

Poor Business Ethics raises the need of Forensic Accounting

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Abstract- *Present study mainly aims at exploring the role of business ethics in accounting failures and establishing the linkage between business ethics and forensic accounting with each other. Being the study descriptive as well as exploratory in nature, findings have been made through theoretical analysis as well as snap survey analysis which consisted of 100 market participants and their preferences towards ethical issues in forensic accounting. It has been found that poor business ethics leads to corporate frauds and to curb such frauds there is a great need of forensic accountants/ accounting. Effective execution of forensic accounting also involves the need of ethical values. With the downturn of economies, increasing accounting fraud day by day for business, white collar crimes and occupational frauds are increasing in India as well as in foreign countries which leads to the increase in the demand for application of forensic accounting.*

Key Words: Business Ethics, Forensic Accounting.

Introduction

Ethical values provide the foundation on which a civilized society exists. Without the foundation, civilization collapses. On a personal level, everyone must answer the following question: What is my highest aspiration? The answer might be wealth, fame, knowledge, popularity, or integrity. But if integrity is secondary to any of the alternatives, it will be sacrificed in situations in which a choice must be made. Such situations will inevitably occur in every person's life. When ethical values are falling, people often turn to government for help. However, there is little government, especially in a free society, can do when its citizens are unethical. The scandals of the last few years came as a shock not just because of the enormity of failures like Enron and WorldCom and recently Satyam case in India, but because of the discovery that questionable accounting practice was far more insidious and widespread than previously envisioned. A definite link between these accounting failures and poor business ethics is beginning to emerge which initiates the researcher to make the study on this topic.

As per the reports of American Institute of Certified Public Accountants (AICPA) forensic accountants are high in demand. In June 2008, AICPA introduced its Certified in Financial

Forensics (CFF) certification program, by the end of the year. The goal of AICPA was to award 900 credentials. That goal was surpassed. The AICPA had awarded more than 3,500 CFF certifications by the end of September 2009, which is more than four times the number of certifications projected.

Forensic accountants basically work on the accounting criminal and civil disputes and they possess a number of additional skills therefore they are more than just number crunchers. For finding frauds they have to conduct investigations, should have knowledge of computer and should know how to use a variety of computer programs and communicate the results well. Forensic accountants are specialized in specific industries that are susceptible to fraud, such as insurance or banking, and have the knowledge of the business practices associated with those fields.

The aim of the Forensic accounting is to protect the companies from the frauds; it consists of socio-professional activities. Thus forensic accounting represents the implementation of legal, economic, social and political functions in order to protect the companies. Forensic accounting is the combination of accounting, auditing and law. The law means that the

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government's ability to establish, manage and develop social, economic and political order. Forensic accounting is considered as a separate branch of accounting. This branch deals with the control of legal and professional recordkeeping. In developed market economies, in the upcoming year, a forensic accountant is likely to be one of the 20 most wanted professions.

While conducting investigations these accountants follow the same forensic accounting basics, regardless of whether their financial work is criminal or civil. The first step of the forensic accounting is that they meet with a government representative, which consists of attorney or other client to come to know about the specifics of the alleged fraud. After that they begin with their initial research and plan the whole process of the investigation. The third step is to search the records of the business which includes bank statements, credit statements, journals, ledgers, databases, e-mails and memos anything that will show or give great information about the financial situation of the business.

Meaning of Forensic Accounting

In 1946, Maurice E. Peloubet, a partner in the accounting firm in New York, in his article he published the phrase "forensic accounting". He is considered as the first economist to publish the phrase forensic accounting. There are vast array of definitions of forensic accounting that can be found in the accounting literature itself. There is no single definition which properly defines the meaning of forensic accounting. Out of the numbers of definitions in the accounting literature, the most suitable and widely used one, according to Association of Certified Fraud Examiners, is the one defining "forensic accounting as a set of skills to use in potential or actual civil or criminal cases, including generally accepted accounting and auditing ones; determining loss of profits, revenue, property or damage, assessment of internal controls, fraud and everything else that leads to the applying of accounting knowledge to the legal system."

