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## Accounting function, a new profit center for some

When companies put together their financial statements for the public at period ends, they aim to portray themselves in the best possible light, which is sometimes achieved by distorting the truth in the public disclosures using creative accounting techniques.

Creative accounting is an unethical practice of manipulation of financial figures, usually within the letter of the law and applicable accounting standards, but quite against their spirit with intent to favour the preparers of financial statements. A healthy financial status is deceptively demonstrated by overstating incomes and assets and understating expenses and liabilities. Common motivations to misrepresent include an attempt to attract investors or a pressure to conceal the company's deteriorating financial condition to meet debt covenants or prevent a takeover. Personal incentives in the form of increased compensations linked to financial results, also present a reason to misrepresent financials. The massaging of figures may be easy to rationalise at first but grows to a point where it gets lethal and often impossible to manage.

The Association of Certified Fraud Examiners' 2012 report on fraud trends said financial statement fraud is the most costly form of occupational fraud, causing a median loss of US\$1 million. As a response to curb this, regulators are taking companies to task for not adhering to reporting guidelines and imparting punitive measures to minimise the scope for presenting misleading financial reports. The consequences associated with financial statement fraud are severe – companies have in the past experienced bankruptcy, significant asset sales, delisting from stock exchanges and financial penalties, apart from reputational losses. Individuals involved in such cases have been charged with civil fines, class action legal suits and prison sentences.

### Building an effective anti-fraud framework

Financial statement fraud is the toughest to detect, especially as it is never isolated to a single fiscal period and the creative accounting techniques change with changing accounting standards. The key is in prevention at inception and detection at an early stage. Below are a few items to consider when developing a risk management framework.

1. **Fraud Risk Assessment:** Review and assess the internal control framework of your organisation and assess the likelihood of occurrence of fraud risk and its impact. Develop an anti-fraud program with a continuous monitoring mechanism to identify red flags or early warning signs.
2. **Investigate the red flags before it's too late:** Monitor red flags on an ongoing basis and investigate them. A financial investigation conducted by forensic experts often becomes the key to a conviction if conducted using a multidisciplinary approach in the field of accounting, law, investigation and criminology and make prosecution and recovery easier.
3. Establish a **whistle blower mechanism** to identify potential financial fraud issues early. The mechanism should ensure anonymity, independence and the safety of the whistle blowers. Fraud reporting mechanisms, including employee 'hotlines', are a critical component of an effective fraud prevention and detection system.
4. Extensive **due diligence** before entering into new business relationships: As an investor, underwriter or lender, conduct financial and integrity due diligence using forensic experts to help investigate potential exposures to hidden risks. Hire ethically and morally sound employees after conducting adequate pre-employment background checks and investigative due diligence on them.

Today, the biggest challenge posed to management across the globe is to strike a balance between meeting market expectations and exhibiting transparency in financial reporting. Financial reporting scams which lead to unwarranted enrichment of a few at the cost of many are the non-violent crimes committed by white-collar offenders, for personal or organisational financial gain causing far more serious damage than any other crimes.

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