Exploring a New Element of Fraud: A Study on Selected Financial Accounting Fraud Cases in the World

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Abstract
It has always been the case that auditors serve as the protector of many stakeholders that depend on financial statements being issued by businesses annually at the very least. What auditors usually do is to enhance the degree of confidence that stakeholders can place on the financial reports. But recent incidents of financial accounting fraud involving auditors have placed the accounting profession in bad light. Investors who are on top of the list of those whose confidence was understandably stunned started to question the competence and integrity of auditors in today’s dynamic business environment. Members of the top management of many businesses began to become paranoid with regard to the level of objectivity and prudence their auditors are exerting on their financial reports. Worst of all, the general public itself turned its head on business regulators for legal aid and political intervention. Not to anyone’s surprise, the government indeed intervened. The passage of the Sarbanes-Oxley Act of 2002 (a United States law) became the landmark of action coming from the government that it is serious in its stance to eradicate questionable practices in the auditing profession. This initiative was then replicated across many countries around the world including the Philippines. Alongside these developments are the many researches exploring on the elements that contribute to the taking place of fraud in business organizations. First is the fraud triangle which espouses that the following three elements should exist for fraud to also exist: pressure, opportunity, and rationalization (Wells, 1997). The second is just an extension of the original fraud triangle which added capability to be the fourth element, thereby being referred to as fraud diamond (Wolfe & Hermanson, 2004). And in this light, the researcher was motivated to explore more on the elements of fraud. By studying eight selected financial accounting fraud cases in the world vis-à-vis the review of the Report to the Nation on Occupational Fraud and Abuse for 2002, 2004, and 2008, the researcher was able to come up with a new element of fraud which is external regulatory influence thereby extending fraud diamond to fraud pentagon. Several implications and recommendations were made at the end of this paper which would be very useful to financial auditors, top management, investors, and legal and regulatory bodies.

Keywords: External regulatory influence; financial accounting fraud; fraud triangle; fraud diamond; fraud pentagon; legal environment.

1. Introduction
The role auditors play in lending confidence to interested users of the financial statements can never be overemphasized. The reported massive corporate failures such as Enron, Parmalat, and Satyam are more than enough justifications to conclude that at a steady state any fraud incident can just occur. Worse, at a state of instability as characterized by economic downturn and prolonged inflation, fraudulent financial activities can just slip through easily. Amidst all of these situations, one cannot help but ask, “Where are the auditors and what are they doing?”

The practice of the accounting profession, more specifically external audit, can be traced to as early as the late 1920s. And through time, there were refinements that took place as regulators must adhere to what is timely, applicable, and implementable. The most general definition of auditing comes from a committee of the American Accounting Association (AAA) which states that [Auditing] is a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between the assertions and established criteria and communicating the results to interested users” (Louwers et al., 2011). Through time, several auditing frameworks have been developed to address the ever-changing business environment.
Hall (2011) defines fraud as anything that denotes a false representation of a material fact made by one party to another party with the intent to deceive and induce the other party to justifiably rely on the fact to his or her detriment. According to common law, a fraudulent act must meet the following five conditions:

1. False representation – there must be a false statement or a nondisclosure.
2. Material fact – a fact must be a substantial factor in inducing someone to act.
3. Intent – there must be the intent to deceive or the knowledge that one’s statement is false.
4. Justifiable reliance – the misrepresentation must have been a substantial factor on which the injured party relied.
5. Injury loss – the deception must have caused injury or loss to the victim of the fraud.

But in the business environment, fraud has a more tailored meaning. It is an intentional deception, misappropriation of a company’s assets, or manipulation of its financial data to the advantage of the perpetrator (Hall, 2011). Moreover, in accounting literature, fraud is also commonly known as white-collar crime, defalcation, embezzlement, and irregularities. In the conduct of their job, the auditors may encounter fraud at two levels: employee fraud and management fraud (Hall, 2011).