Forensic accounting can be traced as far back as 1817 to a court decision. If not the proper forensic accountant at least there are witnesses of accounting experts back then. The Accountant's Handbook on Fraud & Commercial Crime

defines forensic accounting as: "the application of financial skills and an investigative mentality to unresolved issues, conducted within the context of the rules of evidence."

Financial accountant should be impartial and independent while conducting investigations. The reputation of the business depends upon the investigation by the forensic accountant. If they come out with any accounting fraud in the business it would go to downgrade the reputation of the business. Once the reputation gone it would be going to make the image again in the market in the today's competing scenario. The forensic accountant considers financial statement, financial records and the conduct of employees while investigating the business. Financial accountants do this investigation in order to find the sign of accounting frauds in the financial statement of the business. These investigations are also known as audits. Their basic aim is to find whether the financial statements presented to the end users are accurate and complete. If there is any need arises they may take out internal databases from the business and court records. With the use of psychology attributes the forensic accountant must go beyond the accounting number and must anticipate criminal action, Because people committing fraud have hidden the evidence of their crimes, Forensic accounting are also referred to as an investigative accounting, it is an area where in addition to accounting knowledge also requires the knowledge of information technology

"The integration of accounting, auditing and investigative skills yields the specialty known as Forensic Accounting." Webster's Dictionary defines "forensic" as, "Belonging to, used in or suitable to courts of judicature or to public discussion and debate."

Forensic accounting analyzes the financial records of the companies according to the accounting laws which will form the basis for discussion and debate. It is considered as the ultimate dispute resolution. Forensic Accounting encompasses both Litigation Support and Investigative Accounting. Forensic Accountants

have accounting, auditing and investigative skills which he utilizes while conducting an investigation. It is also critically required from the forensic accountant to respond immediately and to communicate financial information clearly and concisely in a courtroom setting.

Forensic Accountants should be trained in such a way that they would with the business reality of the situation and to look beyond the numbers. They basically deal with the study of the area of financial fraud and malfeasance. "The concept of forensic accounting is a thorough and complex setting in which an accountant, in his professional independent judgment, forms a presentation at such a high level of reliability that it can qualify as evidence in legal proceedings conducted"

After gathering the records, and if the forensic accountant comes out to know that something is wrong in the financial statement, the next step of forensic accounting is that conducting interviews with the accused and other involved parties by the forensic accountants to get individual stories about the irregularities. Forensic accountants must have observational skills so that they would find up subtle hints or get to know about suspicious clues that may eventually lead them to the perpetrator. The Clues of finding perpetrator may include new cars, numerous vacations and starting additional businesses without other visible sources of capital etc.

How far will forensic accountants go to obtain information? Basically it depends upon the kind of the case. Forensic accountant have to work with law enforcement and the district attorney's office in criminal cases. Forensic accountant as the prosecution have to obtain search warrants and look to locate financial information and contact with the people and take interviews with the people in order to find the situation. But in civil case, they have client, who is usually a part of the company being investigated by the forensic accountant or he holds agreements that permit accounting investigations.

After obtaining all of the information, the next step of a forensic accountant is to begin the analysis. He or she has to trace the assets of the

company, next step is to calculate the total loss and exactly how it occurred, and summarizes various transactions. The final step is to prepare a detailed report consisting of the plan of action and what the investigation have uncovered. In order to explain the case in an understanding the whole case, this report may also include graphs, charts, spreadsheets and other methods.

In addition to investigating, forensic accountants may provide litigation support. Attorneys engage the services of forensic accountants to audit existing documentation and testimony and explain their financial significance. In order to solve the case, a forensic accountant can help the attorney what additional information may be needed and what questions to ask of witnesses. Again the forensic accountant can also review financial reports and comes to know whether the report was accurate and supports the case.

The task of a forensic accountant is to analyze, interpret summarize and communicate interconnected business and financial positions, so that they can be properly understood and appropriately supported. In order to present the appropriate position of the business, a forensic accountant often participates in the following activities:

Research for the evidence of accounting fraud committed in the business and analyzes them,

Developing applications using information and communication technologies used in the analysis and presentation,

Presentation and communication of research results, and

Participation in legal proceedings (usually as a witness in court, as an expert in forensic accounting)

Objectives of the Study

1. To explain the conceptual framework of ethical issues in accounting.
2. To link the business ethics and accounting with each other.
3. To know whether forensic accounting meets the need of corporate world where poor business

ethics are leading the financial crimes.

