International Journal of Research Publication and Reviews, Vol 5, no 12, pp 2427-2430 December 2024

International Journal of Research Publication and Reviews

Journal homepage: www.ijrpr.com ISSN 2582-7421

Accounting Frauds in India: Critical Analysis

Samiksha Shrotriya[1], Prof. Pravin Saxena[2]

[1]Research Scholar, Department of Accountancy and Law Faculty of Commerce, Dayalbagh Educational Institute (Deemed to be University) Dayal Bagh Agra, Uttar Pradesh, Email: samikshashrotriya26@gmail.com

[2]Professor, Department of Accountancy and Law Faculty of Commerce, Dayalbagh Educational Institute (Deemed to be University) Dayal Bagh Agra, Uttar Pradesh, Emai: pravinsaxenadei@yahoo.co.in

DOI : https://doi.org/10.5281/zenodo.14463588

ABSTRACT:

Accounting fraud is a form of white-collar crime that has negative on the whole Economy. These frauds often involve the misappropriation or manipulation of public funds by perpetrators for personal economic gain. With technological development, the frequency and complexity of accounting frauds have increased. High-profile cases such as those involving Vijay Mallya, Ramalinga Raju, and Nirav Modi underscore the gravity of the issue. Additionally, accounting fraud committed in the digital monarchy is equally concerning. Cyber fraudsters exploit the invisibility of the internet to execute scams, including KYC frauds, identity theft, and UPI payment frauds. Technology has thus emerged as a key enabler for fraudulent activities. This study seeks to analyze critical aspects of accounting fraud in India, including its methods and implications. Common methods of perpetrating accounting fraud include, Operational and financial decisions influenced by accounting manipulation, choosing particular accounting policies to distort true financial condition of a company, Misrepresentation of accounting estimates within the framework of accounting standards, Formulation of transactions or reporting of fictitious ones, Misclassifying revenue expenditures as capital or deferred revenue.

Keywords: Frauds, Accounting Frauds, Control Systems, Challenges, Impact, India

Introduction:

Accounting frauds refers to the intentional falsification or manipulation of financial records and reports to mislead stakeholders about a company's financial performance or condition. This illegal practice is driven by motives such as personal enrichment, misappropriation of assets, or achieving corporate targets, often at the expense of shareholders, creditors, and the general public. By exploiting systemic weaknesses, capitalizing on economic incentives, and openly violating fiscal laws and regulatory frameworks, accounting fraud erodes trust and distorts the foundations of ethical business practices.

Types of Accounting Fraud

The following are the primary categories of fraud within this domain:

1. **Corporate Frauds**: Malpractices committed by businesses to deceive stakeholders, manipulate markets, or gain unlawful advantages.
2. **Financial Statement Frauds**: Misrepresentation or falsification of financial data, including inflating revenues, understating liabilities, or concealing expenses.
3. **Financial Institution Frauds**: Deceptive practices within banks or financial organizations, such as falsified loan approvals, embezzlement, or unauthorized transactions.
4. **NBFC/Co-Operative Bank/Chit Fund Frauds**: Irregularities or scams in non-banking financial companies, co-operative banking systems, or informal savings schemes, often targeting unsuspecting investors.
5. **Money Laundering**: Processes designed to disguise illicit funds by integrating them into the legitimate financial system to mask their origins.

Such fraudulent practices not only harm individual investors but also destabilize the economy, erode public confidence, and necessitate stringent enforcement of laws and corporate governance principles.

The importance of auditors in instilling confidence among users of financial statements cannot be overstated. However, instances of financial accounting fraud have often highlighted the involvement of auditors, either through deliberate actions or negligence. This observation prompted the researcher to delve deeper into the issue, aiming to uncover new patterns and insights that could provide a clearer understanding of the underlying causes of such fraudulent activities.

Overview of an Internal Control System

Faud prevention focuses on stopping fraudulent activities before they occur, while fraud detection aims to identify fraud promptly after it happens. Both aspects are interdependent and must function cohesively. Since fraudsters continually evolve their methods to bypass detection systems, fraud detection must be an ongoing effort. Prevention strategies include a clear separation of duties, employee supervision, monitoring of performance, and implementing robust controls to ensure secure system access.

Internal control mechanisms allow management to oversee their staff effectively, especially when direct supervision is not feasible. These systems are designed to be self-monitoring, detecting and correcting any anomalies automatically. However, failures in internal controls have been at the core of some of the most significant accounting scandals globally. Such incidents have led to massive financial losses for investors, job losses for employees, and the erosion of retirement funds due to firm pension plans being heavily invested in compromised schemes.

Frauds Detection and Prevention

raud has existed throughout history, evolving into various forms over time. Accounting fraud, in particular, has expanded alongside the growth of corporate industries, fueled by technological advancements and the widespread use of the Internet. According to the fraud triangle, three key factors—pressure, rationalization, and opportunity—must be present for fraud to occur. Employees with access to internal systems, classified information, and advanced technologies may exploit these resources to commit fraud. Coupled with personal pressure and rationalization, they can become part of fraud networks, siphoning significant sums from companies.