During those times when financial accounting fraud took place, the sin of commission or omission from the auditors’ end were both present. This initial realization motivated the researcher to bring this matter to a higher level of consideration. That is, to look for new patterns and clues that can lead to a clearer understanding as to the reasons why these fraudulent activities occur. If such can be surfaced, even just one, this can serve as a signal or warning to the auditors, business organizations, investors, and legal and regulatory bodies in the future that a financial accounting fraud might happen.

2. Research Problem and Objectives

This study aims to explore a new element of fraud which can be evidenced by what happened to selected eight companies that were involved in financial accounting frauds. This seeks to provide an answer to the question: “what can be common to the cases of the selected eight companies that were involved in financial accounting fraud?”

Moreover, this study specifically aims:

1. To find out how the financial accounting fraud slipped through from the internal controls that were in place in these companies;
2. To investigate whether financial accounting frauds can be more evident in less developing countries;
3. To develop plausible recommendations that will benefit the auditors, the business organizations, the investors, and the legal and regulatory bodies as regards prevention, detection, and correction of financial accounting fraud.

3. Research Significance and Limitations

As a matter of significance in the local arena, the framework of analysis employed in this paper can highlight the strengths and weaknesses of the applicable laws and regulations currently enforced in the Philippines. In the international arena, this research study has the potential to provide a global perspective on the susceptibility of business organizations to financial accounting fraud. In a general sense, this research study has the capability to increase the level of awareness and promote the advocacy of ensuring fair presentation of financial position and performance as attested by more prudent auditors. Likewise, court decisions made with regard to these companies can be used as a strong jurisprudence in deciding for future cases that may involve business organizations and auditors. For the limitations, this study focuses only on eight selected companies that were involved in financial accounting fraud locally and internationally. The results might have been different if a new set of companies was selected.

4. Literature Review and Legal Repurcussions

This section of the paper is divided into three parts. The first part discusses the legal bases for the practice of auditing in the United States (US) and in the Philippines, the second part discusses the results of major fraud studies across time periods, and the third part discusses the facts and legal repercussions in the eight selected cases concerning companies that were involved in financial accounting fraud.
Part 1 – Legal Bases

The United States

In response to the number of major corporate financial accounting fraud, on July 30, 2002, the US Congress passed the most comprehensive financial reporting legislation since the 1930s when it established the Securities and Exchange Commission (SEC), the Sarbanes-Oxley Act (SOX). This was drafted by Senator Paul Sarbanes and Representative Michael Oxley. Sarbanes-Oxley aims to enhance corporate governance and strengthen corporate accountability by formalizing and strengthening internal checks and balances within corporations and instituting various new levels of control and sign-off. The intent of the SOX is to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes. This act created new standards for corporate accountability as well as new penalties for acts of wrongdoing. It changes how corporate boards and executives must interact with each other and with corporate auditors. It removes the defense of "I wasn't aware of financial issues" from CEOs and CFOs, holding them accountable for the accuracy of financial statements. The Act specifies new financial reporting responsibilities, including adherence to new internal controls and procedures designed to ensure the validity of their financial records (www.sox-online.com).

To substantiate further how SOX delimits consulting and advisory services, it prohibits public accounting firms from providing any of the following services to a public audit client:

1. Bookkeeping and related services;
2. Design or implementation of financial information systems;
3. Appraisal or valuation services;
4. Actuarial services;
5. Internal audit outsourcing;
6. Management or human resources services;
7. Investment or broker/dealer services; and
8. Legal and expert services (unrelated to audit).

Moreover, Section 302 of SOX underscores Corporate Responsibility for Financial Reports. To wit:

“The Commission shall, by rule, require, for each company filing periodic reports under section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o(d)), that the principal executive officer or officers and the principal financial officer or officers, or persons performing similar functions, certify in each annual or quarterly report filed or submitted under either such section of such Act that:

