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## **Financial Shenanigans: The Importance of Anti-Fraud Education**

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### **Abstract**

*“Education is fundamental to the prevention of crime and corruption and to the promotion of a culture of lawfulness that supports the rule of law and human rights while respecting cultural identities.” United Nations’ Doha Declaration*

*Fraud, Financial Distress and Liquidation, Audit Failures, Hubris and Narcissism, are all very real and serious issues in today's business environment, but what are their implications for higher education teaching and future managers and leaders? Challenges exist for organisations in many different guises as they strive to achieve their goals. This often results in a balancing act between the right course of action and an action which could be seen to be ethically immoral or even illegal. Recently many organisations have encountered financial distress for different reasons, at a high cost to employees, pensioners, and other stakeholders. How can organisations ensure that legal and ethical decisions and actions are taken? Employees can be effective corporate watchdogs in the fight against financial deception and unethical decisions, and so surely fraud awareness and understanding education should be one of the essential requirements for our future business managers and leaders. A significant number of U.S. universities and colleges educate students on the basic elements of fraud prevention and detection; we consider why this is not replicated to such an extent in other countries? We suggest why anti-fraud education is important in the fight against financial shenanigans. The issue of financial shenanigans is significant; total global fraud loss is estimated to be nearly US\$4 trillion per annum.*

### **Introduction**

Over the last fifty years, the business community has experienced a syndrome of ethical breakdowns worldwide, including extremely costly financial statement frauds (Albrecht, et al., 2015). Many companies have experienced financial distress since the global financial crisis of 2008. This has had serious adverse consequences for a range of stakeholders, most notably employees, pensioners and creditors.

In recent times, accounting scandals have become perpetual in nature (Awolowo, et al., 2018). For example, in 2001, the news of Enron's collapse rocked the capital market damaging investment of over \$74 billion (Ackman, 2002); in 2002, WorldCom investors lost

over \$180 billion because of financial misstatements; then in 2003, accounting fraud and a \$20 billion black hole were discovered at Parmalat, an Italian milk processing giant (Boland, 2008); in 2011, Michael Woodford exposed the biggest corporate accounting fraud in Japanese history, namely the Olympus accounting scandal which was valued at over \$1.7 billion (Greenfeld, 2012); in 2014, Tesco was caught overstating its profit by £263 million (BBC News, 2014); in 2015, the revelation of Toshiba inflating its profit by \$1.2 billion came to light (Suzuki, 2015).

These kinds of occurrence are a serious threat to the integrity of financial reporting and corporate governance systems (Hogan, et al., 2008; Smith & Crumbley, 2009; Bhasin, 2013) and often result in a loss of confidence in the financial reporting process by investors and other stakeholders (Hogan, et al., 2008; Smith, 2015).

The beginning of (quarter 1) 2018 saw the number of company insolvencies in England and Wales at the highest level in the first quarter of a year since 2014 (McDaid, 2018). Between January and March 2018, there were 4,462 company insolvencies as opposed to 3,964 during the same period in 2017.

A company going through insolvency or nearing default has far-reaching effects beyond the company itself. It has an effect on the workforce, customers, the economy, the taxpayers etc. There have been countless examples where corporate failure due to financial misdemeanours or malpractice has led to the taxpayer paying redundancy costs for the failing business. One example of this was the insolvency of Comet, which left taxpayers with a £49.4m bill (Neville, 2012).

Recently the discount chain Poundworld announced the closure of nearly 100 stores putting over 1,500 jobs at risk as part of an insolvency procedure (Cahill, 2018). Palmer and Harvey went into administration in November 2017 without any warning signs resulting in loss of jobs, and creditors taking significant write downs against what they were owed (Garrow & Awolowo, 2018). TPG Capital (owners of Prezzo restaurants) went through a similar procedure, closing nearly a third of their stores and losing around 500 jobs.

The impact of corporate insolvency was further noted in one of the UK's biggest collapses in a decade, namely Carillion a FTSE 350 construction business. The collapse of Carillion led to over 2,300 job losses; it had a knock-on effect on the entire sector and caused financial difficulty for firms within its supply chain (Thompson, 2018).

