University of Jijel

Departement of Economic Sciences

Module : English for Specific Purposes *Teacher :Manel.A*

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ACCOUNTING FRAUD

Accounting fraud is when a company's financial statements or tax returns are intentionally manipulated to project better financial health than what is real. An organization might exaggerate its revenue, understate its costs or liabilities, or inflate its assets. This is usually done to gain more investors, create a better financial image about the brand, or for personal gains on behalf of the company by a member of staff, an accountant, or the company itself. It is important to note that manipulating numbers is a criminal offense and the people involved could face legal consequences.

- **FRAUDULENT ACTIVITIES IN ACCOUNTING**

1. Revenue Recognition Fraud(Altering real revenue)

When a company over states its revenue, the company is committing accounting fraud. For example, if a company is underperforming in terms of revenue and is not making enough profit, and still intends to project false profits to maintain better status among investors and customers, then it is a clear use case of accounting fraud. They most likely may do this to boost their share value and cover up any negative perceptions.

Here are some warning signs to identify revenue manipulation:

- Keeping the books open after the end of the reporting period to log more sales.
- Recording income before the actual sale of goods or services happens.
- Delivering goods or services well ahead or before an actual purchase takes place.
- Sending goods to a warehouse in a different location and recording them as a sale.
- Not finalizing invoices within the reporting period.

2. **Expense Manipulation**

Expense manipulation occurs when individuals falsify or misstate expenses to distort financial results. Common tactics include understating expenses, deferring expenses to future periods, or misclassifying expenditures to conceal losses. In other words When a company keeps its expenses intentionally "off the books," While in reality the company may be losing money, a false impression is created about the net income it receives. To prevent expense manipulation, establish clear expense approval processes, conduct regular expense audits, and enforce strict controls over expense reporting and reimbursement.

- **Misstating assets and liabilities**

Sometimes, companies commit accounting fraud by stating they own more assets and owe less money than they actually do. For example, a company might claim to have a lot of valuable assets, but not as many bills to pay. This gives out a projection like the company has a lot of money in the short term.

Consider a company with $1 million in assets and $5 million in liabilities. If the company states that it has $5 million in assets and only owe (liability) $500,000, it is not being honest about how much money it has to cover its bills. This can trick people into thinking the company is in a better financial position than it really is.

Here are the activities that denote an underlying asset and liabilities manipulation:

- Recording incorrect depreciation rates.
- Not disclosing contingent liabilities.

3. **Manipulating inventory**

Inventory accounting is highly important as companies generate income when the inventories are sold. Also, the revenue will be recorded in the Cost Of Goods Sold in the income statement. Some companies manipulate the inventory to show a decrease or increase in revenue for that particular year.

- Watch out for these activities to find out if there's evidence of inventory manipulation:
- Adjusting the cost of products sold to show increased earnings.
- Concealing cash as an inventory asset.

4. **Financial Statement Manipulation**

Financial statement manipulation entails altering financial statements or omitting material information to mislead investors, creditors, or regulatory authorities. This may involve inflating assets, understating liabilities, manipulating reserves, or misrepresenting financial performance. To detect and prevent financial statement manipulation, conduct regular financial statement reviews, implement internal controls over financial reporting (ICFR), and ensure compliance with Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS).

- **Signs of accounting fraud in financial statements**

When the statements show the company makes more money, but there is not any actual cash is an indication of active financial fraud.

- The company shows consistent growth in sales while the entire market and its competitors are struggling.
- The company's performance spikes questionably in the reports that are generated in the final quarter of the year.
- There are frequent complicated, unexplained third-party transactions that have no logical reasoning or purpose.
- Unexplained items listed in the reconciliation with no invoices or valid records.
- Growth in sales without matching or corresponding growth in inventories or the opposite.

Strategies for Fraud Prevention:

1. **Establish Strong Internal Controls**: Implement robust internal controls, segregation of duties, and approval processes to prevent unauthorized access to financial records and transactions.
2. **Conduct Regular Audits and Reviews**: Schedule periodic internal and external audits to detect anomalies, inconsistencies, or irregularities in financial records and transactions.
3. **Promote Ethical Culture and Whistleblower Protections**: Foster a culture of integrity, transparency, and accountability, and provide channels for employees to report suspected fraud anonymously.

4. **Leverage Technology and Data Analytics**: Utilize accounting software that detects policy violations, automates accounting processes, enforces segregation of duties, and implements strict approval mechanisms, reducing vulnerability to unauthorized transactions. and data analytics tools to monitor financial transactions, detect patterns of fraud, and identify anomalies in real-time.
5. **Invest in Employee Training and Awareness**: Provide training on fraud risks, warning signs, and reporting mechanisms to empower employees to recognize and report fraudulent activity.

- **ROLE OF ACCOUNTANT IN DETECTING AND RESPONDING TO FRAUD**

Certified public accountants (CPAs) are crucial gatekeepers, as they identify fraud risks and detect material misstatements in financial statements. They may encounter challenges in fulfilling their gatekeeping responsibilities, such as a lack of substantive procedures tailored to fraud risks, insufficient testing of journal entries, failure to assess revenue recognition as a potential fraud risk and inadequate communication with audit committees about fraud risks. Audits do not protect against misstatements but provide reasonable assurance that fraud and errors will be detected.

❖ **<u>TextBased Activities</u>**

Exercise 01: **Define the following terms using context from the passage**

a) Contingent liabilities

b) Depreciation

c) Revenue recognition

Exercise 02: Identify and explain the difference between the following pairs

a) Revenue vs. Profit

b) Expense vs. Liability

c) Financial Statement vs. Invoice

Exercise 03: Match the following terms to their definitions

Term	**Definition**
A. Expense manipulation	1. Recording revenue before the sale occurs
B. Revenue recognition fraud	2. Misstating expenditures to distort income
C. Financial statement manipulation	3. Misleading stakeholders by altering official reports
D. Asset Inflation	4. Expenses intentionally excluded from official financial statements
E. Off-the-books expenses	5. Direct costs attributable to the production of goods sold
F. Cost of Goods Sold (COGS)	6. Recording more assets than the company owns

Exercise 03: Complete the sentences below using the appropriate academic term from the box:

[liabilities | depreciation | fraud | revenue | inventory | understatement | reconciliation | reserves | understated | manipulation | transparency | liabilities | invoice | depreciation | inflated | fraudulent]

1. Accounting _________ occurs when a company intentionally manipulates its financial information.
2. A company may use incorrect _________ rates to distort the value of its assets.
3. Overstating assets and understating _________ gives the impression of financial strength.

4. A suspicious rise in ________ without a corresponding increase in sales may indicate manipulation.
5. ________ recognition fraud involves recording sales that have not actually occurred.
6. The company presented an ________ value for its machinery to attract more investors.
7. The absence of an ________ for the mysterious transaction raised suspicions.
8. Financial ________ ensures that all monetary activities are accurately reflected.
9. Companies must maintain adequate ________ to cover future losses.
10. To appear solvent, the firm ________ its actual debts.
11. The ________ of accounting entries is a serious legal offense.
12. The error was discovered during the bank ________ process.
13. ________ reporting of earnings may be used to avoid tax obligations.
14. ________ in accounting practices can build investor trust.
15. The equipment's annual ________ was not recorded, overstating the asset's value.