Deterrence to corporate fraud critical thinking

Business, Company

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Introduction

Satyam limited, which is a Nasdaq-listed company, is one of the largest Global IT services firm. It has a portfolio of Major American and Australian companies such as Coca Cola, Citigroup, Telstra and Quantas.

The former chairman of the company, Ramalinga Raju admitted he had been tampering with the books of accounts. The company had been experiencing losses which he was covering up to reflect that the company was making a profit. He shockingly revealed that 94% of the cash and other assets, amounting to US$1 Billion, of the company did not exist. There was also the pressure from the market that motivated the chairman to manipulate the books. The US$50 Billion Indian Outsourcing industry was experiencing high growth rates.

The Chairman, his brother and the CFO were charged by the Indian government on fraud charges and conspiracy. The prosecution revealed that the chairman paid 13, 000 fictitious employees. The salaries of these fake employees amounted to US$4 Million per month. The money was channeled out of the company through front companies and family accounts and used to purchase land. The scandal saw its share price plummet down by over 75% of its share price. This affected the Indian stock exchange was adversely affected going down by 7% that day. The company accounts used to be audited by the PricewaterhouseCoopers which faced under a lot of pressure to explain why the deception went on for so many years.

Forensic Accounting and Auditing

There are several arguments that aim to give insight into the reasons why the fraud continued for so long without being detected. Professor Sudhakar Balachandran, a lecturer at the Columbia Business School, argues that the traditional methods such as auditing, corporate governance and legal consequences have proved to be insufficient or inadequate in detecting and preventing corporate fraud. He proves his point by highlighting that Satyam had always been seen as company with great corporate governance. In fact it had even won an award for corporate governance.

With the failed effort of the statutory audits to prevent corporate fraud, many companies are now gravitating towards employing a forensic accountant (Asaolu & Owojori, 2009). There has been an increase in managers using such techniques such as under-stating expenses and liabilities, non-disclosure of certain items in the financial statements, overstating assets and income and asset misappropriation. The new approach of risk-based audit is also deemed to have contributed to the frauds not being detected in companies (Myers, 2006).

It does not examine financial accounts at the depth that traditional auditing used to do. It is a good method if used well however if it is used inappropriately or the management lacks integrity, the auditor is given false answers and fraud is not detected.

The use of forensic accounting and auditing in an organization is imperative. Forensic accounting is the use of audit and investigative skills to check the integrity of the financial statements.

They are able to resolve conflicts on the accounts in the company and even assist in litigation. The statutory audit and the board are not able to reveal hidden aspects of corporate fraud. Even if the internal auditors detect any anomaly, they are hardly in any position to initiate the appropriate action. There is hardly any hard scrutiny into the audit certificates when the reports are clean or unqualified. The statutory auditors may also assist in combating frauds as there is the risk of collusion and lobbying. Forensic accountants and auditors have a different role from the traditional auditors. The traditional auditors do not have a duty to the company to identify fraud (Gray, 2008)

The forensic staff is equipped with skills to carry out investigations into any irregular transactions or activities in the organization. They know what constitutes suspicious or irregular financial transactions. They are also trained on personal-related symptoms of fraud such as change in personality and lifestyle changes. They carry out activities such as surveillance, supervision and look for tips from anonymous sources. They seek to understand the source of an individual’s money and the application of his funds. Forensic staffs are also equipped with interviewing skills such as interpreting non-verbal communication or gestures. They know how to carry out the interview and what kind of questions to ask. Do they use confrontational, open-ended or close-ended questions?

The forensic staff should possess certain qualities. The person should be an individual of integrity, honesty and a high level of competence. He should be able to work within strict deadlines and the required urgency and commitment. He should operate with the utmost objectivity. Interpersonal and communication skills are also highly important since he will be interacting with other staff and third parties in his efforts to get to the root causes or irregularities in the financial statements. Forensic staff is also involved heavily in court proceedings. He should be able to gather the requisite financial documents and present them appropriately as evidence in a court of law. He should therefore be familiar and well-versed in legal matters. He should also be independent with the requisite authority and powers to serve the organization optimally.

The forensic accountant is therefore better suited to suggest internal controls in the organization that will assist greatly in preventing fraud. He also assists in the recovery processes where the company wants to get back its assets, money and other resources that the company staff has misappropriated.

Deterrence to Commit Corporate Fraud.

The other argument into the prevailing nature of corporate fraud in the recent years is that the penalties and consequences of white collar crime are not severe or intense enough to serve as deterrents. White collar crime is like any other crime and should be given due consideration by the criminal justice system. It has to reach a point where the penalties of committing fraud far outweigh the benefits of cheating. It is true that white collar crime is serious and it should be taken more seriously. It has devastating effects in the society. It causes loss of retirement funds, unemployment and loss of creditor and investor funds.

However, higher penalties and longer sentences may not act as a deterrent for reducing white collar crime. After the 2002 financial scandals in America, the Congress went ahead to increase the prison sentences to maximum terms of ten and twenty years which represented a 200% increase in prison term sentencing for financial crimes. In mail and wire fraud, the prison sentences were increased by over 400%. The prison sentence was now twenty years up from five years. However, when comparing States that had increased penalties with those that had not showed that there was no reduction of financial crimes.

What the corporate officers need to have is the awareness that the risk of getting caught in recording fraudulent transactions is high. The awareness of the high risk will be determined the corporate culture in the organizations. How is the institutional setting? Does the company’s work ethic and practices clearly spell out that fraudulent behavior is prohibited and charges will be enforced? In an institution where aggressive managers are valued and they are advised to be competitive at all costs, it will tend to attract risk-takers who are highly confident whose decisions may cross into illegal zones.

The tendency to also think and act as a group increases the tendency towards making unethical decisions. The employees are also expected to be loyal to the company and the decisions made by management (Moohr, 2007)

The system should be in such a way that the probability of getting convicted is also high. However, this is quite a challenge due to the nature of existent criminal laws in the country. The laws are written in open-ended language that fails to describe the elements of what is defined as a fraudulent crime (Mohammed, 2006). There is therefore a range of flexibility that can prove to be disadvantageous. The potential offenders are in the dark about what activities will lead to criminal liability. The juries find themselves using an inadequate standard to measure and punish criminal conduct. These broad terms constitute words such as “ willfully” and “ corruptly” in the criminal law. The white collar criminals are able to use loop holes in the criminal laws to get lighter sentences or penalties.

Conclusion

Companies have to get serious about reducing corporate fraud. They need to engage and consult with forensic personnel who have the ability to identify and resolve peculiar financial transactions. The forensic staff should carry out continuous assurance tests on the financial statements (Kuhn and Sutton, 2006). There should also be a strong ethical culture that discourages staff from making and enforcing unethical or immoral decisions in the market place. The regulatory bodies should also ensure that the criminal justice system is able to convict white collar criminals. They should know that the probability of getting caught and going to prison is high.

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