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FORENSIC ACCOUNTING AND ITS USEFULNESS TO PREVENT AND UNEARTH GLOBAL CORRUPTION

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Abstract

The concept of prevention and detection of 'Fraud' dates back to 3300-3500 BC when accountants of Egypt were involved in fraud detection and has existed ever since. This paper attempts to analyze the reasons for the commission of the most common form of occupational fraud – Corruption. Corrupt practices in both the public and private sectors have been on the rise and have fueled inequality leading to a plethora of inefficiencies. Forensic Accounting and fraud detection methods can assist in the prevention and discovery of corruption schemes globally which will be further discussed in the paper.

Keywords: *Forensic Accounting, Fraud Detection, Occupational Fraud, Corruption, Combatting Corruption, Anti-fraud measures.*

INTRODUCTION

The hominal species has certain capacities that no other species has. Humans can chuckle and weep; no other species can. Humans are blessed with the capacity to suppose, assess, estimate and innovate. Humans can consider, concentrate, debate and intervene. However, with all these exemplary traits, humans have also evolved into shady and deceptive creatures. Only the mortal species that can think and deceive others with the above-mentioned skills is able of carrying out intellectual and fiscal deception which develops into 'fraud' or white-collar crime. The truth is that 'fraud' always existed, but has advanced and grown exponentially in recent times. As per Sec 17 of the Indian Contract Act 1872, 'Fraud' means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agent, with intent to deceive another party thereto of his agent, or to induce him to enter into the contract. (1) the suggestion, as a fact, of that which is not true, by one who does not believe it to be true; (2) the active concealment of a fact by one having knowledge or belief of the fact; (3) a promise made without any intention of performing it; (4) any other act fitted to deceive; (5) any such act or omission as the law specially declares to be fraudulent[1]. Fraud is a truly universal problem, affecting organizations and economies worldwide. At the top level, occupational fraud- ie. fraud within an organization can primarily be classified into three categories – Asset Misappropriation, Corruption and Financial Statement Fraud [2]. According to the ACFE Report to the Nations 2022, occupational frauds caused losses of more than $3.6 billion worldwide[2]. This paper will focus on the median in terms of the frequency of fraud and the monetary losses, ie. Corruption. It includes offences such as bribery, illegal gratuities, economic extortion and conflicts of interest. These offences can either take place at a minuscule level, known as petty corruption, at large-scale involving top government officials, known as grand corruption or involving the entire economic system known as systemic corruption. Measuring the extent of harm and damage

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caused by these offences can be difficult due to the existence of concealment and deceptive processes but Forensic Accounting can act as a tool to prevent and unearth global corruption. While there may be several versions of the definitions of Forensic Accounting, the one given by Crumbley, Heitger, and Stevenson Smith in their book Forensic and Investigative Accounting, Second Edition, aims to explain the term most effectively. It states that 'Forensic accounting is the action of identifying, recording, settling, extracting, sorting, reporting, and verifying past financial data or other accounting activities for settling current or prospective legal disputes or using such past financial data for projecting future financial data to settle legal disputes' [3]. This paper will further focus on how Forensic Accounting will aid in preventing and unearthing corruption.

THEORY

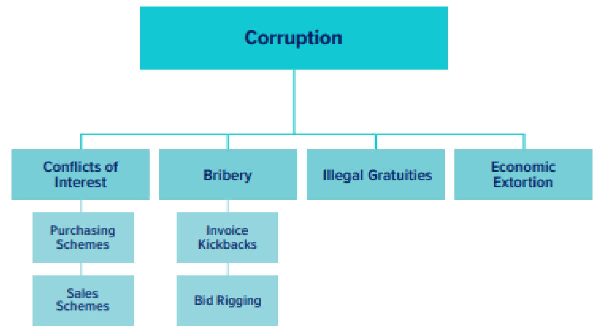
The Fraud Triangle Theory:

The Fraud Triangle Theory is a fundamental framework developed by Donald R. Cressey that defines and explains the intent of an individual to commit occupational fraud. The triangle consists of three elements that outline the reasons a person may commit fraud or increase the risk of fraud: Opportunity, Incentive/Pressure and Rationalization [5]. The theory states that an individual or an organization has three reasons to construct an intentional deception to avail a personal benefit, whilst harming other parties not involved in the fraud. The first vertex of the triangle refers to the 'circumstances' which allow the fraud to occur – Opportunity [5]. In instances where internal controls within an organization/country are not enforced or monitored properly, where there is no segregation of duties and there is a poor 'tone at the top'- which refers to a lack of honesty, ethics and integrity of the upper management of a country/organization, provide opportunity- ie. favourable circumstances to an individual to commit fraud. The second vertex of the triangle is the incentive to commit fraud. This may refer to the personal monetary or non-monetary benefits gained through the commission of fraud. The third vertex of the fraud triangle is Rationalization. It refers to the possibility of the detection of fraud and the probable justification to commit the fraud, which may relate to personal dissatisfaction or the intent to perform a particular task through fraudulent processes.

This theory has further evolved into the Fraud Pentagon Theory which states that along with the three elements of the triangle theory, there are two more elements that play a role in the commission and detection of fraud – Competence and Arrogance. The former refers to the individual's ability to override and go through internal controls, carrying out tasks unlawfully while the latter refers to the 'attitude of superiority ' among others and the feeling that fraud will not be detected[5].

