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CONTENTS

Sr. No.	TITLE & NAME OF THE AUTHOR (S)	Page No.
1.	THE RELATIONSHIP BETWEEN ACCOUNTING REVENUES, INCOME AND EXECUTIVE PAY <i>DR. C. JOE UENG, DR. VINITA RAMASWAMY, DR. YA-HUI HSIEH, DR. YU-TA CHEN & CHING LIANG CHANG</i>	1
2.	TRAFFIC FATALITIES AMONG CHILDREN THAT IS CAUSING EXTENSIVE ECONOMIC DAMAGES <i>MURAT DARCI</i>	5
3.	IMPACT OF CONSUMER PRICE INDEX, REAL EFFECTIVE EXCHANGE RATE INDEX, PER CAPITA INCOME AND DISCOUNT RATE ON PAKISTAN'S STOCK MARKET INDEX <i>MUHAMMAD TOSEEF ASLAM & DR. MUHAMMAD RAMZAN</i>	10
4.	NEW FACE OF MANAGEMENT EDUCATION: ISSUES AND CHALLENGES <i>DR. S. K. BARAL</i>	15
5.	MANAGEMENT OF RURAL FINANCING FOR RURAL UPLIFTMENT -AN ANALYSIS <i>DR. A. JAGADESH BABU & DR. V. V. RATNAJI RAO CHOWDARY</i>	20
6.	PROBLEMS OF WOMEN ENTREPRENEUR IN MAYILADUTHURAI, NAGAI DISTRICT <i>K. MANIKANDAN & DR. K. RAMAKRISHNAN.</i>	24
7.	SWOT ANALYSIS OF WOMEN ENTREPRENEURSHIP IN TIRUPUR WITH SPECIAL REFERENCE TO DALITS <i>P. DEVI BHUVANESHWARI & DR. R. ANNAPOORANI</i>	29
8.	QUALITY WORK LIFE OF MIGRANT CONSTRUCTION WORKERS IN CHENNAI <i>DR. LAVANYA VEDAGIRI RAO</i>	33
9.	AWARENESS LEVEL AMONG WOMEN ENTREPRENEURS TOWARDS STREE SHAKTI AND SGSY – A STUDY OF NORTH KARNATAKA DISTRICTS <i>DR. A. S. SHIRALASHETTI</i>	37
10.	SACK TO SOPHISTICATED: JOURNEY OF JUTE INDUSTRY <i>SANGEETA DEWAN & PREETI SODHI</i>	41
11.	SOCIO ECONOMIC DETERMINANTS OF PARTICIPATION IN MGNREGA: A STUDY IN BANKURA DISTRICT OF RURAL WEST BENGAL <i>BIPUL DE & SEBAK JANA</i>	48
12.	CUSTOMER PREFERENCE AND SATISFACTION TOWARDS CHAT OUT RESTAURANTS <i>DR. C. K. MUTHUKUMARAN, DR. D. SUGUMAR & DR. A. B. ANGAPPAPILLAI</i>	55
13.	IS LABOUR GETTING FAIR SHARE IN ORGANISED MANUFACTURING SECTOR? <i>DR. ASHOK KUMAR & BALJEET KAUR</i>	60
14.	SOCIO-ECONOMIC STATUS OF TSUNAMI SURVIVORS IN KOTTUCHERRYMEDU, KARAICAL DISTRICT - A CASE STUDY <i>DR. N. UDAYAKUMARI & N. MANIMOZHY</i>	65
15.	COINTEGRATION AND CAUSAL RELATIONSHIP AMONG CONTRIBUTION OF AGRICULTURE, INDUSTRY AND SERVICE SECTOR TO GROSS DOMESTIC PRODUCT IN BANGLADESH <i>MD. ARAFAT RAHMAN & TANVIR KHAN</i>	68
16.	ASSET LIABILITY MANAGEMENT IN PUNJAB NATIONAL BANK -WITH SPECIAL REFERENCE TO THEIR INTEREST RATE SENSITIVITY <i>DEVI PREMNATH & GOWRY.R</i>	73
17.	STRUCTURAL CHANGE IN SOUTHERN STATES OF INDIA <i>TINA SINGH</i>	79
18.	ANALYSIS OF INDIAN DIRECT TAX SYSTEM <i>DR. P. AMARJOTHI.</i>	83
19.	FRAMEWORK FOR DEVELOPMENT OF STRATEGIC ELEMENTS TO SELF HELP GROUPS IN JAMMU AND KASHMIR STATE <i>AASIM MIR</i>	86
20.	WEAK AREAS IN ACCOUNTING SYSTEM CONTROL FACILITATING WHITE COLLAR CRIME <i>DR. YOGESH MAHESWARI</i>	88
21.	HUMAN RESOURCE ACCOUNTING: AN EFFECTIVE ANALYSIS AND FUTURE ASPECT <i>SUJAN KANTI BISWAS & SUMAN KANTI DEB</i>	92
22.	EFFECT OF HEALTH INFORMATION LITERACY ON THE ATTITUDE OF WOMEN TOWARDS FAMILY PLANNING <i>ARAMIDE OLUFEMI, AYO ODUROYE & AKIN ALAGBE</i>	99
23.	VARIATIONS IN EXTERNAL CAPITAL FLOWS AND GROWTH IN THE CEMAC ZONE <i>GEORGES DIEUDONNÉ MBONDO</i>	104
24.	ECONOMIC MODELING OF THE COST OF INPUTS FOR RICE PRODUCTION: A CASE STUDY ON BANGLADESH <i>MD. GHULAM RABBANY, SHARMIN AFRIN, AIRIN RAHMAN & FARJANA SALAM</i>	111
25.	THE ROLE OF MARKETING-MIX STRATEGIES ON GROWTH OF MICRO AND SMALL ENTERPRISES IN MERU COUNTY-KENYA <i>MWIRIGI RAELE NKATHA & LENITY MUGENDI</i>	116
26.	BANK -SPECIFIC DETERMINANTS OF PROFITABILITY OF QUOTED COMMERCIAL BANKS IN KENYA <i>UMULKHER ALI ABDILLAHI & MUGANDA MUNIR MANINI</i>	122
27.	TREND OF AREA, PRODUCTION AND PRODUCTIVITY OF RICE CROP IN ASSAM <i>ANANYA BORGHAIN</i>	130
28.	ANALYSIS OF HOME LOANS BY PUBLIC SECTOR BANKS: INTER-BANK & INTRA-BANK ANALYSIS <i>JYOTI BHATIA</i>	136
29.	TREND AND PATTERNS OF FDI INFLOW INTO INDIA <i>RANJAN KUMAR NAYAK</i>	143
30.	HEDONIC CONSUMPTION & CHANGING DEMOGRAPHICS OF THE INDIAN CONSUMER: EMERGING TRENDS AND STRATEGIC IMPLICATIONS <i>ANURAG KANSAL</i>	156
	REQUEST FOR FEEDBACK	165