1. the signing officer has reviewed the report;
2. based on the officer's knowledge, the report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading;
3. based on such officer's knowledge, the financial statements, and other financial information included in the report, fairly present in all material respects the financial condition and results of operations of the issuer as of, and for, the periods presented in the report;
4. the signing officers are responsible for establishing and maintaining internal controls; have designed such internal controls to ensure that material information relating to the issuer and its consolidated subsidiaries is made known to such officers by others within those entities, particularly during the period in which the periodic reports are being prepared; have evaluated the effectiveness of the issuer's internal controls as of a date within ninety (90) days prior to the report; and have presented in the report their conclusions about the effectiveness of their internal controls based on their evaluation as of that date;
5. the signing officers have disclosed to the issuer's auditors and the audit committee of the board of directors (or persons fulfilling the equivalent function) all significant deficiencies in the design or operation of internal controls which could adversely affect the issuer's ability to record, process, summarize, and report financial data and have identified for the issuer's auditors any material weaknesses in internal controls; and any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls; and
(6) the signing officers have indicated in the report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Likewise, Section 404 of SOX emphasizes Management Assessment of Internal Controls. To wit:

“The Commission shall prescribe rules requiring each annual report required by section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) to contain an internal control report, which shall:

1. state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and
2. contain an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.

With respect to the internal control assessment required by subsection (a), each registered public accounting firm that prepares or issues the audit report for the issuer shall attest to, and report on, the assessment made by the management of the issuer. An attestation made under this subsection shall be made in accordance with standards for attestation engagements issued or adopted by the Board. Any such attestation shall not be the subject of a separate engagement.”

In addition, Section 406 of SOX requires public companies to disclose to the SEC whether they have adopted a code of ethics that applies to the organization’s chief executive officer (CEO), chief finance officer (CFO), controller, or persons performing similar functions. Whereas Section 406 of SOX applies specifically to executive and financial officers of a company, a company’s code of ethics should apply equally to all employees. The SEC has ruled that compliance with Section 406 of SOX necessitates a written code of ethics that addresses conflicts of interest, full and fair disclosures, legal compliance, internal reporting of code violations, and accountability (Hall, 2011).

The Philippines

In the Philippine context, Rep. Jesli Lapus proposed that the “Corporate Reform Act of 2004,” similar to the SOX, as a means to “jump-start” the awareness and regulatory interest in promoting corporate governance within the business community as well as the government. Sections 15, 24, and 25 of the Philippine proposal are almost the same as Sections 302, 404, and 406 of SOX. Moreover, the Philippine proposal also adopted the prohibited services to be performed by public accounting firms to audit clients. Another important legal basis worth discussing in this part of literature review is that of Republic Act (RA) 9298 – An Act Regulating the Practice of Accountancy in the Philippines, Repealing for the Purpose Presidential Decree No. 692, Otherwise Known as the Revised Accountancy Law, Appropriating Funds Therefore and For Other Purposes. This republic act is also known as the “Philippine Accountancy Act of 2004.”

Section 2 of RA 9298 states that:

“The State recognizes the importance of accountants in nation building and development. Hence, it shall develop and nurture competent, virtuous, productive and well rounded professional accountants whose standard of practice and service shall be excellent, qualitative, world class and globally competitive though inviolable, honest, effective, and credible licensure examinations and though regulatory measures, programs and activities that foster their professional growth and development.”

Republic Act 9298 aims to provide and govern the standardization and regulation of accounting education, the examination of registration of certified public accountants, and the supervision, control, and regulation of the practice of accountancy in the Philippines. The practice of Accountancy shall include, but not limited to, public practice, commerce and industry, education, and government (www.lawphil.net).

Part 2 – Major Fraud Studies

Though what can only be studied are fraud cases detected and therefore known about, researchers have been quite initiative in conducting many studies and surveys to determine the nature and extent of fraud. In the US, major fraud studies include the landmark 1987 Committee of Sponsoring Organizations of the Treadway Commission (COSO) fraud study and the 2002, 2004, and 2008 reports published by the Association of Certified Fraud Examiners (ACFE).
All these studies attempt to discover trends in occupational fraud, such as what kinds of fraud are most likely to be perpetrated, who the most likely perpetrators are, and what methods are used.