4. To clearly understand the essential traits and characteristics and core skills that forensic accountants.

Literature review

According to Ramaswamy, V. (2005), "Corporate Governance and the Forensic Accountant," "financial deceptions are distinctively uncovered by Forensic Accountants. Forensic accountants are basically positioned for this work." With the in-depth knowledge of financial statements and fraud schemes, he also has the capability of thorough analysis of financial statement of businesses and understanding frauds into the financial statements of the illegal advantage by the businesses. According to Ramaswamy, V forensic accountants should have to be psychologist or they should have knowledge of psychology, which would help them to understand the motive behind the discrepancies in the financial statement. According to him Forensic Accountants should also have the capability to understand the internal-control systems of businesses and able to asses risk.

Dr. Madan bhasin (2007) believed that "with the day to day increase in the white collar crimes recently, lack of experts in Indian law enforcement agencies and the lack of time to uncover the frauds in the business leads to the increase in the demand of Forensic accounting. He believes that a large accounting firm should support and devote strictly an independent unit to forensic accounting. In India according to his study "In India all the larger accounting firms as well as the medium sized firms have the forensic accounting department, even the small firm's supports forensic accounting".

"Forensic accountants have combination of skills and are considered as important assets to the todays accounting legal teams of the country. With the increasing level of accounting frauds, the role of forensic accountants is also growing, for detection of these frauds" believed Dr. G.S. Mehta and Tarun Mathur (2007). He also believed that the demand for the forensic accountant will for sure grow in the near future in

order to curb the day to day increasing accounting frauds.

According to Joshi (2003) forensic accounting need for accounting frauds originated by Kutilya. The first economist who openly recognized the need for the forensic accountant was Kutilya. He also believed that "forensic accounting term was coined by Peloubet in 1946."

Crumbley (2001) also wrote on the origination on the need of the forensic accounting, according to him the need of forensic accounting can be traced back to an 1817 court decision. He also wrote that a "In the arbitration support in 1824 a young Scottish accountant issued a circular advertising regarding his expertise" but that Peloubet was probably the first to publish the phrase forensic accounting.

Research Methodology

Research methodology of this study consists of following procedures:

Research Design: Being the study descriptive as well as exploratory in nature, it will go through sampling, data collection, and its analysis.

Source of Data: This study is mainly based on secondary data gathered from various newspapers, magazines, journals, and websites. In addition to this primary data has also been collected through a snap survey using the questionnaire designed for this purpose to know the preferences of market participants about ethical values in forensic accounting.

Sampling:

Sample size: 100

Sampling unit: Stock Market Participants

Type: Deliberate/ purposive sampling has been taken.

Research Method: Study is based on sampling not the census method which limits its universality.

Ethical Standards

When applying these fundamental principles, members must be aware that in order to retain public confidence they should conduct their activities in such a way that they can demonstrate that these principles are being applied.

Integrity: It implies not merely honesty but reliability, fair dealing and faithfulness.

Members are expected, in appropriate circumstances, to provide advice and comment on a financial matter of which they may become aware even if not invited to do so.

Objectivity: Objectivity is exercised when members make judgments supported with evidences, not depending on, by, personal biasness or prejudices.

Competence and Due Care: Members should independent of agreeing to perform professional services which they are not capable to carry out, whether in terms of skill or resources, unless competent advice and assistance is obtained so as to enable them satisfactorily to perform such services. Where the organization has issued codes of conduct or there is other formal guidance, such advice should be complied.

Confidentiality: Members have an obligation to information secured about an employer's or client's affairs in the course of professional services. The duty of privacy continues even after the end of the relationship with the employer or client. Confidentiality is not limited to disclose the information. It also requires professionals should not use that information for personal advantage or for the advantage of a third party.

Proper Conduct: Members pursue their profession conduct which would not discredit, or likely to diminish public confidence in them in their professional capacity, or the accountancy profession or the Institute. They should also set the example to follow fundamental ethical principles through leadership.

