

FINANCIAL FRAUD AND THE ROLE OF AUDITOR¹

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Abstract

The financial fraud as a criminal offense can be committed by a company, organized groups or individuals. There are cases when a large number of companies to protect employees who have committed financial fraud, in order to protect their brand and reputation, and it is a procedure that is treated as additional problem in detecting financial fraud. In the analysis made on the financial fraud in the country, are coming to the realization that there are few published data that could bring relevant conclusions on the representation of financial fraud and the threat of their increase in the country.

Therefore, the theme of this paper is inspired by the trend of increasing financial fraud, in the country and internationally, as well as the role of auditors in their disclosures.

Key words: financial fraud, companies, audit

¹ professional paper

INTRODUCTION

Financial fraud can be defined as intentional acts of fraud that involving financial transactions due to the exercise of personal gain. They are performed by persons who have specialized knowledge in the field and in most cases they have not previously convicted.

The threat of financial fraud is growing, and at the same time becomes subject to observation and analysis, because the crimes in economic relations represent a dangerous social deviation that has profoundly negative impact on economic flows. Also, increased the number of seminars, symposia, conferences devoted to the problem of financial fraud.

As reasons for the increasing trend of financial fraud mostly are short custodial sentences for perpetrators of fraud, the inability to prove the cases, insufficient regulation of measures for protection and so on.

Because of the danger of the proliferation of financial fraud, needs a contemporary audit, for studying and applying the practice to be consistent to study the most important categories, forms and techniques of involvement in criminal activities.

REPRESENTATION OF FINANCIAL FRAUD IN COMPANIES

Financial fraud can occur in any company, regardless of its size. In recognition of that, there are more research on the world market. When it comes to the representation of the financial fraud at companies can use research done by COSO and Delloite².

- COSO – Committee of Sponsoring Organizations of the Treadway - commission is a joint initiative of five private sector organizations, dedicated to providing leadership through the development of frameworks and guidance on enterprise for risk management, internal control and fraud deterrence.
- Delloite – as one of four international companies for professional services, which has taken the responsibility of

² COSO, "Fraud Financial Reporting:1998-2007", An Analysis of U.S. Public Companies 2008

being a leader in providing professional services, including: audit, consulting, financial advice and other business activities.

In the analyzed research done by COSO, in the period from 1998-2007, covers 347 reported cases of financial fraud from new companies with small equity, to companies with capital assets of over \$ 400 billion and annual revenues over \$ 100 billion. Hence, it can conclude that financial fraud is present in companies of different sizes.

According to research by COSO, most financial fraud observed in technological industries and manufacturing industries, and the lowest number of financial fraud have been reported in companies working with insurance and real estate.

Research done by the company Delloite for the period from 2000 to 2007, taking into account 344 cases of financial fraud, leading to the conclusion that most financial fraud is related to manipulation of financial statements of earnings in companies, then manipulate with contracts to customers and companies costs and ultimately, manipulation with investment and voluntary targets³.

Among the biggest financial frauds that have entered in history, is a scandal relate with company Enron, caused damage to more than 60 billion dollars as collective fraud and investment fraud of Bernard Madoff, with an estimated damage of over 65 billion dollars at the individual level⁴.

ELEMENTS OF TRIANGLE OF FRAUD

Given the fact that financial fraud is a way or a deliberate act that involving financial transactions to meet some human needs, it is classified as a criminal offense.

So the question arises, what are the reasons that motivate people rather legally, to choose illegal means to achieve their goal?

Because often have comparison of the financial fraud and fire, the question arises whether is the comparison justified? Also, the question is what are the elements that are common for the fraud and the fire?

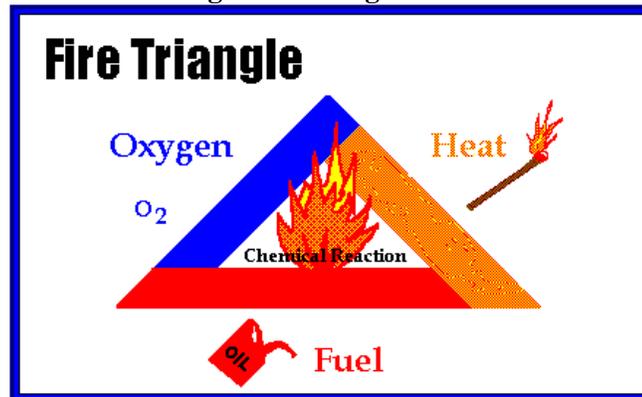
The arson attack can be defined as a criminal intent on setting fire to cause damage. For fire should be contained three elements: oxygen, fuel and heat.

³ COSO, "Fraud Financial Reporting:1998-2007", An Analysis of U.S. Public Companies 2008

⁴ Пеце Николовски, Бизнис шпионажа, Македонско научно друштво, 2008

When all three elements are present, then fire occurs and thus creates a triangle of fire. To stop the fire, should be completely eliminated one of the three elements. The three elements of the fire are interconnected as follows: if the fuel is more flammable, requires less oxygen and heat, if the heat is bigger, it will take less amount of fuel and oxygen and when there are high levels of oxygen, then need smaller amounts of fuel and heat⁵.

