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Fraudulent Financial Statements of Enterprises: Research in Vietnam

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Abstract

Fraud on financial statements is one of the issues that has received special attention and is topical after a series of events where leading companies in the world went bankrupt in the early 21st century such as: Enron., Worldcom, Lehman Brothers, Xerox... This study addresses the concept of financial statement fraud; Factors affecting financial reporting fraud through Cressey's (1973) ^[2] research on the fraud triangle, a typical form of financial reporting fraud in

the world. At the same time, the article documents a number of cases of financial statement fraud reported by the Association of Statistical Fraud Investigators. Based on the research results, the author clearly points out the causes leading to fraudulent financial statements of businesses, thereby providing synchronous solutions to overcome this situation.

Keywords: Fraud, Fraud Triangle, Financial Reporting

Introduction

In a market economy, financial reports are an important and indispensable source of information to connect businesses. With investors, regulatory agencies and relevant parties. In the stock market, financial reports play an important role, serving as the basis for creating public confidence so they can make the right economic decisions. However, in reality in recent years, there have been many fraud cases when preparing financial reports of typical businesses such as: Vien Dong Pharmaceutical Company (2011), Tay Bac Mineral Investment Joint Stock Company. (2012), Wood Industry Group (2016)... Fraud cases of these businesses have raised doubts and concerns from shareholders and those interested in the quality of information. On financial statements.

Overview of corporate financial reporting fraud

About fraudulent financial statements

Looking at financial reporting fraud, Thornhill and Well (1993) said: Financial reporting fraud is committed by managers and often involves understatement of income and assets. On the other hand, the Committee of Internal Auditors (2004) believes that: Financial reporting fraud involves leaders at all levels intentionally making false or inappropriate representations or covering up related violations. Regarding financial reporting.

Meanwhile, the American Association of Fraud Investigators (ACFE) (2002), financial statement fraud is the intentional, calculated, misrepresentation or omission of material events, or data. Accounting data can lead to misunderstandings when readers consider the information used and can be a reason to alter judgment and decision making.

Thus, financial statement fraud is the intentional misrepresentation of information on financial statements, committed by one or more people on the company's Board of Directors, employees or third parties.

Financial reporting fraud around the world

Some outstanding fraud cases

Accounting scandals are not new, and the scale of each case often varies. In the history of the global financial market, there have been many famous cases of financial reporting fraud. In some cases, accounting fraud at a business is discovered, leading not only to the bankruptcy of the business but also to the collapse of the entire auditing firm.

An energy company headquartered in Texas (USA), before its collapse, Enron was the 7th largest company in the US in terms of revenue. Using complex accounting methods that involved shell companies, Enron was able to remove hundreds of millions of dollars in debt from its books. Investors and analysts were fooled into believing that Enron's finances were much more

stable than they actually were.

In addition, shell companies operated by Enron's senior directors inflated revenue many times over, thus Enron created impressive revenue and profit figures. However, when the complex network of fraud was exposed, Enron's stock price went into free fall. Enron's bankruptcy also led to the collapse of Arthur Andersen - the 5th largest auditing firm in the world at that time, when this company had signed Enron's financial statements for many years.

Not long after Enron's collapse, the US stock market was shaken by another accounting scandal. Telecommunications giant WorldCom is under intense investigation after showing signs of "cooking" accounting data. Specifically, WorldCom was discovered to have recorded operating expenses as investments. WorldCom recorded \$3.8 billion of normal expenses as investments. Accounting tricks helped WorldCom overstate its profits. In 2001, WorldCom reported profits of about \$1.3 billion even though the company actually had a net loss. WorldCom filed for bankruptcy on July 21, 2002.

Next is the Lehman Brothers incident. Since the financial crisis began in 2007, although it knew it was necessary to reduce dependence on loans, this was an unfavorable period for selling off assets and repaying debts, so Lehman Brothers took advantage of accounting tricks to record short-term debt financing operations as revenue. According to a report by Examiner, in the second quarter of 2008, Lehman Brothers hid debts of up to \$50 billion from its balance sheet.

However, Wirecard's financial reporting fraud is considered the latest financial scandal that shook the world and Germany. From its position as a leading financial technology company, Wirecard went downhill so dizzyingly that it had to apply for court protection from creditors. Since 2019, Financial Times has been investigating signs of wirecard book fraud and discovered that Wirecard's Singapore office used fake contracts to inflate revenue. In addition, Wirecard employees at subsidiaries in Dubai and Dublin appear to have conspired to overstate revenue and profits.