The COSO Study

The 1999 COSO study focuses mainly on financial statement fraud committed from 1987-1997. This study revealed 300 cases of alleged fraudulent reporting by SEC registrants and analyzed 200 randomly selected cases. In the cases analyzed, the most common method used to commit financial statement fraud was some type of improper revenue recognition (50 percent). Other methods included overstatement of assets (50 percent), understatement of expenses/liabilities (18 percent), asset misappropriation (12 percent), and improper or inappropriate financial statement disclosures (8 percent). Several unique characteristics of these fraud cases surfaced such as companies analyzed in the COSO study were found to be relatively small, with less than USD100 million in assets in the year immediately preceding the occurrence of the fraud. The COSO study also highlighted a problem concerning governance. The COSO study found that board members were typically individuals with family or fraternal ties to the owners and, in many cases, were people who had little experience as corporate directors. Moreover, in more than 20 percent of the companies involved in fraudulent financial reporting, officers held incompatible job functions like serving as both the CEO and CFO. In addition, of the balance sheet accounts that were frequently involved in the fraudulent financial reporting, inventory was the most commonly misstated account. As for the industries where fraud occurred, the COSO study highlighted computer and manufacturing industries to be the highest, both with 15 percent, and financial services, following closely at 14 percent (Hunton et al., 2004).

The ACFE Reports

While the COSO study focuses on fraudulent financial reporting, the ACFE fraud reports on occupational fraud and abuse is broader as to the type of fraud being covered and examined. The 2002 ACFE Report is based on 663 known occupational fraud cases reported by certified fraud examiners who investigated those cases. Of the many findings discussed in the 2002 report, five main areas relevant to fraud with comparative 1996 reported statistics are worth emphasizing. These areas are: (1) the costs associated with fraud; (2) the methods for committing the frauds; (3) who the victims are; (4) who the perpetrators are; and (5) the legal aspects and outcomes of the 663 cases. For the costs associated with fraud, fraud in 1996 and 2002 were estimated at USD400 billion and USD600 billion, respectively. Over half of the frauds in the study resulted in a loss of at least USD100,000. Sixteen percent resulted in a loss of at least USD1 million and 3.2 percent were more than USD10 million. For the methods for committing the frauds, both the 1996 and 2002 reports identified three categories of fraud: (a) asset misappropriation; (b) corruption; and (c) fraudulent statements. Among the three, asset misappropriation came in first with respect to number of cases (85.7 percent) but the lowest in terms of median loss at USD80,000 and fraudulent statements came in last with respect to number of cases (5.1 percent) but the highest in terms of median loss at USD4.25 million. Regarding the duration of fraud schemes, the median time frame from inception to detection was eighteen months.

The 2002 report further states that nearly two-thirds of fraud schemes continued undetected for more than a year. With respect to how the frauds are initially detected, 46.2 percent of the cases were detected by some type of tip while 18.8 percent were detected by accident. Only 18.6 percent were detected by an internal audit while 11.5 percent were detected by external audit. For who the victims are, the 2002 report indicates that the incidence of fraud was highest in privately held companies (31.9 percent) and publicly traded companies coming close at second (30 percent). For who the perpetrators are, the 2002 report found that 58.1 percent of the cases were committed by employees, 35.9 percent were committed by managers and executives, and 6 percent were committed by managers and executives in collusion with employees. And for the disposition of the fraud cases, in most cases (61.1 percent) victims were insured. Approximately 75 percent of the cases were referred for criminal prosecution, and in 75 percent of these cases the perpetrator was convicted, either through a plea bargain (64 percent) or at trial (14 percent). For those cases where no legal action was taken against the offender, the fear of negative publicity (30.6 percent) was the primary reason for taking no legal action, followed by settlement being reached between the employer and dishonest employee (26.6 percent).

The 2004 ACFE Report estimated losses from fraud and abuse to be 6 percent of annual revenues which translated to approximately USD660 billion. The 2004 report covered 508 cases examined and reported by certified fraud examiners.
Of this number, more than 50 percent cost their victim organizations at least USD100,000 and 15 percent caused losses of USD1 million or more. In terms of fraud schemes, the 2004 report showed consistency with 2002 report. Fraudulent statements came in first in terms of losses and ranked third in terms of number of cases. On the other hand, asset misappropriation came in first in terms of number of cases and ranked third in terms of losses. As to who the perpetrators are, 68 percent of the reported fraud cases were committed by non-managerial employees, 34 percent by managers, and 12 percent by executives or owners. In terms of gender, the median loss per case caused by males (USD160,000) was almost three times that caused by females (USD60,000). In terms of education, frauds committed by high school graduates averaged only USD50,000, whereas those with bachelor’s degree averaged USD150,000, and those with advanced degrees were responsible for frauds with median loss of USD325,000.