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WEAK AREAS IN ACCOUNTING SYSTEM CONTROL FACILITATING WHITE COLLAR CRIME

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ABSTRACT

The present study aims to examine the weak area in Accounting Practices facilitating White Collar Financial Crime. The fertility of man's invention in devising new scheme of fraud is never ending the new business methods and the speed, which are making business dynamic are also making them vulnerable to financial fraud. At the same time technology dependency through Enterprise Resource Planning generates unrealistic expectation, where as there is thick fog behind the screen, leaving much to desired, thus creating ideal environments for the wrongdoers to exploit the weakness for their personnel gains. Therefore frauds and white collar financial crimes in the corporate sector have been increasing at an alarming pace, based on inherent risk prevalent in the system. Therefore there is an urgent need to understand the seriousness of the issue and appreciation the concern for the well being of the corporate. This study is an effort to explain that sniffing out frauds is an art and needs a mind-set. There are large number of frauds, which never hit the radar screen and have stealth in built. This primarily happens because the radar lacks the capability of picking up the crime, therefore the technology and the humans expertise needs to be improved, so that fraudster don't go scot-free. At the same time fraud travels to grow geometrically over the period, if not detected on time. Therefore the prevention through right-controls and early detection by professionals with right mind-set could save fortunes, and this study would answer all such questions and more.