In recent years, accountants have been tasked with critically evaluating traditional financial reporting practices to ensure compliance with Generally Accepted Accounting Principles (GAAP) as set by professional organizations. However, there has been a growing trend among companies to manipulate financial statements, portraying an overly favorable image to attract potential investors.

Fraud in financial reporting can be identified through analytical techniques such as vertical and horizontal analysis, as well as ratio analysis. Vertical analysis examines the proportion of individual items to a base amount within financial statements, while horizontal analysis tracks dollar and percentage changes over time. Ratio analysis involves comparing numerical relationships to uncover patterns or irregularities, providing valuable insights into potential financial misrepresentation.

Impact of Internal control System on detecting and Preventing frauds

nternal control systems play a crucial role in identifying and preventing fraudulent activities within organizations. By establishing robust policies and procedures, these systems minimize opportunities for fraud while promoting accountability and transparency. Effective internal controls ensure proper segregation of duties, regular monitoring of activities, and accurate reporting, making it harder for potential fraudsters to exploit vulnerabilities.

In terms of fraud detection, internal control mechanisms enable the early identification of anomalies through systematic checks, audits, and performance evaluations. Automated systems and continuous monitoring help uncover irregularities promptly, limiting the impact of fraudulent actions.

On the prevention side, internal controls create a culture of integrity by establishing clear guidelines, conducting regular training for employees, and ensuring that access to sensitive systems or information is tightly controlled. These measures act as a deterrent by increasing the likelihood of fraud being detected and penalized.

Ultimately, a well-designed internal control system serves as both a shield against fraud and a tool for building trust within the organization and among stakeholders.

A robust control system serves as a safeguard against errors and fraud by monitoring and improving formal and financial reporting processes while ensuring adherence to relevant laws and regulations.

Effective internal control systems are essential for fraud detection and prevention. Conversely, the absence or ineffectiveness of these controls creates an environment where fraud detection and prevention are compromised. As highlighted by the Institute of Internal Auditors (IIA) in their June 2003 publication, "risk and control are virtually inseparable, like two sides of a coin," emphasizing that risks must first be identified and assessed before being managed and mitigated through the implementation of strong internal controls.

For financial institutions, the primary objectives are to achieve growth, profitability, and sustainability, ensuring they fulfill their mission while minimizing the risks of loss or failure in their operations. Effective risk management through internal controls is integral to achieving these goals, demonstrating the pivotal role internal control systems play in supporting the success and resilience of financial institutions.

The increasing frequency of fraud and financial mismanagement has led to fear, anxiety, and eroded trust among customers. Additionally, inadequate internal control systems contribute to rising financial losses for firms. Management has a responsibility to establish internal control mechanisms tailored to their organization's unique characteristics, such as size, operational nature, and strategic objectives. A well-designed and implemented internal control system can mitigate risks, enhance operational efficiency, and restore stakeholder confidence.

Responsibilities and Challenges of prevention and detection of frauds

Internal auditing involves the continuous assessment of an organization's economic activities. It is an independent evaluation carried out on behalf of the entity's management to review accounting, financial, and other operations systematically. This process includes verifying accounting records, financial reports, assets, capital, and outcomes, as well as certifying supporting financial documentation.

According to the National Standard on Audit 240 (SNA 240), titled *Fraud and Error,* the executive board holds primary responsibility for preventing and detecting fraud and errors. This is achieved through the implementation and maintenance of effective accounting and internal control systems, which, minimizing the chances of fraud and errors, it is important to note that they cannot be completely eradicated. Furthermore, the audit committee is responsible for overseeing fraud risk management and closely monitoring the board's initiatives to combat fraud. Internal auditing is also crucial, as it assesses fraud risks and helps in the prevention and detection of fraudulent activities. It acts as an independent mechanism to evaluate the risks and effectiveness of the anti-fraud measures implemented by the executive board

In their role, internal auditors must possess the necessary expertise to recognize potential fraud indicators, stay alert to situations with a high likelihood of fraud, and determine when further investigation is warranted. They should also inform relevant personnel within the organization and take appropriate actions to mitigate or prevent fraud. According to SNA 240, auditors are not held accountable for preventing fraud and errors. Nonetheless, performing regular audits can decrease the chances of these issues occurring. In reality, organizations frequently address suspected fraud or errors internally by dismissing those involved or absorbing losses through their internal resources, with the goal of maintaining their market reputation and credibility.

It is essential to differentiate between internal auditors and fraud investigation specialists in terms of roles, responsibilities, training, and expertise. While internal auditing cannot fully prevent fraud, it can adapt its methods and procedures to enhance the likelihood of identifying and interpreting fraud indicators without error. Internal auditors must have a strong foundation of theoretical knowledge and practical experience to fulfill their responsibilities effectively. They should also understand fraud schemes and scenarios relevant to the organization's industry, such as insurance, retail, or telecommunications, and be skilled at recognizing fraud red flags.

To achieve these objectives, essential investment in the professional development of internal auditors is required. This includes funding specialized training courses. Some organizations opt to engage external specialists through service contracts to perform auditing tasks, believing this proceed towards provides access to high-level expertise at a relatively lower cost.