Figure 1 Triangle of fire



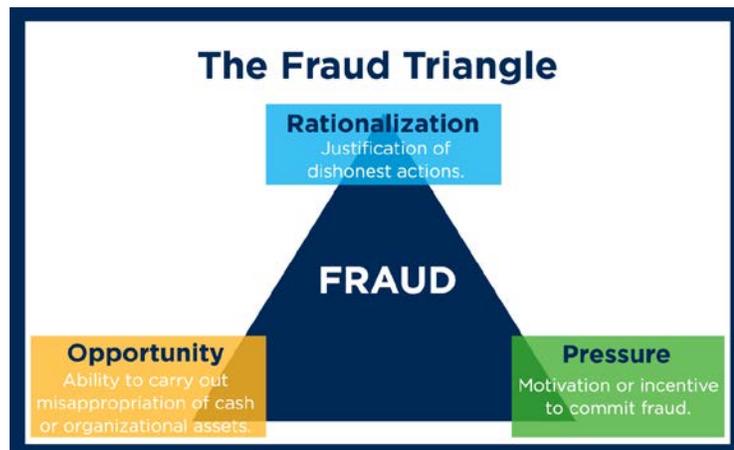
Source: http://www.sc.edu/ehs/modules/Fire/01_triangle.htm

Donald Cressey in 1954 investigated 200 deceivers scammers who have been in US prisons in order to perceive the similarity and connection of fire with fraud. From research Cressey came to the conclusion that for the fraud there should be three elements: pressure, rationalization and opportunity and these elements make up the triangle of fraud⁶.

⁵ <http://nuclearrabo.com/website/The%20Fire.html>

⁶ <http://www.journalofaccountancy.com/issues/2003/jan/auditorsresponsibilityforfrauddetection.htm>

Figure 2 Triangle of fraud



Source: <http://blog.umb.com/associate-fraud/>

Also, the three elements of fraud are linked each other, just like the fire, which means that if the pressure is greater, then the perpetrator would have required lower levels of opportunity and rationalization. When the possibility is greater, the pressure and rationalization should be at a lower level.

Element 1 - Pressure is something that happened in the life of the perpetrator of the fraud and create immediate need of funds.

Element 2 - Possibility of fraud is the enforcement of financial fraud, but also to pass without punishment.

Element 3 - Often, the perpetrators have no prior criminal record, were not convicted and they justify their deeds.

DISCLOSURE OF FINANCIAL FRAUD BY THE AUDITORS

The auditor has an independent position in relation to the company where audit is conducted and that independence is a crucial prerequisite in detecting

financial fraud. It is necessary to conduct deep analysis, but also the ability of the auditor to recognize the signs of criminal activity and in any case possess knowledge of modern techniques or the manner of their execution⁷.

It is also essential for auditors to know what criteria will help to identify criminal activity in the financial statements. The role of auditors in detecting financial fraud also depends on the type of audit that is conducted. When conducting an audit to detect financial fraud, there is no guarantee that auditors will definitely disclose any financial fraud at the company. If financial fraud is well planned, there is the probability to pass unnoticed, and thus the risk of damages from the fraud is even greater.

In the US there is a separate profession called examiners of fraud⁸. This profession is different from auditors that examine the financial statements of the companies because examiners of fraud have not disclosed only way of financial fraud, but also explore the reason that caused it.

The similarities and differences of the auditor and examiner of fraud can be seen from the following table:

Table 1 The similarities and differences of the auditor and examiner of fraud

Issue	Auditing	Fraud Examination
<i>Timing</i>	Recurring Audits are conducted on a regular, recurring basis.	Non Recurring Fraud examinations are non recurring. They are conducted only with sufficient predication.
<i>Scope</i>	General The scope of the audit is a general examination of financial data.	Specific The fraud examination is conducted to resolve specific allegations.

⁷ Александар Петковиќ, "Форензичка ревизија", Нови Сад, 2010

⁸ <http://www.acfe.com/>

<i>Objective</i>	Opinion An audit is generally conducted for the purpose of expressing an opinion on the financial statements or related information.	Affix Blame The fraud examination's goal is to determine whether fraud has/is occurring, and to determine who is responsible.
<i>Relationship</i>	Non Adversarial The audit process is non-adversarial in nature.	Adversarial Fraud examinations, because they involve efforts to affix blame, are adversarial in nature.
<i>Methodology</i>	Audit Techniques Audits are conducted primarily by examining financial data.	Fraud Examination Techniques Fraud examinations are conducted by (1) documentation examination; (2) review of outside data such as public records; and (3) interviews.
<i>Presumption</i>	Professional Skepticism Auditors are required to approach audits with professional skepticism.	Proof Fraud examiners approach the resolution of a fraud by attempting to establish sufficient proof to support or refute an allegation of fraud.

Source:<http://www.laredoisd.org/departments/internalauditor/AuditingvsFraudEx.htm>

CONCLUSION

In conclusion are systematized all findings arising from research into the theme, inspired by the trend of increasing of financial fraud in the country and internationally, as well as the role of auditors in their disclosure. Од бројните истражувања кои се направени во оваа област, се забележува дека финансиските измами се во постојан пораст. Special attention in this paper is dedicated to the triangle of financial fraud by comparison with a triangle of fire and its three components: the pressure, the possibility of fraud and rationalization of fraud. With analyze and understand of the financial fraud as crimes, auditors would prevent financial fraud.

If consider the financial fraud in history, it can be concluded that financial fraud is present in companies of different sizes, in all areas and there is no industry that is fenced off from financial fraud.

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