

The recent trend of major accounting frauds show an increase involvement of senior management including the Chief Executive Officer and/or the Chief Financial Officer in fraudulent activities.

Fraud on the Rise

Various surveys in Malaysia and worldwide has shown that fraud is on an increasing trend. Fraud schemes are much more complex and more organised than ever before, especially with the sophisticated links among individuals and organisations carrying out fraudulent activities.

The roles of the Board and Forensic Accountant are becoming critically important as most of the recent major accounting frauds are perpetrated by senior management in collusion with third parties or other employees.

Fraud risk is expected to increase further due to:

- Rising trend of fraud activities involving senior management;
- Companies' tendency of not reporting to authorities fearing negative impact on reputation;
- Weakness in prosecution cases involving accounting fraud i.e. missing key evidence resulting in perpetrator escaping punishment;
- Lean custodial sentencing in

Malaysia when compared to fraud cases in Singapore and the West; and

- Job losses leading to lack of segregation of duties and staff finding other means to supplement their income when job loss/pay cuts to maintain lifestyle.

In addition, based on the Transparency International Corruption Perceptions Index (CPI), the CPI score for Malaysia, as shown in diagram 1 below, has dip from 5.28 in the year 1995 to 4.4 in the year 2010 where a score of 10 indicates a highly clean environment and score of 0 indicates a highly corrupted environment. In addition, Malaysia is now ranked 56 out of 178 countries in the world from being ranked 23 out of 41 countries in 1995.

	1995	2008	2009	2010
Ranking	23	47	56	56
Score *	5.28	5.1	4.5	4.4

*** Score 10 (highly clean) to 0 (highly corrupt).**

Diagram 1: Corruption Perceptions Index for Malaysia

Forensic Accounting – An Effective Method for Fraud Detection?

Are Board of Directors and Auditors able to prevent major fraud perpetrated by senior management and how forensic accounting can help in resolving complex accounting frauds?

The need to discover complex accounting fraud schemes supported by proper evidence, which can withstand court scrutiny has made forensic accounting a critical discipline.

Forensic accounting is a discipline that deals with the relationship and application of financial facts to business problems, conducted in a legal setting. Hence having the right person conducting the forensic accounting work is an important starting point.

The professional skills and attributes of a forensic accountant include having sufficient knowledge on accounting (including understanding complex double entry transactions), audit, fraud, information technology and law of evidence. In addition, forensic accountants are expected to have good communication skills, an investigative mentality and critical scepticism, and an understanding of psychology and motivation.

On the other hand, auditors are not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud but auditors can assist in deterring fraud by examining the effectiveness of the system of internal controls.

The common saying of “**You need to think like a crook to catch a crook**” makes it difficult for a typical auditor to play the dual role of an auditor and a forensic accountant.

Important lessons in conducting forensic accounting work include:

- Planning is critical as it will save millions of dollars of cost of investigation;
- Need to ensure that documentation is complete as it may be called upon during a trial;
- Internal Auditors can get involved in the investigation as they are involved at the process level work; and



- Collecting evidence: Getting it right is important as going back to collect evidence is very expensive and time consuming and in certain instances the evidence may be destroyed by the perpetrator.

In addition, the Audit Committee (AC) plays an important role in initiating an investigation as they are normally provided with the summary of the whistle blower reports, allegations or complaints. Upon receiving these reports, the AC needs to:

- Look at the initial reports & decide on the next step;
- Determining the scope of investigation;
- Determine the independence and competency of internal audit department to carry out investigation involving senior management;
- Engage an experience forensic accountant for complex fraud; and
- Expect a complete and through report from the investigator.

Prevention of Fraud

Developing and Implementing a Fraud Risk Assurance Map: The way forward in preventing fraud in the longer term.

While external audits are clearly important and can have a strong preventative effect on fraudulent behaviour, they should not be relied upon exclusively for fraud detection. Organisations have the tendency to over-rely on external and internal audits.