A member shall carry out professional work in accordance with the technical and professional standards relevant to the work.

Accounting & Poor Ethics

Accounting is a career field where high ethics and morals are important character traits for individuals. Poor accounting ethics can lead companies into bankruptcy from improperly reported financial information. Following are results of poor ethics in accounting.

Fraud: Accountants with poor ethical standards may conduct fraudulent activities, such as

overbilling clients or delaying vendor payments. Most fraud cases involve hiding cash for internal purposes.

Embezzlement: Accountants may misappropriate the things from their employers when given too much responsibility and little failure to notice. These situations give accountants more control than necessary and the ability to mislead their employers on financial information.

False Information: Some companies employ accountants who have the ability to manipulate financial transactions to bring the company results in favor. These ethical situations were witnessed in the various accounting entities.

Tax Evasion: Some accountants create illegal tax shelters to understate the company income. Companies use these shelters to reduce the paying amount of income tax to Government.

Personal Loss: Poor accounting ethics can lead great personal harm in addition to business problems. Accountants found guilty of manipulating accounting information are sent to jail, creating difficult situations for the accountant's family members.

Business Reputation

Poor business ethics also effects on the business reputation. It damages business reputation in the market. Trustworthiness of business stakeholders also gets downgraded. Shareholders, customers, suppliers and business partners are considered as stakeholders of the business. Survival of the business without the stakeholders is difficult. Poor business ethics leads to the Trust deficit with the stakeholders, which would make the business difficult to survive in the competing scenario. Making reputation in the market is one of the required things for the conduct of business in competing scenario. But if there is poor ethics in the business, it will completely damage a business' reputation.

Less Usefulness of Financial Statements

Financial statements become less useful, if for an illegal advantage an accountant deliberately

manipulate the information which is presented on the financial statement of the business. If an accountant deliberately break down the rules of accounting for showing the better position of the business in the market and to the stakeholders is considered as unethical. Financial statements of the businesses should remain accurate and truthful. End users make their decision regarding dealing with the business by using financial statement of the business. Tainted financial statements deter the end users decision-making process. An erroneous figure in the financial statement makes the end users doubtful regarding all the figures in the financial statement and they find it difficult to trust the business in the future.

Need of Forensic Accountants

In today's rapidly changing business scenario, it is now necessary for accountants and companies to step away from the traditional approach that stressed compliance with GAAP, and to focus on the study and investigation of the traits underlying corporate behavior and management. This could be the key to preventing future meltdowns, and to guaranteeing the two important qualities of corporate reporting: transparency and honesty.

Initially, forensic accountants were used by government agencies, such as the CIA, the FBI, and the IRS, to uncover and investigate fraud. They became financial detectives; independent experts employed by management to uncover fraudulent financial reporting and misappropriated assets. In the current reporting environment, forensic accountants are in great demand for their accounting, auditing, legal, and investigative skills. They can play a greater role in coordinating company efforts to achieve a cohesive policy of ethical behavior within an organization.

Forensic accounting can be defined as an application of financial skills, and an investigative mentality to unsettled issues, conducted within the context of rules of evidence. As a discipline, it encompasses financial expertise, fraud knowledge and a sound knowledge and understanding of business reality and the working of the legal system. This implies

that the forensic accountant should be skilled not only in financial accounting, but also in internal control systems, the law, other institutional requirements, investigative proficiency, and interpersonal skills. Corporations can rely on these skills for developing a consistent system of corporate governance, disseminating such information within and outside the company, ensuring that governance policies and objectives are interwoven into the internal control system, setting up fraud prevention systems, and investigating any existing fraud.

As part of the governance committee, a forensic accountant can make a significant contribution in each of the following areas:

Corporate governance. With a strong background knowledge of the legal and institutional requirements of corporate governance, a forensic accountant can help formulate and establish a comprehensive governance policy that: ensures an appropriate mix of management and independent directors on the board; sets out the appropriate responsibilities of the board and the audit committees; has a fair allocation of power between owners, management, and the board; and ensures there is a company code of ethics for employees and management. Ethical behavior is reinforced when top management shows, through its own actions, that questionable behavior will not be tolerated.