In Vietnam, in recent years, there have been many fraud cases when preparing financial reports of typical businesses such as: Vien Dong Pharmaceutical Company (2011), Tay Bac Mineral Investment Joint Stock Company (2011), 2012), Wood Industry Group (2016)... Fraud cases of these businesses have raised warnings about the quality of information in financial reports and subsequently, regulatory agencies Authorities have taken many measures to correct, check, and inspect as well as request businesses to increase the quality of audit reports for units of public interest.

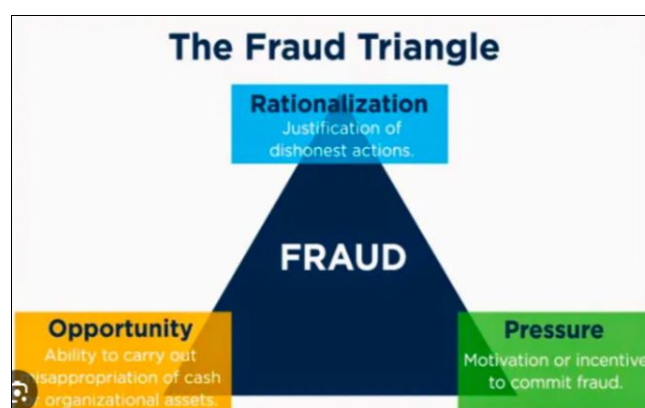
Factors leading to fraud - the fraud triangle

Cressey (1973) [2] conducted a survey of 200 economic crime cases from the perspective of embezzlement and asset misappropriation, in order to find the causes leading to violations of the law. From research, Cressey proposed the fraud triangle model to present the factors leading to fraudulent behavior. Today, Cressey's fraud triangle model has become one of the important theories used in fraud research.

Based on Cressey's theory, the American Institute of Certified Public Accountants (AICPA) has issued accounting standards such as SAS 53, SAS 82, SAS 99 and IFRS (ISA 240). According to Cressey's theory of fraud,

fraud occurs when there are three factors (pressure, opportunity, rationalization of fraudulent behavior) according to the model in Figure 1. Specifically:

- **Pressure:** Fraud often occurs when employees, managers or organizations are under pressure. Pressure can be from personal life, in life or pressure from other parties. Some situations can lead to pressure to commit fraud: (i) Financial stability or profitability is affected by the economic situation, business industry or operating conditions of the unit. taste; (ii) High pressure on the Board of Directors to meet the requirements or expectations of third parties; (iii) Information showing that the personal financial situation of the Board of Directors or Board of Management is affected by the performance of the enterprise; (iv) High pressure on the Board of Directors or executive personnel to achieve financial goals set by the Board of Directors, including reward policies based on revenue or profit margin.
- **Opportunity:** Creates the possibility of committing fraud. Opportunities often appear when internal control is weak and management and supervision are limited. Among the three factors that cause fraud, the element of opportunity is commonly applied by units to limit opportunities for individuals and organizations within the unit to commit fraud. There are two factors to commit fraud: Grasping information and execution skills.
- **Rationalization of fraudulent behavior:** After committing a fraudulent act, the person who commits it always has the attitude of giving reasons to explain and defend his or her fraudulent act. Some cases of justifying fraud: Management communicates, implements, supports or requires the implementation of corporate culture or professional ethical standards that are inappropriate and ineffective; Members of the Board of Directors do not have professional knowledge in accounting, but interfere too deeply and intend to impose on the preparation of financial statements and requirements for the results of the report.



Source: Cressey, D. (1973) [2]

Fig 1: Fraud triangle model

Forms of corporate financial reporting fraud

In 1993, the Association of Fraud Investigators (ACFE) was founded with the goal of specializing in research on fraud and its impact on material misstatements. To date, ACFE is the largest fraud research and investigation organization in the world.

Through the results of ACFE research, it shows errors in financial reporting of businesses such as: Recording bogus

revenue (overstating revenue); Recording the wrong accounting year; Concealing debts and expenses; Mispricing of assets; not fully disclosing information.

First, recording bogus revenue (inflating revenue): The recognition of bogus revenue can be done by recording it in the books of sales operations or providing bogus services. during the accounting period by creating fictitious customers; creating fake documents but the goods were not delivered at the beginning of the period after the accountant made a sales return entry; Overstating revenue by intentionally overstating elements on the value-added invoice in terms of quantity and unit price.

Second, recording incorrect accounting period: Is recording revenue or expenses incorrectly with the accounting period in which they arise. Revenue or expenses of this period can be recorded to the next period or vice versa for the purpose of increasing or decreasing profits as desired.