In our definition, financial shenanigans are any form of action aimed at misrepresenting the true financial performance or position of a company and can be closely linked to financial statement frauds. A financial statement fraud is the "deliberate misrepresentation of the financial condition of an enterprise accomplished through the intentional misstatement or omission of amounts or disclosures in the financial statements to deceive financial statement users" (ACFE, 2018). Therefore, in one sense financial shenanigans are inappropriate behaviours, and possibly fraudulent, since they misrepresent the true financial performance and position of an enterprise.

Hubris (Roll, 1986) and narcissism (Chatterjee & Hambrick, 2007; Higgs, 2009) have frequently been cited as causes or contributors to deleterious financial performance arising from a merger or acquisition. It is therefore probable that both these behavioural traits are influential in terms of performance outcomes in other business situations. Traditional audit methodologies take no account of these characteristics being present within an organisation, and hence there is no 'red flag' for them in Annual Reports.

Challenges exist for organisations in many different guises as they strive to achieve their goals. This often results in a balancing act between the right course of action and an action which could be seen to be ethically immoral or even illegal. Recently many organisations have encountered financial distress for different reasons, at a high cost to employees, pensioners, and other stakeholders. How can organisations ensure that legal and ethical decisions and actions are taken? Employees can be effective corporate watchdogs in the fight against financial deception and unethical decisions, so we suggest that surely fraud awareness education should be one of the essential requirements for our future business managers and leaders.

### **Cost of Fraud**

The Association of Certified Fraud Examiners (ACFE) estimate that the average company loses approximately 5% of its revenues to fraud each year (ACFE, 2018) equating to an estimated total global fraud loss of nearly US\$4 trillion. Their most recent bi-annual study shows that the median loss from a single occupational fraud for an organisation is US\$130,000, although financial statement fraud can cause losses much higher than this with a median loss by scheme of US\$800,000 (ACFE, 2018).

Within the UK specifically, the KPMG UK Fraud Barometer identifies that 2017 was “a record-breaking year which had registered £3.6 billion of fraud - the largest value in KPMG's Fraud Barometer's 31-year history” (KPMG, 2018). If, as the statistics suggest, fraud is such an enormous problem, what are we doing to educate our future business managers and leaders in the fight against such a situation?

### **Forensic Accounting**

Traditionally within the UK, the practice of forensic accounting fitted neatly into specific categories i.e. matrimonial and commercial disputes, personal injury, professional negligence and criminal cases which mainly consisted of fraud prevention, detection and investigation work. Over time, the types of cases requiring the involvement of a forensic accountant has developed beyond anything that could have been initially envisaged, leading to a great deal of diversification and fragmentation away from the original classifications.

Academic literature has struggled to keep pace with the rate of change of the forensic accounting discipline which is clearly highlighted by the multitude of different definitions which have been composed, all of which are attempting to identify exactly what forensic accounting is. Huber & DiGabriele (2014) made a credible attempt to consider all of the aspects of the role and compiled the following definition:

*"Forensic accounting is a multidisciplinary field that encompasses both a profession and an industry, where civil or criminal economic and financial claims, whether business or personal are contested within established political structures, recognised and accepted social parameters, and well defined legal jurisdictions, and informed by the theories, methods and procedures from the fields of law, auditing, accounting, finance, economics, psychology, sociology and criminology"* (Huber & DiGabriele, 2014, p. 45)

What the Huber & DiGabriele definition makes evidently clear is the exceptionally broad nature of the forensic accountant's role and assumed expertise. Describing it as *multidisciplinary*, the definition demonstrates the distinct features that the forensic accountant has to consider; civil/criminal, business/personal, political impact/social behaviours etc. as well as requiring the knowledge of a number of other specialisms; law, economics and psychology to name just three. Add to this the uniqueness of each individual forensic case

and it begins to throw into doubt the idea that any one individual can claim to be an expert in all areas.

