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Analysis of cause of financial fraud and precautions

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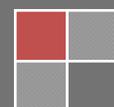
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ABSTRACT

Financial fraud refers to conceal all kinds of financial defects and hidden dangers of enterprise, which makes stakeholders do the wrong judgment and decision making, disrupts the order of market economy as well as encroaches on national and social public benefits. In fact, fraud cannot change enterprise's real earning performance. As the means of financial fraud emerge in endlessly, which greatly influences the orderly and stable running of national market economy, analysis of real causes of financial fraud and seeking its strategy are extremely urgent for setting up a normal and well-organized accountancy order.

KEYWORDS

Financial fraud; Cause; Strategy.



THE MEANS OF FINANCIAL FRAUD

Fictitious Transaction

Set up A Company which in form is not correlative with the Company, but actually is totally controlled by the Company. Then, the Company counterfeits a great number of economic businesses and transactions by virtue of A company.

Manipulating Revenue

Some companies usually take improper revenue recognition methods to confirm earning in advance and hide real income as their concealing methods of accounting statements. Such a kind of manipulation is used to counterfeit profit of the period and conceal deficits.

Manipulating Expenses

Revenue is corresponding to the recognition and measure of expenses. The false expenses will result in untrue business performance of enterprise and company as well. Moreover, the inaccurate expense calculation is always followed by the inaccuracy of assets accounting, thus, the financial conditions of enterprise and company will be demonstrated in a distorted way.

THE CAUSE OF FINANCIAL FRAUD

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Counterfeiting Driven by Interests

Due to the insufficient development of China's market economic system, various systems are still not be rationalized. It is very common that there is no rule to comply with or rules are not enforced. a) out of political interests. The government's work achievements are associated with its local large enterprises' performance. If the enterprises earn good benefits, both of them will be satisfied. But when the benefits of enterprises go down, in order to keep the good image of enterprises, they will naturally make use of fraud means like making a false report of production value and profits. And under such situations, local governments or competent authorities also acquiesce in enterprises' temporary fraud behaviors. Even in some places, local governments will offer bank loan to those enterprises through administrative inference in hope that paying tax money problems caused by enterprises' false profit reports could be solved. b) Out of economic interests. For listed company, its good benefit image will provide a relatively smooth way in financing and raising funds or ensure this enterprise's stocks to go public. Many local governments have formulated corresponding performance evaluation standards and the relevant rewards and punishment measures in order to improve local enterprises' management level and economic effectiveness. To improve its business performance, the enterprise' administrator will try every means to achieve this goal, such as cooking the book.

Low Occupational Qualities of Accountants

With the constant changes of economic society and the further deepening reforms, accountants play an increasingly important role in economic activities, but meanwhile, the requirements of their qualities asked by society is also becoming more and more. Therefore, we will discuss about the insufficiency of current accountants' qualities from three aspects. a) The professional qualities of accountants are not high. And due to this, their failure to work on accountancy in a skillful and regulated way often causes several mistakes during the accounting work as well as makes their inability to complete work smoothly and efficiently. As a result, many troubles will be caused to prevent normally carrying out the accounting work as well as influence the rapid development of accounting industry. b) The accountant has a very weak awareness of law. At present, some accountants don't seriously learn the relevant national laws and regulations, and set strict requirements on themselves, thus, their awareness of law is very weak. In recent years, it occasionally occurred that accountants broke the laws and regulations. Some violated financial and economic disciplines to cook the book under the forced orders, threatens, instigations and inspirations of unit leaders; some even helped give suggestions instead of preventing counterfeiting out of their economic interests pursuit; some accountants ignored the national laws and took advantage of their positions for corruption and embezzlement of public funds. c) The moral qualities of accountants are not high. As China pays inadequate attention to the moral education of accounting major, a lot of accountants take indifferent attitudes to jobbery and speculation, and even positively participate in cooking the book, counterfeiting and joining together in practising fraud.