KEYWORDS

ERP Application, Fraud, Motivation Factor, White Collar crime.

INTRODUCTION

A statement of fact which one party makes in the course of negotiation with view to inducing the other party to enter into a contract is known as **representation**. It must relate to some fact which is material to the contract. It may be expressed by words spoken or written or implied from the acts and conduct of the parties.

A representation, when wrongly made either innocently or intentionally, is a misrepresentation. It may be-

1. an innocent or unintentional misrepresentation or
2. an intentional deliberate or willful misrepresentation with an intent to deceive or defraud the other party

The former is called misrepresentation and the later is *fraud*.

The fraud exist when it show

- (i) a false representation has been made
 - (a) knowingly or (b) without belief is it truth
 - (b) recklessly, not caring whether it is true or false, and the maker intended the other party to act upon it or
- (ii) there is a concealment of a material fact or that there is partial statement of fact in such a manner that the with holding of what is not stated makes that which is stated false.

Fraud is a generic term; No definite, explicit or formal statement can be laid in defining fraud. Fraud, theft and embezzlement are the term that are often used interchangeably. Although they have some common elements, they are not identical in the criminal law sense. Theft is referred to as larceny the taking and carrying away of the property of another with the intention of permanently depriving the owner of its possession. In larceny the perpetrator comes into initial possession of the stolen item illegally. In embezzlement, the perpetrator comes into initial possession lawfully, but converts it to his or her own use. Embezzlers have a fiduciary duty to care for and to protect the property. In converting it to their own use, they breach that fiduciary duty.

Fraud in a nutshell, is intentional deception, commonly describe as lying, cheating and stealing. Fraud can be perpetrated, against the company and for the company. Business frauds are more common than most of us realize. There is no need to the types of frauds that is why, The Indian Penal Code,1860 has not strictly define a fraudulent act, even the courts have not explicitly elaborated and have kept it to themselves to interpret, as the fertility of man's invention in devising new scheme of fraud is unlimited.

WHAT IS WHITE COLLAR CRIME?

When a person employed by the corporate or by government, in a position of trust, breaches the trust imposed on him is termed as **WHITE COLLAR CRIME**. In other words it's a species of "Breach of Good Faith". As per section 52 of IPC 'Nothing is said to be done or believe in "Good faith" which is done or believe without due care and attention'.

In essence White-Collar crime involves a criminal breach of trust when the authority has not been exercised prudently, when the authority is exceeded or corrupted the violator of trust may be held liable civil or criminal.

TYPES OF FRAUDS

In nutshell, fraud in books of account comes in two major categories, transaction and statement frauds. Statement frauds involve intentional misstatement of certain financial values to enhance the appearance of profitability and deceive shareholder and creditors. Transactions frauds are intended to facilitate the theft or conversion organizational assets to one's personal use. Senior management in general commit statement frauds, hoping to gain some personal benefit (promotion, raise bonus) from their fraud. The other fraudster generally commit transactions fraud to cover up or facilitate a theft of embezzlement. So the fraud perpetrators can come from any level of management or society.

Corporate small or big which compromise on perfect controls are the most fertile fields for the fraudsters. In the 1950 and early 1960, "Atlantic Acceptance built into one of the Canada's largest and most reputed finance firm with 105 small loan offices and 35 sales offices. The Company collapse in June 1965 with \$150 MILLION in receivables outstanding. Levels of fraud in India can be construed from a report published in Times of India dated 15th March 2002 on page 4 stating the Indians have \$ 2500 Billion slashed away in Swiss Bank.

WHY DOES FRAUD HAPPEN?

Fraud and white collar crime are the product of motivation and opportunity.