Corruption as occupational fraud:

The world bank has given a concise definition of corruption as "the abuse of public office for private gain." While this definition focuses on the public sector, it can also be used to define corruption in the private sector; the term public office may refer to any commercial organization [4]. There is a common misconception that corruption only involves public officials. However, corruption can occur in businesses, governments, courts, media and across all sectors including healthcare, finance, sports and education. As stated in the introduction, corruption in an organization can be classified into four primary offences which can further be divided into micro-offences. These are Conflicts of Interest, Bribery, Illegal Gratuities and Economic Extortion as shown in the figure. A conflict of interest refers to illicit private gains made by entrusted employees of an organisation whilst adversely affecting the company through Purchasing Schemes, Sales Schemes or any other processes. Though these kinds of schemes are uncommon in government offices, they are fairly familiar to the private commercial sector. The next form of offence is the most common in all sectors of the economy – Bribery. Bribery is the agreement of an individual to offer something of value to an official for doing or failing to do a certain task. This can be done through both cash or kind. A kickback is the most common form of bribery in which an individual receives a 'kickback' ie. compensation for doing a favourable task. Over-billing is an example of a kickback where the vendor sends a deceitful invoice with higher prices, inferior goods or unnecessary goods, with an employee of the organization helping to receive the payment. Bid-rigging is another form of bribery where two or more parties collude with each other to submit a rigged bid in agreement with who will be the winning bidder. The federal trade commission gives out certain forms of bid-rigging where competitors may agree to take turns being the low bidder or sit out of a bidding round or provide intentionally high bids to cover up a bid-rigging scheme.[6]. An illegal gratuity is the same as bribery, however, the only difference is that the payment or gift is made after an official does or fails to do a certain task. Economic extortion is the other side of bribery or illegal gratuities where the official demands money or other consideration to make a particular decision or to perform/not perform a task, with or without threatening the other party.



Literature Review

The Association of Certified Fraud Examiners' Report to the Nations 2022 outlines data from 133 nations covering around 2110 cases which, in total, caused monetary losses of more than $3.6 Billion [2]. ACFE reports that corruption was the most common scheme in every global region, with southern Asia reporting the highest percentage of corruption schemes.

Table 1 Percentage of corruption schemes in global regions [2].

Region	% of Corruption Schemes
Asia-Pacific	57
Eastern Europe and western/central Asia	64

Latin America and the Caribbean	59
Middle East and North Africa	59
Southern Asia	71
Sub-Saharan Africa	62
United States and Canada	37
Western Europe	44

These schemes have a median loss per month of $12,500. This is calculated by dividing the loss amount by the number of months the scheme lasted before detection [2]. The study also reveals that schemes committed by an owner/executive have a velocity nearly three times that of schemes committed by employees and manager-level individuals, which means that cases involving higher officials are likely to cause greater damage in a shorter time period. The main cause of corruption in both the public and the private sector is low pay scales. Lower income of employees and other individuals leads to the employees resorting to corruption for financial benefits. National-level government agencies reported the highest median loss of $200,000 while state/provincial governments reported a median loss of $56,000. As of 2013, corruption took up 33% of occupational frauds which has drastically increased to 50% in 2022. Moreover, with the rise in the usage of blockchain technology and cryptocurrency, the opportunity to attempt fraud has increased, also increasing the difficulty to detect and prevent fraud – 48% of kickback payments or bribery were made through cryptocurrency. Creating fraudulent physical documents (39%) was the most used concealment procedure used by perpetrators, with alteration of physical documents (32%) being the second-most used concealment procedure while 12% of cases did not involve any attempts to conceal fraud[2].

RESULT

The literature review revealed that the occupational fraud of corruption is generally detected through tips from employees and internal audits. This data shows that when fraud is identified proactively, it is caught more promptly and results in fewer losses; on the other hand, passive detection results in longer-lasting schemes and greater financial harm to the victim.

DISCUSSION

There are several red flags (behavioural characteristics associated with fraud) that can be observed in the individuals involved in corruption schemes. These are when an employee is noticed living beyond their means or there are financial difficulties in the perpetrator's family, abnormally close connection with vendors/buyers (revealing the risk of purchase/sales schemes) or when the behaviour of the suspect is too good to be true- ie. no red flags are observed. 85% of all perpetrators displayed at least one behavioural red flag. Internal and external surprise audits, job rotation of employees and formal fraud risk assessments can be conducted to prevent and detect corruption.

CONCLUSION

With the increasing rate of corruption schemes around the world, the existence of fraud detection and prevention methods has become of paramount importance. An effective system of detecting and preventing corruption will not only reduce the monetary losses faced by organizations but will also aid to eradicate financial inequality among the population. While the intention to commit fraud can be referred to from the fraud triangle or the fraud pentagon theory, Forensic Accounting and Audit are of utmost relevance and importance in ascertaining the financial losses and identifying the perpetrators of corruption schemes. This paper attempted to shed light on occupational fraud – Corruption, in particular, and the statistics regarding the same. It also aimed to show the available methods to unearth and prevent corrupt practices worldwide.

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