Imperfection of Enterprise's Accounting System

Accounting reform belongs to a category with rich connotation and wide extension, including accounting system and accounting management system, among which the accounting system reform is the essential and core part of the accounting reform, a decisive factor of its success or failure as well as reflecting the merits and defects of the effects of accounting reform. However, a lot of deficiency exists in China's accounting system: a) the original certificate, also the most basic evidence recording and reflecting economic businesses will be off the docket due to accountants' failure to comply with regulations to make real and legal one; the permission to send back the inaccurate and incomplete original certificate and make correctness and supplement will result in wrong records, and subsequently the accounting voucher will be inaccurate or wrong. Hence, the account book and accounting reports will be proved untrue. Finally, personal and national interests will be damaged. b) Certain incompatible positions usually held only by one person, which easily leads to mistakes and frauds.

Related personnel will modify the records due to his personal purpose, and the accounting information will be distorted. c) The enterprise usually makes two sets of accounting books, the false one for publishing, and the true one for the enterprise. By doing this way, the publishing enterprise' information becomes valueless.

Inadequate intensity of national punishment

The intensity of punishment decides the fraud cost. The greater the intensity of punishment, the higher the cost will be, and vice versa. In China, a great number of lenient punishment problems exist in this aspect: a) most handling with public accounting firms and certified public accountants involved mainly takes the form of administrative penalty. In recent years, the intensity of punishment has been enhanced, among which personal punishment directly at certified public accountants has become more and more severe, until to be investigated for criminal responsibility according to law, but lawsuits aimed at the civil liability to be borne by auditing of CPA (Certified Public Accountant) are still rare. Such a kind of punishment can hardly generate enough deterrent effects on auditing profession circle. b) The planning and commanding executives usually focus on administrative penalty and neglect civil compensation, which results in a very small probability of fraud being investigated and charged for compensation. c) Punishment on enterprises which gain benefits from counterfeiting is insufficient, generally compensating for involved tangible property instead of assessing the involved intangible loss and implementing corresponding punishment. Therefore, the current revealed costs of counterfeiting are far less than the gains of counterfeiting.

Slack supervision of social auditing

In order to maintain their good relationships with listed companies and the immediate interests, some certified public accountants fail to perform duties very well or break professional ethics. They not only don't reveal the false accounting information, but also provide services for counterfeiters like unqualified audit reports. If the joint-stock company wants to go public or allot shares, it has to first pass the auditing of certified public accountants. Although it is difficult to keep absolutely accurate information, the obvious financial fraud will definitely be discovered by accountants. The existing certified public accountant team has possessed of a certain degree of independence, but due to its main economic benefits from auditing targets, some auditing institutions with poor independence and principles as well as auditors with low professional ethics will become immoral for profit. When they discover the falsehood of auditing unit accountants, they don't correct or reveal it, and sometimes, they even offer financial fraud advice to make the fraud more concealed.

PRECAUTIONS FOR FINANCIAL FRAUD

Improving the identification ability of correlative companies

In order to maintain the normal transactions of correlative companies, attention should be paid to their original certificates. The original certificate gained or filled when the economic business transactions occur or completed, is written evidence used to prove the occurrence or completion of economic business transaction. In economic activities, illegal gain, filling, counterfeiting or alteration of original certificates to defraud incomes will make accountants check computation on the basis of untrue original certificates. As a result, a series of accounting information will be distorted. According to the filling requirements of original certificates stipulated in *The Accounting Law* and *The Accountant Foundation Work's Standard*, the original certificate of the occurring economic business transaction must be filled or gained and sent to the accounting institution in time. And meanwhile, the accounting institution and accountants shall check the original certificate in accordance with the uniform stipulations of national accounting system. Those real, legal and reasonable original certificates with incomplete contents and errors in filling should be sent back to the concerned handling personnel who should be responsible for completing, correcting errors or refilling the relevant certificates, and then conduct formal accounting procedures. For those correlative companies, the great attention to the sources of original certificates should be paid.

Specifying the revenue recognition and measure

The revenue recognition essentially refers to when the income is recorded and how to be reflected in the profit and loss statement. The whole process of accounting information processing can be divided into four steps: recognition, measure, record and report. We discover that the recognition of transactions and events dominates in the process. Enterprise should first confirm its operation revenue when selling goods, rendering labor service, receiving payment or acquiring the evidence of asking for payment, and then gradually make the final information report. The recognition of accounting information has the most important effect on the accounting information report. Only the correct recognition of transactions and events can provide the most important quality characteristic of accounting information---correlation and reliability. Although the balance sheet gradually gets more attention, the users of accounting statement seems to have a higher degree of recognition of profit and loss statement. In the course of business transactions, the comparison between specific invoicing time and the time stipulated in contract is vital. The selling occurring within the time stipulated in contract should be included in main business income immediately and do corresponding records.