The motivation may be:

- Economic need or greed
- Self Centered
- Ideological
- Psychosis

FACTOR WHICH INFLUENCE THE MOTIVATION ARE

Human being is a great situational adaptor; he fits into the environment fairly easily, though the degree to get influence may vary. Therefore motivation is not something, which is absolutely born quality of constant, it changes and is influenced by various factor which create and culminate into environment influencing motivation; factors such as:

- The organization's internal control is so lax that one is tempted to steal.
- The employee believes he or she can get away with it.
- No one has ever been prosecuted from stealing from the organization.
- Most fraudster are caught by accident rather than by audit or design.
- Employees never go to jail or being harsh prison sentences for such fraud.
- The employee feels frustrated or dissatisfied about some aspects of the job.
- His or her personal life is not job related
- The employee feels abused by the employer and wants to get even more
- Lack of trust and respect for each other.
- The employee fails to consider the consequences of being caught.
- The employee thinks "Everybody else steals so why not me"?
- The employee thinks, "They are so big, stealing a little bit won't hurt them

FACTORS WHICH PROMOTE OPPORTUNITIES ARE

Accounting rules are designed to provide standardized frame work in which the financial position of a corporate or a government can be assessed. However **BAD ACCOUNTING PROCEDURE** have serious long term consequences, over and above the bad accounting procedure the factors which promote opportunities are:

- **NO CONTROL** Fraud however big is not technically sophisticated- Lack of controls has helped it to go through. No control can function unless there is system of accountability.
- **NO TRUST** Transparency builds trusts. Trusts breeds loyalty & honesty, distrust breeds disloyalty and perhaps dishonesty.
- **NO ETHICAL CODES** Code of ethics must prohibit employees taking gifts & gratitude which often are not enforced.
- **NO PROFIT** Bad time aggravated and advertises are enchased.
- **NO FUTURE** No one wants to sit in sinking ship.

The opportunities to commit fraud are rampant in the presence of loose or lax management or administrative and internal accounting controls. These control become venerable by half hearted and inadequate compliance of computerization. Most of the white collar crimes are prompted by opportunities and committed for economic reasons. Loose or lax controls and works environment which does not value honesty, provides the opportunity. **Motivator and opportunity are interactive; the grater the economic need, the less weakness in internal controls is needed to accomplish the fraud. The greater the weakness in control, the less motivation need. So when one has the motivation and opportunity it is the right recipe for the fraud because:**

- It pays to do it
- It is easy to do it
- It is unlikely that you will get caught

THE REASONS FOR GROWTH OF WHITE COLLAR CRIMES

- Inadequate in Computerization: ERP applications needs much better execution and often generates unrealistic expectation. Changes are not documented and often systems are put to scrutiny to only those who accord specifications or those who created them, thus leaving lacunas.
- Compromising controls: We all think our system are the best, inadvertently important aspects are ignored safety valves are often not installed, at the same time controls are not regularly updated and evaluated and the complete control operation often has various holes.
- Relentless drive to do more with less: To remain fit, all fats are being thrown away and in the bargain you even shed from those comers where it is essentially required thus compromising with controls.
- Increasing turnover of manpower: Loyalty and concern by the employees for the employer is diminishing fast. Gone are the days when we joined the company by all probabilities that we would retire from the same company.
- Increased volumes: Turnover have multiplied but we still have same attitudes. We all want to have paperless office, without developing the culture for such environment.
- Organization structures: The organization structure has undergone major changes, wherein the geography has no boundaries, the middle level supervision has vanished and loyalty towards organization has attained new low
- Fundamental Changes: Business has got into state of merry go round, if we loosen the grip we are bound to fall, the undercurrent is too strong, the management is bogged down with these changes and plays no attention to such issues. Even if we have suspicion we have no time to go in depth and the corporate wants to close the chapter at the earliest, without getting the insight.
- Lack of punishment: Most of the White Collar Crimes do not surface and those which do the perpetrator often go Scot-free and this does not motivate the fraudster.

