

FORENSIC ACCOUNTING: THE ESSENCE AND PROSPECTS OF DEVELOPMENT IN UKRAINE

Maryna Dubinina¹, Iryna Ksonzhyk², Svitlana Syrtseva³

Mykolayiv National Agrarian University, Ukraine

Abstract. The *subject of the study* is a set of theoretical, organizational, and methodological principles for the development of forensic accounting in Ukraine. General scientific and special methods of cognition are the *methodological basis of the study*. The content of the concept "forensic accounting" is specified using theoretical generalization methods; the comparison of audit and forensic accounting using comparison method is carried out. Using the abstract-logical method and structural-logical analysis, features, current problems, and obstacles to the development of forensic accounting in Ukraine are determined. The objective of the study is to consider the essence of the concept of "forensic accounting", to introduce the main obstacles, and to propose a list of measures for its development in Ukraine. As a result of the study, it is established that forensic accounting is a combination of legal and financial audit and forensic accounting expertise. Therefore, experts of all these profiles should be involved to the forensic accounting, which will help the company solve the conflict situations related to fraud. It is substantiated that when improving the method of forensic accounting, it is necessary to understand its difference from the audit. The study found that the most common types of fraud faced by Ukrainian companies are asset theft, unreasonable and inappropriate spending. The most common ways to detect fraud in Ukraine are internal audit and informal internal sources. Only 10% of Ukrainian companies have experience in attracting external consultants to independent investigations. However, as practice shows, the very independent, unbiased view of the external specialist on the control system and business processes allows creating a high-quality system of preventive mechanisms for counteracting fraudulent actions and in general, improving the efficiency of business processes of the company. It is substantiated that forensic accounting is one of the effective instruments of an independent economic investigation. It is established that forensic accounting is quite new for Ukraine and audit and specialized companies are only at the beginning of the path in this direction. In order to develop this type of services, audit and specialized companies were suggested to expand the range of services in the direction of forensic accounting and the appropriate procedure for carrying out such activities. In addition, it is necessary to take into account the foreign experience of the training of specialists in the field of forensic accounting, that is, to start the training of specialists by including specialized courses on forensic accounting in the curricula of higher educational institutions. It is also necessary to develop the cooperation of Ukrainian professional organizations with foreign professional organizations in order to provide specialists with the possibility to obtain international certificates, as well as to involve audit, legal, and consulting companies in the process of professional training in forensic accounting. *Study conclusion.* Thus, forensic accounting includes a set of measures for the settlement of financial, economic, legal, commercial, and other issues that involve significant economic risks. The use of forensic accounting by domestic companies will increase the effectiveness of managing their business risks by adopting optimal management decisions and ensuring the profitability of the business.

Key words: forensic accounting, audit, economic investigation, fraud, risk.

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Corresponding author:

¹ Department of Accounting and Taxation, Mykolayiv National Agrarian University.
E-mail: dubinina@mnaeu.edu.ua

² Department of Accounting and Taxation, Mykolayiv National Agrarian University.
E-mail: iryna_ksenzhyk@meta.ua

³ Department of Accounting and Taxation, Mykolayiv National Agrarian University
E-mail: sirceva@mnaeu.edu.ua

1. Introduction

When carrying out financial and economic activities, business entities are often faced with various manifestations of fraud, which further adversely affect the results of their activities. Identifying internal economic crimes during the normal operation of a large company is not easy since fraud is often a pre-conceived process. The most popular types of fraudulent operations remain: misappropriation of the assets, financial distortion, bribery. At the same time, the most popular method of concealing fraud abroad is the falsification of various documents. In large companies, corruption is the most widespread method of fraud, and in small ones, there are theft of cash, falsification of checks, etc. Therefore, the detection and termination of unlawful economic actions in the company become a topical task, which can be handled by experienced professionals who have skills in conducting a forensic accounting.

Forensic accounting service is a fairly new phenomenon, even in countries with a developed market economy. The first consulting and audit firms that provide such a service are only appearing in Ukraine. Therefore, a number of relevant issues related to the development and spread of forensic accounting service remain open and require more in-depth research and decision.

The objective of the study is to consider the essence of the concept of “forensic accounting”, to introduce the main obstacles, and to propose a list of measures for its development in Ukraine.