Moving on, the 2008 ACFE Report estimated losses from fraud and abuse to be 7 percent of annual revenues which translated to approximately USD994 billion. The 2004 report covered 959 occupational fraud cases cases examined and reported by certified fraud examiners. Of this number, the median loss from fraud was USD175,000, while 25 percent of the organizations experienced losses of USD1 million or more. In terms of fraud schemes, the 2008 report showed consistency with 2004 and 2002 reports. Fraudulent statements came in first in terms of losses and ranked third in terms of number of cases. On the other hand, asset misappropriation came in first in terms of number of cases and ranked third in terms of losses. As to who the perpetrators are, 40 percent of the reported fraud cases were committed by non-managerial employees, 37 percent by managers, and 23 percent by executives or owners. In terms of gender, the median loss per case caused by males (USD250,000) was more than twice that caused by females (USD110,000). In terms of education, frauds committed by high school graduates averaged only USD100,000, whereas those with bachelor’s degree averaged USD210,000, and those with advanced degrees were responsible for frauds with median loss of USD550,000.

Part 3 – Selected Fraud Cases

This paper focuses on eight companies that were involved in financial accounting fraud cases for the past three decades. These companies are based in one of the following countries during the time fraud took place: United States, Japan, Italy, India, and Philippines. The following table, Table 1, (next page) shows profiles of these companies:

<table>
<thead>
<tr>
<th>Company</th>
<th>Country</th>
<th>Fraud Allegations</th>
<th>Auditor</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Enron</td>
<td>United States</td>
<td>The debts of the company were hidden and profits were inflated by more than USD1 billion</td>
<td>Arthur Andersen</td>
</tr>
<tr>
<td>2. Kanebo Limited</td>
<td>Japan</td>
<td>Inflated profits by USD2 billion over a five-year period</td>
<td>Chuo Aoyama</td>
</tr>
<tr>
<td>3. Parmalat</td>
<td>Italy</td>
<td>Total debt was more than doubled on the balance sheet and forgery</td>
<td>Grant Thornton, Deloitte Touche Tohmatsu, PricewaterhouseCoopers</td>
</tr>
<tr>
<td>4. Satyam Computer Services</td>
<td>India</td>
<td>Inflated cash and bank balances of more than USD1.5 billion, overstated debtor’s position of USD100 million and understated liability of USD250 million</td>
<td></td>
</tr>
<tr>
<td>5. PTL Club</td>
<td>United States</td>
<td>Excessive management compensation, excessive expenditures</td>
<td>Laventhol &amp; Howarth</td>
</tr>
<tr>
<td>6. WorldCom</td>
<td>United States</td>
<td>Underreported interconnection expenses by capitalizing on the balance sheet and overstated USD3.8 billion cash as capital expenses rather than operating expenses</td>
<td>Arthur Andersen</td>
</tr>
<tr>
<td>7. Best World (BW) Resources Corporation</td>
<td>Philippines</td>
<td>Very dramatic increase in stock price (18,025 percent increase); stock price manipulation and insider trading</td>
<td>Punongbayan Araullo</td>
</tr>
<tr>
<td>8. Health South Corporation</td>
<td>United States</td>
<td>Overstated income by as much as 4,700 percent to meet expectations of investors</td>
<td>Ernst &amp; Young</td>
</tr>
</tbody>
</table>