Accurate analysis of fixed-asset investment

The fixed-asset investment is an important entry point for company to cook the book, but this kind of false account can't go too far. After all, the fixed-asset investment is irremovable, and easy to be revealed. As an investor, you should maintain high vigilance in fixed-asset investment. According to the completion time of letter of commitment provided by the company, an analysis of whether the company has completed work within schedule time should be conducted.

Improve the internal control system of enterprise

The improvement and perfection of enterprise' internal accounting management system is the connotation of ensuring the authenticity of financial information. a) improving the internal accounting management system; b) perfecting the accountant post responsibility system; c) specifying financial processing procedures; d) setting up an internal check system; e) establishing an investigation and auditing system; f) setting up an original record management system; g) setting up a quota management system; h) establishing a property inventory system to regularly make an inventory and check on property and materials so as to ensure the account conforms to the real one; i) setting up a financial revenues examination and approval system to confirm its range, assessing officers, limits of authority, procedures and responsibilities; j) establishing a cost accounting system to formulate the rules of cost accounting, collection and allocation for enterprise units.

Improving the content of accounting laws and regulations

With the improvement of market economy, the gradual nationalization of accounting has become the inevitable trend. China must speed up the pace of deepening the accounting reform, further improve accounting standards and relevant systems, standardize accounting behaviors, avoid subjective randomness and narrow down the difference between accounting information and real situations, which is the prerequisite of ensuring the quality of accounting information. a) on the basis of serious summary on existing accounting standards' implementation as well as under the development requirements of market economy and stock market, a batch of specific accounting standards coordinating with international practice and reflecting China's economic development features should be formulated to further improve the quality and transparency of accounting information and standardize its disclosure; b) considering the practical situation that accounting check computation system will be with accounting standards in parallel for a long time, we must greatly improve the sensitivity of accounting check computation system and reflect the changeable and increasingly complex economic businesses in time; c) in the process of standards formulation, we should handle the relationship between uniformity and flexibility of accounting standards with extreme prudence to avoid that some enterprises make false financial statements and manipulate their profits by virtue of legal but unreasonable ways; d) narrowing down the selecting space of accounting policies as much as possible so that the regulations in accounting policies choosing can be made more specific.

Strengthening social supervision of independent auditing

Independence is the soul of certified public accountant in auditing. Firstly, we need to strengthen the independence of certified public accountant in auditing, which includes the independence in form and in fact. The independence in form means that certified public accountants must have no special interest relationship with companies or individuals under review. And the independence in fact requires that certified public accountants must strictly keep transparency in the process of practice, not partial to any one party, especially not making their own conclusions depending on or yielding to the influences and pressures of interest groups or persons who hold dissenting opinions. When certified public accountants make assurance service like auditing, examination, verification and approval, they should scrupulously abide by the principle of independence. Also, they ought to maintain deserved professional skepticism, keep and improve professional competence as well as comply with independent auditing standards. Secondly, we need to enhance the communication with predecessor and successor of certified public accountants. Judging from the conditions in China, accounting firms change too frequently. The successor of certified public accountants should conduct communication with the same enterprise together with the former accountants. They should make reports on the important errors and reveal them in the financial statements. By this way, we can avoid some companies' improper means to influence auditing opinions.

It can be concluded that the result of financial fraud is caused by the reason of interests and loopholes existing in regulations and systems. As the financial fraud severely interrupts the normal economic orders, we should seriously study the corresponding treatment measures to solve the current problems and eliminate the root in a multi-pronged way as well as accelerate the solving of accounting information fraud phenomenon. The total train of thought should be: Each company is unwilling to make fraud through enhancing education; each company is unable to make fraud by virtue of improving laws and regulations; each company is afraid to make fraud due to the intensifying administrative and criminal penalty. In such a way, the qualities of financial information of all companies can be improved greatly. After all, the appearance of financial fraud is a product of certain specific stage in the process of economic development. With the gradual improvement of systems, the quality of information demand subject will get promoted, and the rationalization of decision-making and the moral qualities of accounting practitioners as well as administrative staffs of enterprise are also improved. Then, the company will set up a good corporate image to provide potential capital and competitiveness for its future development.

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