General scientific and special methods of cognition are the methodological basis of the study. The content of the concept “forensic accounting” is specified using theoretical generalization methods; the comparison of audit and forensic accounting using comparison method is carried out. Using the abstract-logical method and structural-logical analysis, features, current problems, and obstacles to the development of forensic accounting in Ukraine are determined.

2. The essence of the concept of “forensic accounting”

Forensic accounting is interpreted as an independent economic investigation, which is usually carried out in the interests of the owners (shareholders) of companies.

In general, the term “forensic” is used to characterize independent initiative activities related to investigation, examination, analysis, evaluation, settlement of situations, and the development of procedures aimed at counteracting fraud, corruption, commercial bribery, evaluating contractual activities, resolving disagreements between parties regarding financial and business issues (Suits, Khoryn, Kozeltseva, 2015).

Forensic is at the same time the science and art of investigating and preventing the facts of fraudulent actions by offenders, which are often the managers of large companies. It helps to identify potential financial and nonfinancial issues and focuses on both internal and

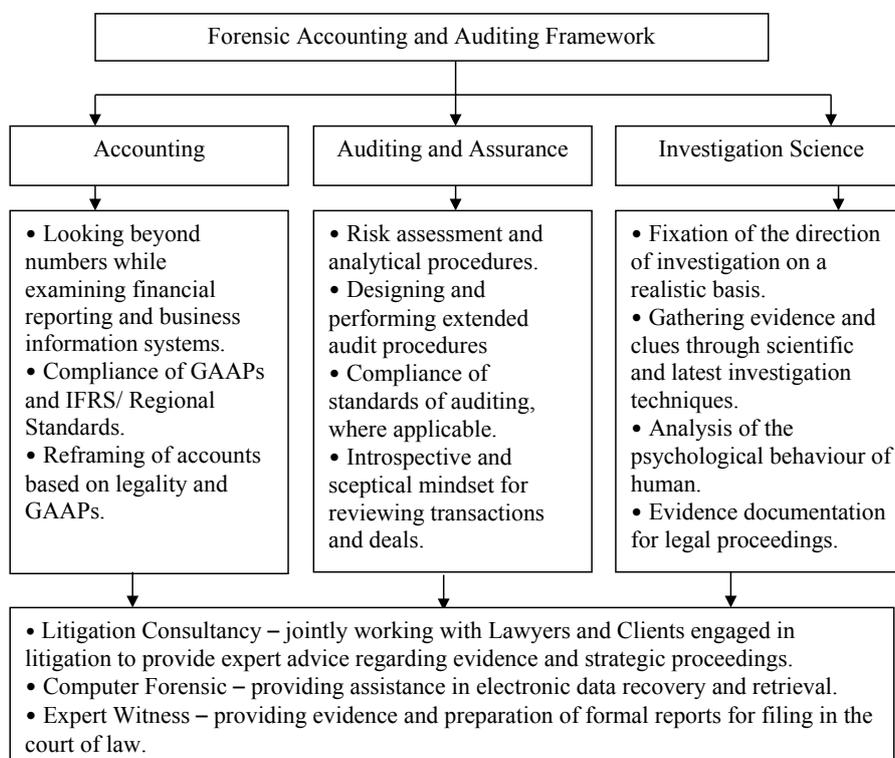


Fig. 1. Forensic accounting and auditing services: anatomical sketch

Source: (Crumbley, 2006)

external analysis of corporate intelligence – the analysis of related individuals and the personal dynamics of the financial position of the top manager (Kovbyl, 2017).

When analysing the internal corporate intelligence:

- identification of the risks of fraudulent operations (according to fraud tree – this is the appropriation of assets, intentional distortion of financial reporting, bribery, kickbacks);
- analysis of the internal control system (financial, informational, legal, physical security);
- identification of inefficient managers in the company;
- transparency of tender procurement;
- efficiency of spending company's expenses;
- transparency of sales.

When analysing the external corporate intelligence:

- provision of preventive measures for raider attacks on the enterprise;
- elimination of conflicts of interest and ensuring transparency in the implementation of procurement;
- provision of company information security with the OSINT, HUMINT, and others procedures (Kovbel, 2017).

Along with the term of “forensic accounting”, there is also used the term of “forensic auditing” (Weaver, 2008), which is usually understood as the study and evaluation of the financial information of the entity, the results of which can be used as evidence in court. Obviously, there is no fundamental difference between these concepts since results of forensic accounting can also serve as evidence in the litigation process.

