which the scam was committed:***

The main limitation arising on shareholder frauds is that it is understanding the time period exactly for which the specific accounting scandal was carried on by the shareholders and to what degree the financial statements were already affected by such a scam.

2. Meticulousness of Actual Knowledge is needed:

Just the fact that the fraudulent party has the chance to investigate the fraud, is not enough to charge him with notice of the fraud, so as to start the running of the law of limitations. For example, when the parties are ordinarily charged with knowledge of facts reflected in the public record, this is generally not the case with regards to fiduciary relationship. The complainant has no legal duty to investigate at least until he has actual knowledge of facts adequate to incite an inquisition.

3. The quantitative research method was not suitable for the study:

As it includes definite conclusions with statistical sampling .The quantitative method proves or tests one or more hypotheses by inferential statistics. The combination of both the methods includes qualitative and quantitative research methods, so it was not appropriate.

4. ***Subjectivity and labor intensive in nature:***

As qualitative studies lead to procedural and duplication problems, focusing that, the qualitative method leads to an understanding of difficult procedures. In the study to reduce

corporate financial fraud, implementing the qualitative procedures helped to explore the financial management skills needed by corporate financial managers.

Since it is tasking to find various corporate frauds via qualitative research methods only, as little data is available through quantitative tools of analysis.

DATA ANALYSIS AND INTERPRETATION:

DATA ANALYSIS:

1. Satyam case–

1.Special court under India's central bureau of investigation (CBI) on April 10 held the founders and former officers of an outsourcing firm, Satyam computer services, guilty of an 999accounting scam worth Rs 7,000 crore ($1.1 billion).

2. Ramalinga Raju, the company's former chairman, has been imprisoned for seven years.

3 The scandal which is also called as the Enron of India, dates back to 2009. Six years ago, Raju wrote a letter to the securities and exchange board of India (SEBI) and his company's shareholders, accepting that he had manipulated the company's revenues and profits, and defrauded investors.

4. Nearly $1 billion—or 94% of the cash—on the books of accounts was fabricated.

5. In an immediate reaction to the confession, investors near about Rs14,000 crore ($2.2 billion) as Satyam's shares showed a downward trend.

6. The Satyam accounting scam, one of the biggest in India, left millions of investors at the bay, as the stock fell from Rs 179 to Rs 23 in one trading session.

7. The founder of Satyam computers admits to inflating cash and bank balances by Rs 5,040 crores, overstating debtors' position of Rs 2,650 crores as against the actual figure of Rs 490 crores and non-disclosure or understatement of liabilities worth Rs 1,230 crores.

2***. Coal Gate case :***

1. A special CBI court in Delhi called for the industrialist Naveen Jindal and 14 others for alleged money laundering in a case related to irregularities in allocation of a coal block in Jharkhand.

2. Special Judge Bharat Parashar had called for Jindal- promoter of Jindal Steel & Power Ltd --along with former company employees including Essar Power's executive vice-chairman Sushil Kumar, Jindal's ex-advisor Anand Goel, KE International's chief financial officer Rajeev

Aggarwal and Green Infra vice-president Siddharth Madrato and others to appear before the court on October 15, sources said.

3. The Enforcement Directorate had filed a charge sheet against Jindal, his company JSPL, Gagan Infra and others for allegedly influencing the screening committee to allot Amarkonda Murgadangal coal block by investing more than Rs 2 crore in illegal gratification

4. The case was filed under the provisions of Prevention of Money Laundering Act (PMLA).

5. A report by the Comptroller and Auditor General of India showed inefficient and illegal allocation of coal blocks between 2004 and 2009. It estimated losses upto Rs 10.7 lakh crore but it later toned this amount down to Rs 1.86 lakh crore in the final report.

6. One of the principal offences was abuse of public office, securing financial advantage without public interest and criminal scheme.

7. This case deals with wrongful allocation of coal blocks in Madhya Pradesh to Kamal Sponge Steel & Power Ltd. (KSSPL)

3. Punjab National Bank case

1. Billionaire jeweller Nirav Modi allegedly acquired fraudulent letters of undertaking from one of its branches for overseas credit from other Indian lenders.

2. The Enforcement Directorate (ED) conducted raids on jeweller Nirav Modi's properties in Mumbai & Delhi. A case of money laundering has also been lodged against Nirav Modi and others.

In a statement issued to exchanges, Punjab National Bank said it has detected some fraudulent and unauthorised transactions (SWIFT messages) in one of its branch in Mumbai for the benefit of a few select account holders with their apparent involvement.