As forensic accounting continues to develop and diversify, so must its educational and training model. A *one size fits all approach* may have been appropriate when UK higher educational establishments initially designed their courses i.e. basing them on the traditional categorisations, but consideration now needs to be given to the employability of their graduates. Having a broad introduction to relevant forensic topics and skills is of course useful knowledge for all budding forensic accountants and much of that knowledge will be relevant in all forensic areas but each niche area will also have its own niche educational requirements which need to be met. It is time to differentiate education and training in line with the diversification of each of the emerging specialisms.

Currently, within the UK there is no recognised UK based professional forensic accounting qualification. This situation is, in the main, replicated throughout the world. In comparison, Huber (2011) identified that the United States has five forensic accounting corporations all offering accreditation albeit with differing levels of credibility and having grounding in different aspects of the forensic accountant's work. The lack of professional qualifications throughout most of the world is very likely due to the diverse nature of the services that come under the forensic accounting umbrella. ACFE is the most recognisable of the accrediting bodies within the United States and is specifically aimed at fraud examiners with their website claiming that they are *"the world's largest anti-fraud organization and premier provider of anti-fraud training and education"* (ACFE, 2018).

### **The Importance of Anti-fraud Education**

The success and growth of the offering of US education and training can, in part, be attributed to the introduction of the US Department of Justice's Model Curriculum (West Virginia University, 2007) which has guided universities and training establishments in how best to develop and deliver relevant courses. This has led to significantly more courses being offered, with a rise from 19 universities offering courses in the early part of the 21st Century (Peterson & Reider, 2001; Hegazy, et al., 2017) to in excess of 400 universities in more recent years (Seda & Kramer, 2014).

The impact of this framework along with other initiatives within the US has resulted in a very strong and positive momentum. Significantly more forensic accounting education is available to students today than even just one decade ago (Seda & Kramer, 2014).

The need to pull together Counter Fraud specialists from all sectors throughout the UK has recently been recognised by the UK Government with the launch in October 2018 of the Government Counter Fraud Profession (GCFP). Initially, this new profession will aim to incorporate the 10,000 Counter Fraud Specialists working across all government departments but has an ultimate goal of also including counter fraud specialists working external to government.

At the launch event of the Government Counter Fraud Profession (GCFP) in October 2018 it was said that the profession will "deliver new standards, guidance and tools to help build counter fraud capability" and that "...building this community will help improve detection and prevention of fraud" (The Cabinet Office, 2018). The full detail of how the government intend to deliver this and whether it will be suitable for counter fraud specialist's external to government will need further scrutiny as more information is released.

In the UK currently, only five of its 127 universities include forensic accounting in their programmes at postgraduate level and only two universities have specific undergraduate degrees in forensic accounting (Hegazy, et al., 2017). A handful of other universities include some element of fraud awareness education within the syllabus for their accounting degrees.

The statistics seem to be compounded further when looking at the world situation. Although there are 210 US universities and colleges participating in the ACFE's partnership program which provides support and resources for student education on fraud awareness and prevention, there are only seven participating universities in Europe (Damijan, 2017) and one African university (Damijan, 2018). Other universities in Africa, particularly South Africa, as well as Europe do offer courses, albeit not particularly extensive, on fraud awareness and related topics.

It is not always evident how the skill set of a fraud examiner can be differentiated from that of an auditor, given that some of the skills identified include critical thinking, problem solving, communication (written and oral), scepticism, and natural inquisitiveness (Souza, 2017; Hegazy, et al., 2017). It is worth noting at this point that the role of the auditor and the audit framework is currently under considerable scrutiny in the UK in light of recent financial

'disasters' and concerns being expressed about the quality and integrity of the 'traditional' audit, particularly those being conducted by the 'Big Four'.

It seems apparent from the literature that academic opinion in relation to the skill set of the fraud examiner has not particularly evolved over the past decade or so, suggesting that as an area of research it has now reached a consensus. Is it the ability to apply the identified skills in a more subjective environment working with fewer guides or rules (Medland, 2012) which makes the difference? It is appropriate therefore to consider the education and training of fraud examiners now that the skill requirement has been identified. So what form should this education take?