(Crumbley, 2006) stated that forensic accounting is an accounting that is suitable for legal review offering the highest level of assurance and including the now generally accepted connotation of having been arrived at in a scientific fashion (Fig. 1).

Forensic accounting is a combination of legal and financial audit and forensic accounting expertise. Therefore, experts of all these profiles should be involved in the forensic accounting, which will be able to comprehensively check every transaction, find violations where it, at first glance, does not exist.

Thus, the term “forensic accounting” should be understood as a set of measures for the settlement of financial, economic, legal, commercial, and other issues that involve significant economic risks by auditing, consulting, and specialized companies to meet the interests of owners (shareholders) of companies of various organizational and legal forms.

3. The main differences between forensic accounting and audit

The main difference between the audit of the forensic accounting is that the audit activity is regulated at the legislative level, but the requirements for carrying out forensic accounting are not established by law. Thus, the main legislative and regulatory documents regulating audit activity in Ukraine are the Law of Ukraine “On Audit Activity” on April 22, 1993 No. 3125-XII and the Law of Ukraine “On Audit of Financial Reporting and Audit Activity” on January 21, 2017 No. 2258-VIII (effective from October 01, 2018). In addition, international auditing standards are used while the implementation of audit activity published in the official language on the official website of the central executive authority, which ensures the formation and implementation of state policy in the field of accounting and auditing, which ensures their updating.

Also, there are other differences that are presented in Table 1.

Table 1

Comparative characteristics of audit and forensic accounting

Criteria for comparison	Audit	Forensic accounting
Objective	Expressing an independent opinion of the auditor on the compliance of the financial statements of the organization in all material respects with the requirements of national accounting requirements (standards), international financial reporting standards or other requirements.	Search, termination, and prevention of economic crimes in the organization
Subjects	Auditors, audit companies	Audit, consulting and law firms
The presence of requirements for mandatory conduct in cases established by law	Yes	No
Reporting	Audit report and other official documents	List of possible reporting documents: - report on conducting analytical procedures; - report on established evidence of fraud; - list of deficiencies in internal control of processes and results; - possible fraud scenarios and schemes; - recommendations on the risk management system

Source: formed by the authors

At the same time, forensic accounting involves a wider range of analytical procedures than an audit. The auditor expresses an independent opinion as to the reliability of financial reporting, and the inspector discovers data indicating signs of violations and crimes. Moreover, for their detection, other methods and mechanisms are used than during the audit.

The fact that forensic accounting is based on both official and unofficial sources, in addition, independent economic analysis analyses not only the initial documentation, accounting, and management reporting, but also the testimony of employees, counteragents, independent experts, and former partners.

In addition, the report on the inspection may be in the interest of one interested person, for example, one owner who suspected a partner in fraudulent acts or in relation to the general director of the company selected in the competition, in case of suspicion of fraud of the company's funds (Shestakova, 2013).

4. The prospects of development in Ukraine

The economic crisis in Ukraine and the deterioration of the financial performance of business entities force the owners to take measures aimed at improving the efficiency of companies. One of the reasons for the deterioration of the financial performance of business entities is fraudulent actions and negligence of the personnel.

So, in June 2017, Kreston GCG, a part of the international auditing network Kreston International,

conducted an independent study "Fraud in Ukrainian Companies." The study covered 130 companies throughout the country, including recognized leaders in the fields of agriculture, construction, industrial production, food industry, pharmaceutical business, and many others. Among the participants in the study, there were owners, directors general, and financial directors, first managers, heads of the internal security service etc.

The key task of the study was: to estimate the extent of the spread of fraud in companies in Ukraine; to establish measures taken to prevent fraudulent schemes in companies and organizations.

The study found that more than half of companies (61.5%) had ever faced fraud, with nearly a third of companies recording some or other cases of fraud during the past 3 years. However, another group of companies (about 40% of respondents) points out that they have never faced fraud. In the opinion of (Kovbel, 2017) Kreston GCG's partner, most likely, the reason consists not in the unique favourable atmosphere of companies, but in the absence or lack of effectiveness of control systems that create the illusion of no fraud.

It is characteristic that in the sectoral section, representatives of the following sectors faced the cases of fraud significantly more often than in the whole market: industrial production, trade, food industry, and agriculture.

The most common types of fraud faced by Ukrainian companies are: asset theft, unreasonable and inappropriate spending (Fig. 2).