5. Research Framework

This study has its underpinnings rooted on the two internationally recognized frameworks on fraud. These are the fraud triangle and fraud diamond.
According to Hunton et al. (2004), fraud occurs as a result of the interplay between three factors: opportunity, incentive or pressure, and attitude or rationalization. This concept of fraud triangle was first espoused by Wells (1997) on his write-up on occupational fraud and abuse. For Hunton et al. (2004), opportunity exists when internal controls are not sufficient or when collusion exists so that perpetrators can circumvent the controls. Incentive or pressure, on the other hand, is what causes a person to commit fraud. Pressure can include almost anything including medical bills, expensive lifestyle, and addiction problems. Under normal circumstances, the employee might not be tempted to steal from the employer. But under these circumstances, even a scrupulously honest employee might fall victim to situational pressures. Lastly, the final factor that is usually present when fraud is committed is attitude or rationalization. This means the employee finds a way within his or her conscience to justify the misdeed. This may involve reconciling one’s unacceptable behavior with the commonly accepted notions of decency and trust. Fraud triangle can be illustrated using Figure 1 below:

**Figure 1 – The Fraud Triangle**

![Fraud Triangle](image1.png)

The second framework of fraud, the fraud diamond, is just an extension of fraud triangle. Wolfe and Hermanson (2004) believed that the fraud triangle could be enhanced to improve both fraud prevention and detection by considering a fourth element. In addition to addressing, pressure, opportunity, and rationalization, Wolfe and Hermanson (2004) considered an individual’s capability. This includes personal traits and abilities that play a major in whether fraud may actually occur even with the presence of the other three elements. Fraud triangle can be illustrated using Figure 2 on the next page:

**Figure 2 – The Fraud Diamond**

![Fraud Diamond](image2.png)
6. Methodology
This study is both an exploratory and explanatory research. It employs qualitative research design to position the occurrence of financial accounting fraud in the context of the fraud triangle and fraud diamond frameworks in the hope of exploring a new element of fraud evident in the eight cases that were thoroughly discussed in the literature review section. The researcher used secondary data available from the reports taken from books and the Internet.

7. Results, Discussion, and Conclusion

Table 2 – Summary of Findings

<table>
<thead>
<tr>
<th>Company</th>
<th>Pressure</th>
<th>Opportunity</th>
<th>Rationalization</th>
<th>Capability</th>
<th>External Regulatory Influence</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Enron</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>2. Kanebo Limited</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>3. Parmalat</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>4. Satyam Services</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>5. PTL Club</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>6. WorldCom</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>7. BW Resources</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>8. Health South</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

Table 2 shows the summary of findings with respect to the presence of the elements of fraud diamond in the eight cases that were discussed in the literature review section. The element of pressure is present in all eight cases with the compulsion coming from either of the two perspectives: one is the desire to make the financial statements appealing to investors and other stakeholders, and the other one is the desire to enrich oneself at the expense of the business organization. The first perspective is true for Enron, Kanebo, WorldCom, and Health South. The second perspective is true for Parmalat, Satyam, PTL Club, and BW Resources. This observation is being complimented by a conclusion drawn from the ACFE reports stating that individuals in the highest positions within an organization are beyond the internal control structure and have the greatest access to company funds and assets. As revealed, all the perpetrators in the eight cases are exposed to this risk and are susceptible to giving in to pressure because of several expectations coming from their professional and personal lives.

The element of opportunity is also present in the eight cases dissected. As highlighted, there had been a number of weaknesses in the internal control system of the eight companies. These weaknesses were exploited by the persons of various motivations. This has been very evident in cases where possible collusion among employees and outsiders could take place. The cases of Satyam and Parmalat perfectly fit this observation. In a close family business environment, the opportunity to commit fraud is higher due to the perceived belief that the company is an extension of the family members’ home. This is also true for the PTL Club and BW Resources where opportunity to commit fraud could easily be taken advantage of as the internal control environment was overridden by the owners who seemed to have a blurring picture of the accounting entity concept.