There is no doubt that there is a core element of specific knowledge that needs to be imparted, including amongst other things such aspects as scope of fraud and financial crimes, accounting, internal controls and risk management, and computer skills (West Virginia University, 2007). However, it is evident that in addition to the technical content, students need to be educated about how to place their work in context, and also the need to understand how different businesses and industries operate and to be aware of relevant legislation and the workings of law practice, often on a global basis. Students will only become effective fraud examiners if they are taught such skills as report writing, communication and critical thinking and ultimately, fraud examiners need to have the confidence to challenge what they see and not accept matters at face value.

Anti-fraud knowledge is important for all business personnel, not just accountants and auditors, and introducing anti-fraud education to all business courses can broaden the students' skill sets. Outside the business context, it is evident that an increasing number of individuals are being targeted and becoming victims of fraud, for example identity theft (Kranacher, et al., 2008). Raising fraud awareness across all university courses is an important step in fighting this growing problem within the various communities around the world.

This is even more important when one considers that 'tip offs' (both internal and external to the organisation) are the leading method by which frauds are discovered, accounting for 40% of cases identified in the 2018 Report to the Nations (ACFE, 2018), more than internal audit (15%) and management review (13%) combined. If employees are such an important part of fraud detection, consider how much more effective they would be if they had already been

trained on the fraud warning signs and gained an understanding of the effects that fraud can have.

If we know what the issue is and what needs to be put in place, how can it be that we do not have sufficient education around the world taking place to fight it? The issue is often one of resourcing and having the educators with the necessary knowledge and experience to teach such specialist subjects in an appropriate and meaningful way.

Many academic staff lack practical experience and so, understandably, they are often reluctant to teach a class where they may be faced with queries that they are unable to answer. West Virginia University (2007) suggest that the solution to this may be for fraud examiner practitioners to act as guest instructors providing the practical education and for the academics to cover the theoretical aspects. This solution is a possibility but is reliant on the availability of such practitioners and their ability to balance work with this education commitment.

A further solution might be for the academics to undertake some education themselves. The ACFE, for example, as part of their education partnership programme provide education materials for use with students but which can be studied by academics before delivering to students.

For the students to develop the required knowledge and skills there is no doubt that they need a hands-on experience. Ideally, this should come from a forensic accounting placement or an internship, but this is often difficult to achieve in what is a relatively niche employment market.

The main approach to providing this hands-on experience is through the use of case studies - actual and fictitious - which allow the students to identify the red flags of fraud, the circumstances which allowed the frauds to happen, and what can be done to prevent such frauds.

Simulated fraud investigations allow the students to experience, albeit on a simplified basis, the different approaches that can be adopted and the difficulties which may ensue. After all as is often said, each investigation is unique; it has its own cast of characters, facts and circumstances. Without the practical experience though, it is often difficult for academics to produce the necessary class materials to provide the students with this very specialist experience.

## Conclusion

*“Education is fundamental to the prevention of crime and corruption and to the promotion of a culture of lawfulness that supports the rule of law and human rights while respecting cultural identities.”* United Nations’ Doha Declaration.

Increasingly concerns are being raised about the nature and conduct of traditional methods of auditing and their failure to effectively protect all stakeholders, not just some stakeholders. This, in conjunction with some unethical practices displayed by directors and management, indicates that action needs to be taken.

Fraud has a significant financial and personal cost in today's global economy, and yet the extent and application of education in terms of forensic accounting in particular to develop and embed the skills necessary to address this growing problem is very limited, including in the Higher Education sector in most countries around the world.

Employees can be effective corporate watchdogs in the fight against financial deception and unethical decisions. Regardless of the difficulties, it is essential that we provide as many individuals as possible, not only our future business leaders, with the necessary skills to fight these financial misdemeanours. Broadening the coverage of forensic accounting education may be able to contribute to addressing this issue.

The global scale of financial fraud, at US\$4 trillion per annum, means that anti-fraud education must be expanded as a matter of urgency so that 'financial shenanigans' can be reduced and ideally eliminated.

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