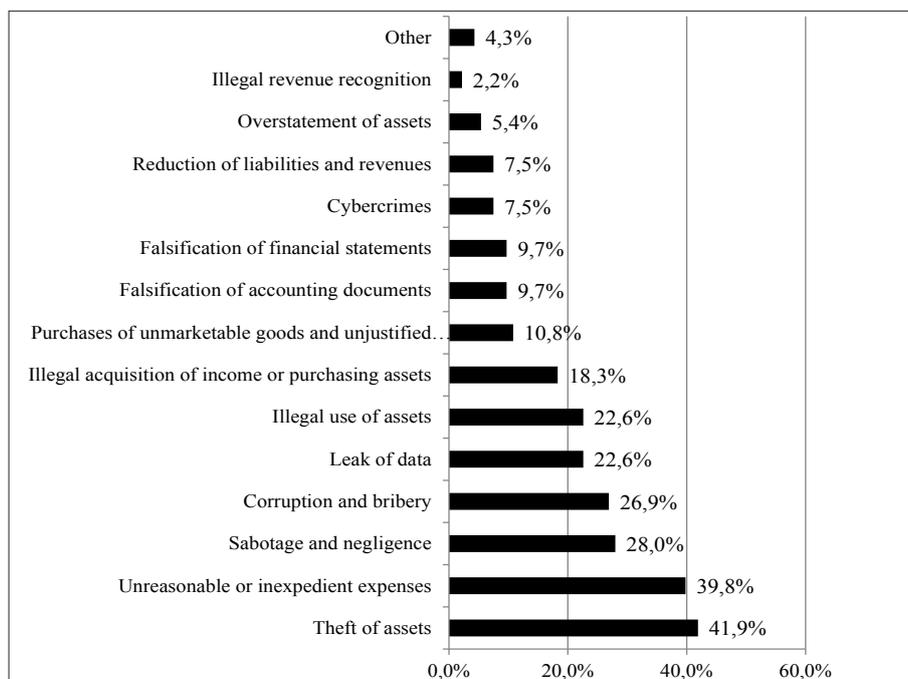


Fig. 2. Types of fraud faced by Ukrainian companies, %

Source: (Data of Kreston GCG Report "Fraud in Ukrainian companies: current situation, mechanisms of counteraction", 2017)

A little more than a quarter of companies faced with such manifestations of fraud as sabotage, negligence, corruption, and bribery (28% and 26.9% respectively). The third group, which was faced by more than 20% of the companies in general, is theft of information and illegal use of assets.

The most common methods for detecting fraud in Ukrainian companies are an internal audit and informal internal sources (Fig. 3). The latter ones are the most common way of detecting in the world as well, but unlike in Ukraine, an efficient and secure channel for receiving information – a hotline

(telephone or online) is developed for their use. In Ukraine, only 9% of companies use it and about the same number are perceived as an effective channel (Kovbel, 2017).

Almost a third of cases of fraud were detected by chance. At the same time, more often the practice of accidental detection is noted by representatives of the sectors of trade and industry, which often show cases of fraud. Informal internal sources more often contribute to the detection of fraud in the field of agriculture, technology, transport and logistics (Table 2).