Preventing fraud. Forensic accountants understand that the best way to prevent fraud is to establish an efficient control system that encompasses: a good control environment determined by management's philosophy of ethical behavior and strong corporate governance policies; a superior accounting system that ensures the proper recording, classification, and reporting of all relevant transactions; and strong procedural controls that provide for safeguarding of assets, proper authorizations, audit mechanisms, and proper documentation.

Creating a positive work environment. Forensic accountants can ensure that governance policies are formulated to avoid high-risk environments

where management is apathetic, pay is inadequate or too high, there is a serious lack of proper training and compliance, or there are unreasonable profit and budget goals. It is also necessary to have well-defined hiring policies that result in honest, well-qualified employees.

Establishing effective lines of communication.

Forensic accountants can support the dissemination of the required information about governance and ethics policies to interested parties within and outside the organization. Adequate reporting is also necessary to meet the compliance requirements of the SEC and the stock markets.

Vigilant oversight. Any system needs to be constantly monitored and evaluated to make sure that it is functioning well. A forensic accountant can monitor not only compliance at the top levels of corporate power, but also management procedures and employee activity. Information gathered as a result of the monitoring can be used to readjust and reformulate governance, ethics, and control policies.

Establishing consequences. Fraud deterrence should also include an expectation of punishment. The forensic accountant can help in creating policies that clearly state the company's intent to take action against any criminal activities, and that such action will apply to all levels of employee.

Fraud investigations. A forensic accountant can ensure the integrity of financial statements by actively investigating for fraud, identifying areas of risk and associated fraud symptoms, pursuing each anomaly aggressively, and delving into the minutest details of accounting and financial anomalies. By helping companies prevent and detect fraud, the forensic accountant's role can easily evolve into a key component in the ethical issues as well as good corporate governance system.

Results and Discussion

A questionnaire was designed and circulated to market participants to establish the relationship between ethical standards and role of forensic

accountants. Each ethical standard was given to five options of role of forensic accountant as stated in table1, of which they had to choose their preferences. Results have been shown in table 1.

Table1 : Relationship between Business Ethics & Forensic Accounting

S. N.	Ethical Skills	Aspects of Forensic Accounting	Respondents Preferences (%)	Ranks
1.	Integrity	Prevention of Fraud	89	C
2.	Objectivity	Establishing Consequences	78	E
3.	Confidentiality	Proper Line of Communication	92	B
4.	Competence & Due Care	Fraud Investigations	86	D
5.	Proper Conduct	Corporate Governance System	95	A

As table 1 shows that there is a strong relationship between various ethical standards and different roles of forensic accountants. High level of integrity is required to prevent the occurrence of frauds in corporates whereas objectivity confirms the occurrence of events with the evidences so that relationship can be established between commitment of fraud and its consequences. Members have an obligation to respect the confidentiality of information about an employer's or client's affairs in the course of professional services but Forensic accountants are required to disseminate required information about governance and ethics policies to interested parties within and outside the organization. Adequate reporting is also necessary to meet the compliance requirements of the SEC and the stock markets. Today the word “confidentiality” is being misinterpreted; it does

not mean to restrict the corporates to disclose the required information to different stakeholders. For the proper investigation of frauds competence and due care of forensic accountants is required. The last but not least is proper conduct which leads to sound corporate governance system; it has been ranked first by market participants.

Conclusion

The main objective of this research was to gain a clearer understanding of the essential ethical skills that forensic accountants are expected to possess for the varied investigative matters for which they are retained. This research study and the results revealed that proper conduct remains the foremost ethical skill that forensic accountants are expected to possess. The results also showed that integrity, objectivity, confidentiality and core competence & due diligence are critical to the effectiveness of the forensic accountant in fraud prevention, detection, investigation and development of sound corporate governance system. There is also a need for the forensic accountant to be able to look beyond the analytical details and see the big picture -- to start with the goal in mind. Along with the increased demand for forensic accounting services, the study demonstrated that the marketplace expects the forensic accountant to possess certain characteristics and core skills as well as ethical skills. Study concludes that there is a strong linkage between business ethics and effectiveness of forensic accounting; both of them supplement each other.

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