Objectives:

1.To study the Impact of Control Systems for the prevention and detection of Accounting frauds.

2.To study the responsibilities and challenges for the prevention and detection of Accounting frauds.

Literature Review:

Md. Abdur Rashid (2022), titled **"An Overview of Corporate Fraud and its Prevention Approach"** provides a comprehensive examination of corporate fraud, its implications, and the strategies for prevention. The conclusion, of this research presents a thorough overview of corporate fraud, emphasizing the need for effective prevention strategies and a strong legal framework to combat these unethical practices effectively. The findings serve as a valuable resource for academics, practitioners, and policymakers aiming to enhance their understanding of corporate fraud dynamics and prevention methodologies.

Niki Hadian (2021) titled **"The Effects of Internal Control on Fraud Detection: Case Study on Several State-Owned Enterprises Banks in Bandung City"** investigates the relationship between internal control systems and their effectiveness in detecting fraud within state-owned banks in Bandung, Indonesia. The research concludes that effective internal controls are essential for detecting fraud in state-owned banks. By implementing comprehensive control measures, these institutions can significantly reduce the risk of fraud, thereby protecting their assets and maintaining stakeholder confidence.

Okere, and Aro (2018) examined the underlying reasons for the ineffectiveness of anti-corruption agencies and reforms in Nigeria, advocating for the involvement of forensic accountants to combat escalating corruption. Their findings stressed the necessity of thoroughly analyzing government financial statements to ensure their authenticity and reliability.

Leah Njeri Kabue et al. (2017) titled **"Effect of Internal Controls on Fraud Detection and Prevention among Commercial Banks in Kenya"** explores the impact of internal control systems on the ability of commercial banks to detect and prevent fraud. Here's a summary of the key

aspects of the study. The research concludes that effective internal control systems are crucial for detecting and preventing fraud in commercial banks. The findings highlight the need for banks to strengthen their control measures to combat increasing fraud incidents effectively.

Formigoni (2013) distinguished forensic accounting from auditing, establishing it as a specialized career in developed nations. The study emphasized aligning forensic accounting practices with international standards to uncover fraudulent or suspicious transactions. Furthermore, it revealed that weak internal controls and inadequate regulations often contribute to corrupt management practices.

Methodology

The study used primary and secondary data collection survey method design to collect data from the key respondent. By using survey design considering the relevancy in a survey because it involves collecting data which can then be used to answer the research question in the current state of Conclusion Findings Methodology and results Purpose, aim & objectives: A Critical Study of Accounting Frauds in India 3 the object of the study. In this study there were 237 key respondents selected and Firstly (primary) data was collected using questionnaires' survey from India region. Secondary data was collected using international journals, articles, research, review papers, documents and other.

Conclusion

The study concluded that reconcilement control measures play a crucial role within current control systems and their challenges in India regarding the prevention and detection of accounting fraud. It found a significant negative relationship between reconciliation control and the effectiveness of fraud prevention and detection, indicating that weaknesses in this area can hinder fraud management efforts. Additionally, the impact of financial governance controls was found to be adverse, showing a notable negative correlation with fraud prevention and detection levels. The findings also revealed that higher variances in budgetary controls positively correlate with increased instances of fraud. Commercial banks with inadequate disclosure and poor budgetary control systems tend to experience more frequent fraud incidents. Moreover, the study indicated that employees are aware of the penalties associated with violating internal control procedures, and all payments are authorized by designated officers prior to payment out. The research highlighted that effective internal controls facilitate various processes, such as issuing pre-numbered cash receipts, conducting unannounced cash counts, and reconciling cash receipts on a daily basis with proper documentation. Centralizing cash collection receipts where possible is also recommended. Overall, internal controls are vital for helping companies comply with laws and regulations while preventing fraud. The study concludes that there is a significant positive relationship between robust internal control systems and the effectiveness of fraud detection and prevention.

References:

1. Rashid, M. A., Al-Mamun, A., Roudaki, H., & Yasser, Q. R. (2022). An Overview of Corporate Fraud and its Prevention Approach. Australasian Accounting, Business and Finance Journal, 16(1), 101–118. https://doi.org/10.14453/aabfj.v16i1.7

2. Sood, P., & Bhushan, P. (2020). A structured review and theme analysis of financial frauds in the banking industry. Asian Journal of Business Ethics, 9(2), 305–321. https://doi.org/10.1007/s13520-020-00111-w

3. Cabrera-alvarado, M. S., Langston, M. S., &Urquijo, E. (2013). Electronic copy copy available availableat : Electronic at : https://ssrn.com/abstract=2324573 Electronic copy copy available available at : Electronic at : https://ssrn.com/abstract=2324573. 4(July), 1–13.

4. Sadaf, R., Oláh, J., Popp, J., &Máté, D. (2018). An investigation of the influence of the worldwide governance and competitiveness on accounting fraud cases: A cross-country perspective. Sustainability (Switzerland), 10(3), 1–11. https://doi.org/10.3390/su10030588

5. Enofe, a O., Okpako, P. O., &Atube, E. N. (2013). The Impact of Forensic Accounting on Fraud Detection. 5(26), 61–73