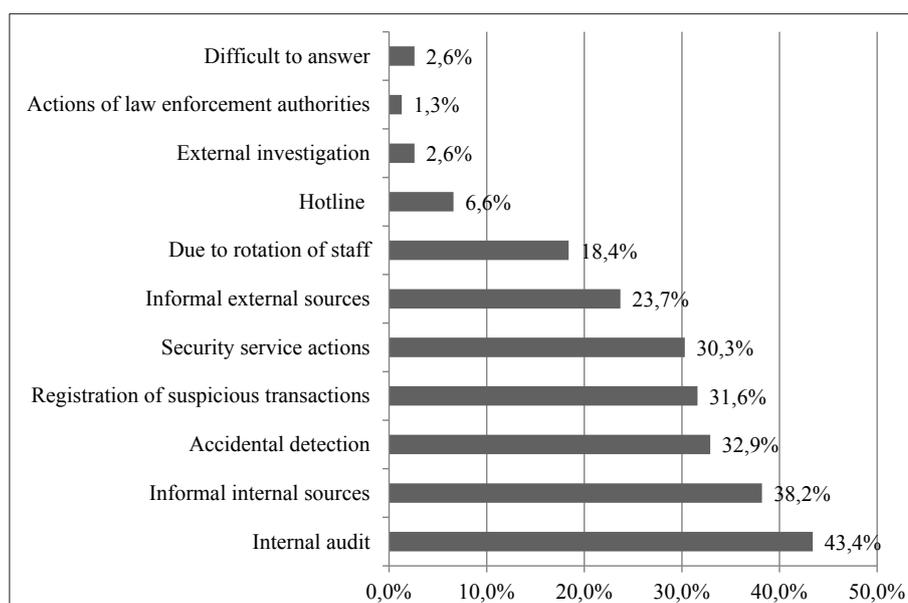


Fig. 3. Operations for detecting fraud in Ukrainian companies, %

Source: (Data of Kreston GCG Report "Fraud in Ukrainian companies: current situation, mechanisms of counteraction", 2017)

Table 2

Operations for detecting fraud in the sectors of the economy, %

Means of fraud detection	Sectors of the economy					
	Trade	Agriculture	Food industry	Industrial production	Transport and logistics	Technology
Internal audit						
Informal internal sources						
Accidental detection						
Registration of suspicious transactions						
Security service actions						
Informal external sources						
Due to rotation of staff						
Hotline						
External investigations						
Actions of law enforcement authorities						

Notes. The colour saturation (from darker to lighter) shows the intensity of using one or another method of detecting fraud. The lightest colour means that this method was not used to register a fraud

Source: (Data of Kreston GCG Report "Fraud in Ukrainian companies: current situation, mechanisms of counteraction", 2017)

Only 10% of Ukrainian companies have experience in attracting external consultants to independent investigations. However, as practice shows, the very independent, unbiased view of the external specialist on the control system and business processes allows creating a high-quality system of preventive mechanisms for counteracting fraudulent actions and in general, improving the efficiency of business processes of the company.

At present, foreign companies actively use independent economic investigations such as forensic accounting.

With the help of forensic accounting, it is possible: to evaluate the effectiveness of organization of internal business processes; to conduct an independent financial examination; to discover the facts of financial fraud within the company; to protect own interests in court; to develop an effective individual system of internal financial security; to ensure effective and transparent interaction with counterparties; to protect the company from aggressive external interference by competitors.

The concept of “forensic accounting” in Ukraine is understood only by few experts. Today this specific service has just started to be offered to domestic businesses. So far, small companies pay attention to it.

Among the services provided by domestic audit, legal and consulting companies, there is a forensic accounting service. However, forensic accounting companies (Spencer & Kauffmann, Kreston GCG, Deloitte Consulting, Otten Consulting, Credo-Audit Company) provide a very narrow range of services in this direction.

Therefore, in order to develop forensic accounting in the domestic market, we offer companies to expand the content of services for forensic accounting. The main content of the proposed forensic accounting service is presented in Table 3.

Also, during the forensic accounting, we propose the following list of procedures, shown in Figure 3.

In order to develop this type of service in Ukraine, it is also necessary to take into account the foreign experience of the training of specialists in the field of forensic accounting. Namely, it is necessary to begin the training of specialists on forensic accounting by including specialized courses on forensic accounting in the curricula of higher educational institutions. It is also necessary to develop the cooperation of Ukrainian professional organizations with foreign professional organizations in order to provide specialists with the possibility to obtain international certificates, as well as to involve audit, legal, and consulting companies in the process of professional training in forensic accounting.

Table 3

The proposed structure and content of forensic accounting services

Type of service	Content of the service
Financial investigations	Analysis of existing security systems of the company. Assessment of procedures and internal policies. Check of the effectiveness of the activity and evaluation of financial losses in the processes of production, supply, and sale. Detection of facts and causes of fraud. Search for stolen assets. Organization of management and control to prevent financial fraud and fraud
Development of a fraud counteraction system	Preparation of a fraud counteraction plan. Organization of the corporate hotline. Organization of work of economic security and internal control service
Corporate intelligence	Collection and analysis of data on the reputation of business partners. Information support in the course of financial investigations. Search for stolen assets. Information support in lawsuits and conflict situations. Search for new business opportunities
Expertise	Forensic expertise – preparation of information for the adoption of administrative measures. Pre-trial expertise – preparation of information for court proceedings. Forensic examination – judicial support in Ukraine and abroad; providing expert evidence
Protection of intellectual property, fulfilment of contractual terms	Investigation of the situation with the relationships arising from the licensing of various forms of intellectual property rights. A comprehensive investigation of problems related to the fulfilment of contractual terms
Automation of anti-fraud solutions	Diagnosis of existing fraud management practices. Development and implementation of a target system for monitoring and managing fraud risk. Development and implementation of anti-fraud systems