The element of rationalization, though very challenging to establish was well manifested in the eight cases that were analyzed. For perpetrators, essentially the top management in the cases considered, they felt that they have convinced themselves that the fraudulent behavior they had just demonstrated was worth the risks. This is particularly evident in Kanebo Limited as this company was operating in a business environment where failure in managing a business is always equated with one’s personal failure that would remain a tag or a stereotype of that person for as long as one lives. Rather than losing one’s face, doing something fraudulent might be worth the risk. Likewise, in the case of Parmalat, key management personnel had known even before the discovery of their fraudulent activity that they had to do it to protect their family business and for them not to lose a face in the society where people expect them to meet current and future obligations as they become due. For them, to make it appear that cash exists at an offshore bank was the way to conceal their financial difficulty.
The fourth element which is capability well compliments several conclusions drawn from the ACFE report. Capability adheres to right mix of given and acquired traits of an individual. Given this, perpetrators feel that they have the necessary traits and abilities to pull it off. The ACFE reports highlighted several traits and qualities of a perpetrator (or fraudster): (1) more men than women occupy positions of authority in business organizations, which provide them greater access to assets – this has been true to all the cases as all the perpetrators were male; and (2) older employees tend to occupy higher-ranking positions and therefore generally have greater access to company assets – this has been validated in all cases as all the perpetrators were older employees.

Before proceeding to discussing the fifth element, the contribution of this paper to the body of knowledge, the observation with respect to collusion is worth discussing. When individuals in critical positions collude, they create opportunities to control or gain access to assets that otherwise would not exist. This has been true to PTL Club, Parmalat, and Enron – which highlighted how auditors participated in the execution of the fraudulent activity. Moreover, collusion or deliberate tolerance by the regulatory bodies to what the business organizations are doing also contributes to the perfect execution of the fraudulent activity. In the BW Resources case, a question can be asked with respect to how effective the regulations and rules are in preventing irregularities, illegal, and corrupt dealings in the capital market. The BW Resources case showed failure in ensuring compliance with already-existing rules and policies. Reportorial requirements abound but needed also the mechanisms to critically assess the accuracy, validity, truthfulness, and veracity of facts and data reported.

All these will bring the researcher’s analysis down to recognizing an equally important element for fraud to exist. This is the fifth element, the element that looks at the external regulatory influence as one of the ever present contributor in all cases where fraudulent financial reporting and practices occurred. The operative word is external to contrast the internal regulations of control with the business organization which is a function of the internal control as implemented and monitored by the management.

**Figure 3 – The Proposed Fraud Pentagon**

As the additional element that will transform the fraud diamond framework to fraud pentagon (Figure 3), external regulatory influence at its weakest will have a multiplier effect on the possibility of fraud to occur. This fifth element will serve as a base in this new fraud framework. Before Sarbanes-Oxley Act was passed, the external regulatory influence only exerts a ministerial force to business organizations. Same was true during the 1930s when the only regulatory influence was that of SEC. As times change and business environment gets modernized, new ways of committing fraud exist. As such agents of good governance should respond proactively to manage these realities. Coming up with and implementing new laws and regulations are just the right responses. In financial reporting, these responses are indirectly an affirmation that external regulatory influence has something to do on the possible occurrence of financial accounting fraud.
8. Recommendations

The contribution of this study rests mainly on how the accounting profession will accept my proposition with respect to the fifth element of fraud. As qualitatively assessed, this study though exploratory in nature, is an attempt to widen the perspective of every business professional with respect to financial accounting fraud. As such, the researcher thus recommends that auditors, in the conduct of their audit, should factor in external regulatory influence in the internal control checklist. For the members of the top management, it is imperative to periodically review the code of corporate governance for changes regarding the mandate of external regulators. It would also be prudent to enhance the levers of controls by improving the culture of compliance within the company thereby building a strong tone at the top. For the investors, the researcher recommends inclusion of good governance as one of the criteria to be used in choosing businesses to venture into. If there is a plan to invest abroad, choose business environments where there are strong culture of regulatory compliance and reportorial requirements. For the legal and regulatory bodies, the researcher strongly recommends passage of a local law akin to Sarbanes-Oxley that will cater to the peculiar needs of the country. Likewise, for countries that have SOX counterparts, more defined mechanisms must be put in place to ensure compliance with the rules and regulations. And lastly to future researchers, to validate the presence of external regulatory influence as one of the elements of fraud in more cases that concern companies that were involved in fraudulent financial accounting fraud.

9. References

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