METHOD

Sample

Coming to White Collar crimes the present sample comprised from each of the selected sub-groups taken from industry- Manufacturing Industry, Banking Industry, Insurance Industry, Construction Industry, Distribution & Service Industry. As there are large number of fraud associated with the industry but our study was restricted to the following kinds of fraud that are commonly found and can be categories as:

1. Bank related fraud
2. Pay Roll Fraud
3. Investment Fraud
4. Invoices (a) Purchases (b) Sales
5. Revenue Account
6. Expenditure Account
7. Computer as an aid to fraud
8. Insurance

Tools Used:

The following tools were used in the present study:

(i) Information Schedule

It was designed in order to derive information regarding the subjects from the Accounting professionals CA, Audit Manager, CWA and the people working in the similar fields.

(ii) Computer as a tool

Computer tool is to add to deception they by no means help prevention. What the computer does is to concentrate all the factors and risks that assist fraud to occur, either the computer is subject itself or is a means. The method that are often used are:

- ❖ False data is fed into computer
- ❖ False output is generated through computer
- ❖ Data is altered while in a computer
- ❖ Programme are modified so that valid data is massaged to give the desired effect
- ❖ System has fudge facility which allows errors to be corrected and there in lies the opportunity.

PROCEDURE

Data were collected from the Industries/Corporate and were distributed in 8 categories of fraud.

RESULT & DISCUSSION

The important results emerged from the study are as follows:

1. Bank related fraud

Bank Management is the single largest vulnerable area which is attacked directly or indirectly: The common frauds that are been observed are:

- Opening a fictitious bank account: Opening a bank account is not a big deal and if we have succeeded in opening a fictitious bank account, the pipe line to play with the system is laid
- Cheque Forgery: On accounts payee cheque, bank donot pay much attention about the signature on a/c payee cheque, easy accessibility of unaccounted cheque in large number, No strict control on cheque books, Issue of Cheque not recorded, A/C payee not bone on receipt of cheque books, cancelled cheque on manual system or computerized cheque not accounted, some cheque intentionally left blank for back dated used and often misused, on manual binding of cheque books for modification not done under control- large number of weak areas.
- Accounts payee cheque in the name of the company fraudulently encashed by opening the account in the same name at different branch the one the we caught was encashed at different place
- Fraudulently issue of draft to the interested party
- Misuse of advance cheque deposited not on actual a/c but for adjustments such as advanced cleared (advance receipts for interest, security desposit, accrual never reconciled)
- Cash shown deposit, in lieu cheque deposited
- By bank employee-misuse of dormant account by transferring the fund

2. Pay Roll Fraud

This type of fraud is applicable to all kind of industries big or small and often happens in one form or other

- Change of master file of those people on deputation with those who left the job but their bank account were in operation by design
- Adding non-existing employee, at different stages, adding of casual manpower is the most common
- Continuation of payment after termination/retirement (Large MNC-Payment Outsourced)
- Altering time records (Workshops records shown present-gate entry shows absence, bank payment last page total changed)

3. Investment Fraud

Investment frauds are among the most costly of all the frauds to the corporate and can easily go through

- Investment with ulterior motives-huge commission on bad investment
- Investment shown but not invested. (Bogus Investment receipts). It is only what Harshad Mehta or Khetan Parikh did to banks, it could be easily gone through with any company.
- On maturity receipts not accounted, written off and in other case shown reinvested.
- Misuse of miscellaneous income and interest. Annual statement received from all Mutual Fund not paid any importance and not reconciled with transaction statement to ensure all receipt.

4. Invoices (a) Purchases (b) Sales

(a) Purchases

In industries over 60-70% of revenue goes in purchases therefore purchases need closer security

- Contract finalization : The terms itself are not very clear, and often encashed by the other party
- Weak area in bidding process: Cartels often exist; the gap between each bid must be monitored and fixed, else can be easily played with
- Evaluate the variances from consistency and see them in isolation e.g. Compare input to output with respect to any consistency.
- Adjustment in consumption, packing materials etc is very easy and hence vulnerable before we clear, accounts receipt must make all such observations (Compare L/Y Vs C/Y)
- See issue and demand procedure, authorization of requisition slip, preservation of requisite slip in continuous number, issue store be linked with production records.
- See purchase price variations; if there are more than two units see the compatibility of purchases price.
- Small value bills often purchased from the same party may be consolidated to rationalized the number of bills for better accounting and monitoring

(b) Sales

Procedure for raising invoices needs closer scrutiny: Invoice price is to be computer generated and any price change in master file only at senior level, if it is not, the system is vulnerable. Price change in master often not monitored.