Organisations need to recognise complex fraud and develop a structured process in addressing fraud risk on a longer-term basis. This includes developing and implementing a fraud risk assurance map (FRA Map).

The critical elements of a FRA Map are shown in Diagram 2 below:

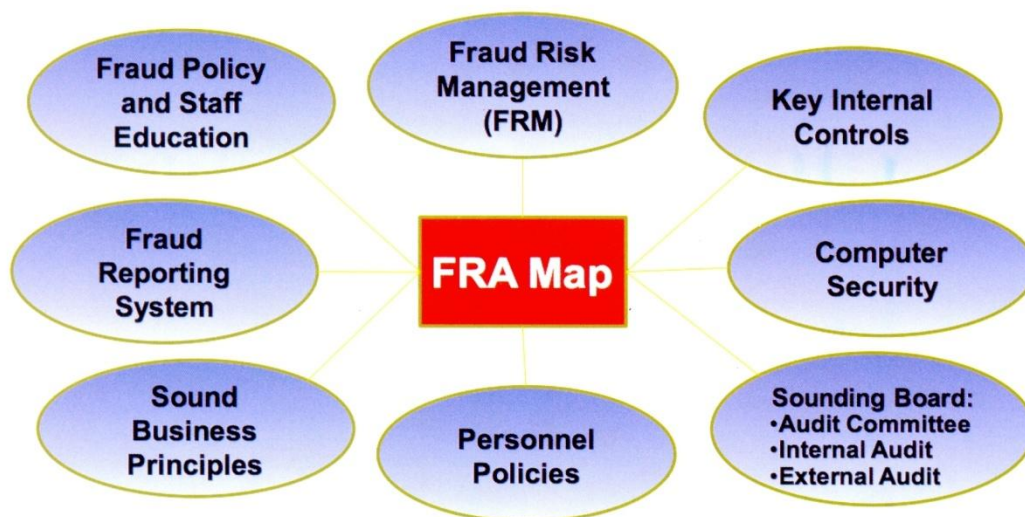


Diagram 2: Critical elements of a FRA Map

Each of the above elements plays a critical role in the fight against fraud activities and all elements must be in place to effectively reduce fraud activities to an acceptable level within an organisation.

Implementing the above elements of FRA Map requires proper planning and commitment from the senior management and the Board. For example, there are 5 different activities in the FRM element including determining fraud risk universe, identifying fraud risks through fraud risk assessment, preparing action plans to deal with the fraud risks, monitoring the implementation of fraud risk action plans and continuous monitoring of fraud indicators. These 5 activities may take 3-6 months to complete depending on the complexity and size of an organisation.

Having a proper fraud policy and staff education is the foundation of detecting and preventing fraud. Management needs to organise fraud awareness sessions involving all staff within an organisation on aspects relating to the fraud policy, fraud risk, fraud reporting mechanism including fraud hotline and importance of internal controls. These awareness sessions should also be extended to other stakeholders of the organisation.

Another critical element of FRA Map, which is gaining popularity, is fraud-reporting systems, which consist of developing and implementing a whistle blowing policy and procedures including a fraud hotline. The fraud reporting programmes must cover all staff, customers, vendors and other external stakeholders of an organisation. This element may take

approximately 2-4 months to develop and implemented in an organisation.

In Conclusion

While fraud activities will continue to rise in the current environment, auditors can play an important role in helping the Board of Directors reduce fraud activities through proper planning and execution of the audit. In addition, the need for forensic accounting is critical to investigate a complex fraud situation and collate evidence, which can withstand court scrutiny.

Staff education is the foundation of detecting and preventing fraud. Proper fraud awareness sessions need to be conducted to train staff on what constitutes fraud, how it affects the organisation and how to report a questionable activity.

The Board needs to set the right "Tone at the Top" and obtain senior management's commitment to properly develop and implement the FRA Map to reduce fraud activities in the longer term.

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