Source: formed by the authors

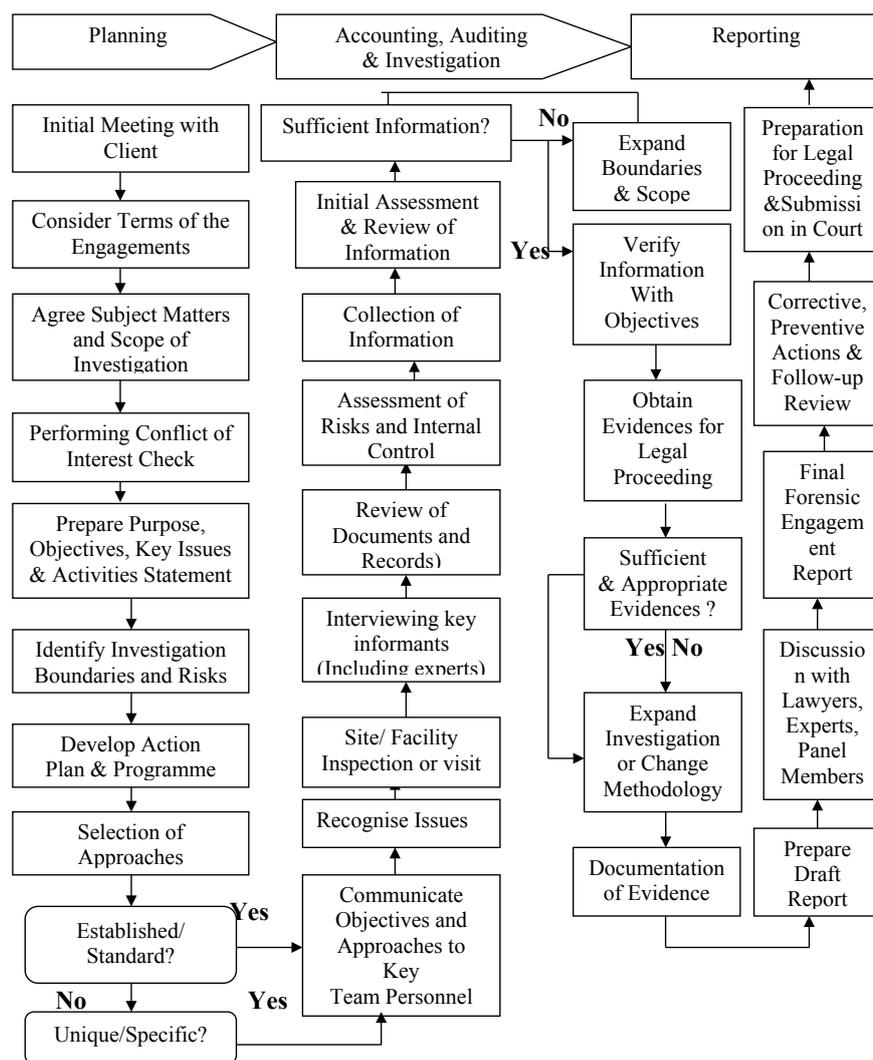


Fig. 3. Flow chart of forensic/investigative accounting

Source: (CA Anandaraj Saha, 2014)

5. Conclusions

Thus, we can conclude that forensic accounting includes a set of measures for the settlement of financial, economic, legal, commercial, and other issues that involve significant economic risks.

Forensic accounting services may be provided by the audit, consulting, and specialized companies to owners (shareholders) of companies of various organizational and legal forms. Unlike the audit, the procedure for the implementation of forensic accounting in Ukraine at the legislative level is not regulated.

In order to develop and expand the forensic accounting, it is necessary to take into account the foreign experience of the training of specialists in this direction; audit, consulting and legal companies need to expand the range of services in forensic accounting.

The use of forensic accounting by domestic companies will increase the effectiveness of managing their business risks by adopting optimal management decisions and ensuring the profitability of their business.

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