3. Based on these transactions other banks appear to have advanced money to these customers abroad. When checked it was seen that transactions are contingent in nature and liability arising out of these on the Bank shall be decided based on the law and genuineness of underlying transactions

4. PNB has suspended 10 officers over the Rs 11,400 crore scam and referred the matter to CBI for investigation.

5. From the medium of media reports, Nirav Modi left the country on 6)January 1 weeks before the CBI received complaint from PNB

His brother Nishal, a Belgian citizen, also left the country on January, while wife Ami, US citizen, and his business partner Mehul, who is an Indian promoter of Gitanjali jewellery chain, departed on January 6.

INTREPRETATION

After the each case that took place there was certain policy changes and it is mentioned below :

SATYAM CASE –

Knowhow of the case: The Satyam Computer Services scam was a corporate scandal affecting Indian company Satyam Computer Services in 2009, in which chairman Ramalinga Raju confessed that the company's accounts had been manipulated.

Accounting policies:

1. The government and the Securities and Exchange Board of India have reinforced corporate governance rules and regulations.

2. The Institute of Chartered Accountants of India (ICAI) came out with a Guidance Note on Reporting on Fraud (ICAI Guidance Note, 2016). The Act also puts forward a strict framework for related party transactions.

Auditing policies:

1. The Companies Act, 2013, has a code of conduct for independent directors. Companies should replace their external auditor every five years for an individual auditor or 10 years for an audit firm. The external auditor must report fraud directly to the government. Shareholders can institute legal proceedings against directors and auditors.

2. Strengthening of the role and responsibilities of independent directors, auditor rotation and enhanced auditor reporting, and class action introduced by the Companies Act, 2013.

Others:

1. Satyam's stocks were included in Sensex and Nifty, stock indices but were removed on 9th January 2009.

2. After the scandal was revealed, Satyam's stock decreased from Rs170 to Rs6.50 because of which its investors suffered the loss of almost Rs14162 crores.

COAL GATE CASE -

Know-how of the case :

The allocation of captive coal blocks without open bidding during 2004-09 had caused the national exchange a huge loss of Rs 1.86 lakh crore, according to the estimate by the Comptroller and Auditor General.

Accounting policies:

1. Transparent accounting standards and auctioning system followed.

2.A significant system of peer review, even if it has the effect of setting one professional against another and a system of dual audit --- simultaneous audit of the same accounts by two firms of auditors

Auditing policies:

1. Bringing transparency and objectivity in the allocation process of coal blocks, and in the auditing process.

2. Securities exchange board of India to implement the allotment of audit as a transparent exercise once in five years, in complete public view.

Others:

1. As a result allocatees received a windfall gain from the program.

PUNJAB NATIONAL BANK CASE :

Know-how's of the case:

1. Punjab National Bank announced a big swindle of an amount that pints upwards of Rs. 11,000 crores , in a surprise letter to the Stock Exchanges.

2. Later, the Stock Exchange sends a memo to several banks, blaming a now retired employee for raising fraudulent several "Letter of Undertaking" over the last six years.

3. The blame was then framed on few people who received the funds, companies owned by a certain jeweller – Nirav Modi.

Accounting policies:

1. The RBI has scrapped quasi bank guarantee instruments such as the Letter of Undertaking and Letter of Comfort that blew a Rs.14,000 crores hole in the books of Punjab National Bank as the regulator attempts to plug a loophole and improve banks' due diligence in trade credit.

2. Cost of funding for companies may rise as Letter of credit* are more expensive, but it will make banking system less vulnerable to fraud.

3. RBI will improve bank's due when it comes to trade credit.

****A letter of credit is more secure because it has the details of the purchase by the importer, date of issue, expiry date, the material purchase and other transaction details.***

Auditing policies

1. The RBI has made forensic audit of the accounts involved in the alleged fraud and also make it compulsory for the banks to carry out forensic audit

FINDINGS AND SUGGESTIONS:

1) India's biggest corporate scandals in memory threatens future foreign investment flows into Asia's third largest economy and casts a cloud over growth in its once-booming outsourcing sector. Due to the scams that took place Bombay's main benchmark index tumbling 7.3% and the Indian rupee fell.

2) The Reserve Bank of India has scrapped quasi bank guarantee instruments such as the Letter of Undertaking and Letter of Comfort due to the PNB scam that took place.

3) Fraud in financial statements lead to bringing Transparent accounting standards and auctioning system are followed that to be followed by the company.

CONCLUSION:

From the above analysis of the financial statement scandals which took place ,we conclude that it has far reaching impact on the respective companies' financial statements , their share prices showed a sharp decline immediately after the detection of fraud. There were certain alterations in the accounting policies and auditing practices adopted by the companies which have been mentioned above.

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