Third, hide debts and costs: To reduce costs on financial statements to overstate profits. At that time, pre-tax profit will increase corresponding to the amount of debt and hidden costs. There are three methods used to hide fraud and costs as follows: Not recording debts and costs, not making full provisions; Cost capitalization; do not record sales returns, deductions and do not deduct expenses.

Fourth, mispricing assets: Misvaluing assets is the failure to record a decrease in the value of inventory when the inventory is damaged, or the failure to make provisions for devaluation of inventory or bad debts., short-term and long-term investments.

Fifth, not declaring enough information: Information is often not fully declared in explanatory reports, causing readers to not have a clear and truthful view. Information about related parties is not presented, or does not present enough content according to the provisions of accounting standards.

Causes and solutions to combat financial reporting fraud

Reason

Through research on international experience and reality in Vietnam over the years, it has been shown that financial reporting fraud originates from the following main causes:

Manage profits according to the subjective discretion of the leader to intentionally create progress in increasing the business's revenue such as this year's loss, next year's profit to be able to reduce the business's loss.

Attract investment capital, issue stocks, bonds, borrow capital, prove financial capacity with partners and customers. For many businesses that need capital to invest but are not doing well, when preparing financial reports they do not generate the desired profit, so there is a motive to cheat on financial reports.

Due to the limited capacity of accountants at the company and the weakness of the internal control system: This is the cause originating from the accountant's subjective opinion when the accountant can embezzle through loopholes. of the enterprise's ineffective internal control activities to take advantage of fraudulent financial reporting.

Because the accounting standards system does not cover all situations in the market with many diverse industries. This makes it difficult for the company's accounting team to handle real-life situations when incidents occur that have not been regulated or guided in detail in accounting regulations and standards.

Solutions

To overcome the above shortcomings and limitations as well as limit cases of financial reporting fraud at Vietnamese enterprises, especially enterprises listed on the stock market, the following solutions need to be implemented:

Firstly, continue to research and improve mechanisms and policies in the direction of strongly increasing sanctions for fraudulent financial reporting at enterprises, as well as strictly handle listed enterprises with fraudulent reporting. Financial statements.

Second, strengthen and perfect the internal control system. When a business has an effective internal control system, the ability to prevent fraud in the company's operations is also well controlled and significantly reduced. The accuracy of the company's accounting data and financial reports is guaranteed.

Third, perfect the legal system of accounting, auditing, and information disclosure according to international standards and practices. Promote inspection, examination and supervision of businesses' activities to improve the quality of financial reporting. At the same time, it is required that businesses, when explaining their financial reports, need to provide clear and transparent information about potential fraud issues, leading to risks for investors.

Fourth, accountants need to update their knowledge every year about the new accounting regime in accordance with the professional expertise of the unit's industry. Enterprises should have a clear reward and punishment regime for accountants in improving their professional qualifications...

Fifth, investors need to improve their skills to be able to analyze and identify fraud on financial statements before making decisions.

From the reality of financial reporting fraud in the world and Vietnam, in order to overcome the above shortcomings and limitations as well as limit financial reporting fraud cases in Vietnamese enterprises, especially Enterprises listed on the stock market need to implement the following solutions:

Firstly, perfect the legal system of accounting, auditing, and information disclosure according to international standards and practices. Continue to research and improve mechanisms and policies in the direction of strongly increasing sanctions for fraudulent financial reporting at enterprises, strictly handle listed enterprises with fraudulent financial reporting, especially especially after recent incidents that affected the stock market and corporate bond market.

Second, promote inspection, examination and supervision of businesses' activities to improve the quality of financial reporting. At the same time, businesses are required when explaining their financial reports to provide clear and transparent information about potential fraud issues, leading to risks for investors.

Third, strengthen inspection against financial fraud at enterprises, specifically the role of internal audit. Internal audit not only checks financial reports but also participates in the process of implementing financial control, evaluating the effectiveness and compliance level of all activities to minimize errors and fraud. When an enterprise has an effective internal control system, the ability to prevent fraud in the enterprise's operations is also well controlled and significantly reduced.

Fourth, guidelines should be issued on procedures and ways

to detect fraud. Fraud is a behavior that cannot be eliminated but will increasingly develop with sophisticated methods. Therefore, to help auditors understand fraud and fraud detection procedures. The Vietnam Association of Certified Public Accountants also needs detailed instructions to help auditors make sharp professional judgments and conduct audits effectively.

Fifth, for accountants, it is necessary to update knowledge every year about the new accounting regime in accordance with the professional expertise of the unit's industry. Enterprises should have a clear reward and punishment regime for accountants in improving their professional qualifications...

Sixth, auditing units and auditors need to fully comply with the requirements and instructions of the profession, especially strictly complying with Vietnamese and international auditing standards.

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