- Signing of invoices
- Code numbers for all the parties, and invoice generation by code number only
- Inter unit transfer-Reconciliation not only monthly basis but also on one to one as under pricing, wrong totaling cannot be over-ruled
- Inter area transfer to authorized agency
- Regular reconciliation of receivables

5. Revenue Account

- Sales made by branch office shown by branch as made through agent, in order to encash commission paid to agents
- Accrued income not reconciled and verified for each investment, hence misused
- Miscellaneous income and licensing receipts on franchising or on leasing not reconciled
- No reconciliation of security deposit from contractors
- Finance companies- repayment of loan by advance cheque (Summary of payment & receipt reported deleted and not accounted records updated)
- Received approval to write-off, the parties changed while writing-off
- International wrong accounting, payment of advances shown as miscellaneous payment, payment of PF as miscellaneous payment

6. Expenditure Account

- Personnel expenses could be repaid either as an addition to monthly salary or as a separate cheque. The clerk authorized some expenses twice, both as an addition to salary and as a separate cheque. Separate cheque are often misused.
- Fictitious Bills(transporter bill and invoices in same hand)
- Purchase of lower grade capacitor against the sanction and payment of high grade capacitor. Supply of capacitor and installation by the same contractor
- Personnel payment not shown in personnel account, PF payment booked as Miscellaneous
- Over billing through multiplication and totaling mistake
- Advance not adjusted against payment subsequently misused on refund

- Adjustment in ledger account expenses against security deposit shown as expenditure to avail tax, security deposit on return not accounted
- Franchising frauds annuity received and not accounted.
- 7. Computer as an aid to fraud
 - Different prices, one for cash sale and other for accounting.
 - Payment transaction amended
 - Bogus report- Bank reconciliation
- 8. Insurance
 - Bogus cover note and insurance policy not issued and the system abused by the agent. Never rely on the cover note and insist for Insurance Policy
 - No insurance register of control chart maintained by the companies
 - List of items insured not attached with the policy, temporary-shed cannot be construed as part of building but often mixed up and such other shortcoming are often observed
 - Over charged rates by the agents
 - Amount of insurance cover not compatible with asset book, consider revaluation if required.
 - Insurance policy for reinstate, read clauses
 - Insurance claims- Please remember incase of delay 75% can be claimed as on account payment.
 - If we claim insurance donot forget to renew the policy.
 - Security precaution- Fire and all records burnt, duplicate records were called at the same time for updating
 - One time payment-Death insurance policy. Policy paid twice due to faulty reconciliation.

SUGGESTIONS

- Distribution of work area should be scientifically allotted and monitored. Electronic data entry as exclusive responsibility may not be possible in present scenario, it was fine in main frame regime and therefore the allocation of duties need better understanding and closer control on input and output.
- Security and password at all level be strictly followed.
- Change in master files need tight control and should only be at senior level and all such must be monitored.
- Audit trial be closely monitored and regularly cleared – to be supervised at senior level.
- Be careful on the source code for its recording and monitoring of regular update.
- Automatic numbering of each transaction and input entry. Statement serial number for each statement is must
- Official stationery can be used in forgery, serial number even if destroyed to be properly lodged and recorded.
- The facility to reset the clock is removed at data entry level
- Whenever new package is used, people may take advantage of the confusion. Till the new system is establish do not disturb the existing system, greater care is required when the package is customized.
- Good security on warehouse and other locations is essentials element in fraud prevention computer system is simply a step in the process of deceiving.
- Must avoid submitting statutory return at last moment
- Preserved the cancelled cheque by computer print out
- Transfer of balance be automatic- not off line
- Code number for each vendor & invoices for vendor to be generated with code number only.
- Must understand the flow chart, codification any amendment be recorded and closely monitored.
- Page total for financial statement be introduced, this could be a deterrent.
- Originator must sign each statement.

In nutshell the fraud cannot be erode away but can be minimized.

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