UDK: 343.983:343.53
657.632
DOI: 10.5937/TokOsig2401146M

***Professor Stefan V. Milojević, PhD*[1]**
***Professor Snežana P. Knežević, PhD*[2]**
***Assistant professor Vladimir Šebek, PhD*[3]**

# IDENTIFICATION AND PREVENTION OF FRAUDULENT FINANCIAL REPORTING

REVIEW ARTICLE

**Abstract**

Effective detection of fraudulent (false) financial reporting requires an integrative conceptual framework. This paper presents a general framework for studying factors related to the causes of fraudulent financial reporting. The purpose is to sharpen our thinking on conducting research modalities for defining a framework for effective risk management of fraudulent financial reporting and to assist scholars, professional accountants, regulators, and policymakers to better understand the drivers of fraudulent financial reporting and the context in which it occurs. We examine the characteristics of companies engaged in fraudulent financial reporting, as identified in the literature, through research related to the fraud triangle, and ethical aspects. We also address the impact of professional and legal regulations on the area of effective fraud risk management. Finally, we summarize previous findings and present conclusions and suggestions for areas requiring further research.

***Keywords:*** *fraudulent financial reporting - professional regulation - ethics - legal framework.*

**JEL classification**: G22, M41, K20

[1] Associate Professor, Educons University - Faculty of Business Economics, Vojvode Putnika 87, 21208 Sremska Kamenica, Serbia, stefan.milojevic@educons.edu.rs

[2] Full Professor, University of Belgrade - Faculty of Organizational Sciences, Jove Ilića 154, 11000 Belgrade, Serbia, snezana.knezevic@fon.bg.ac.rs

[3] 3. Assistant Professor, University of Kragujevac, Faculty of Law, Jovana Cvijića 1; Chief, Kragujevac Police Department, 34000 Kragujevac, Serbia, vsebek@jura.kg.ac.rs

Paper received on: 31.01.2024.
Paper accepted on: 01.03.2024.

## I. Introduction

The frequency of fraud, corruption, and bribery is not a global novelty, but they become increasingly complex with the emergence of more sophisticated techniques. They occur in every type of enterprise, regardless of the type of activity the enterprise engages in, its legal organizational form, size, etc., although the level may vary from one enterprise to another[4]. Fraud remains a pervasive concern for accountants, auditors, and fraud prevention experts, so this issue deserves special attention from academic circles as well as practitioners. As awareness of the damage caused by financial fraud has grown internationally, efforts to combat it and control it adequately have intensified.

According to Webster's Dictionary[5], fraud is generally defined as "an act of deceiving or misrepresenting." Furthermore, fraud can be seen as a skill used to infringe upon the rights or interests of others; cunning aimed at gaining some inappropriate advantage; an attempted or actual gain of an advantage over others by imposition or immoral means, especially by deception in contracts, negotiations, and sales, either by either falsehood or by concealing the truth. Criminologists agree that three basic elements drive fraud. According to the conceptual theory proposed by Cressey in the 1950s[6], the three key elements in fraud incidents are: opportunity, pressure, and rationalization. Today's fraud perpetrators often justify (rationalize) these actions in various ways.

Contemporary organized financial crime encompasses various activities, indicating their constant evolution, emphasizing the need for comprehensive strategies for their prevention and detection. These activities include employee theft, payroll fraud, false billing schemes, management fraud, corporate fraud, insurance fraud, embezzlement, bribery, bankruptcy, and security fraud. Within this spectrum, accounting fraud stands out as the most severe form of manipulation of financial statements. Fraud is a serious concern that can have devastating consequences. Fraud is a global problem that often prompts the question "Why didn't auditors detect fraud?" after the occurrence of catastrophic corporate frauds. Various forms of fraud can arise both internally and out of a company, and the characteristics of fraud often make it unpredictable. For certain individuals, fraud has even become a profession.

The accounting information system is a key information platform for business organizations, and it is essential that the financial information it generates is valid[7].

---

[4] Abdoulaye N'Guilla Sow, Rohaida Basiruddin, Siti Zaleha, Abdul Rasid, Maizaitulaidawati Md Husin, "Understanding fraud in Malaysian SMEs", Journal of Financial Crime, 25/2018, pp. 870-881.

[5] Webster's Dictionary, 1828, https://webstersdictionary1828.com/Dictionary/fraud, pristupljeno 5. 1. 2024.

[6] Donald Cressey, *Other People's Money*, Montclair, NJ, Patterson Smith, 1953.

[7] Milena Ilić, Svetlana Anđelić, "The role of computerized accounting information system in detecting accounting errors and accounting fraud", *BizInfo (Blace) Journal of Economics, Management and Informatics,* 8/2017, pp. 17–30.

To understand the concept of fraud in financial statements, one must be aware of what constitutes fraud and where financial statement fraud fits into the definition of a fraud. There is no single definition of financial statement fraud, and professional bodies such as the Institute of Internal Auditors (IIA) and the Association of Certified Fraud Examiners (ACFE) have their own definitions[8]. However, what stands out as a unanimous opinion is that management is involved in the process of fraudulent financial reporting, fraud is intentional, and it causes harm to stakeholders. Additionally, financial statement fraud undermines the integrity of financial reporting as a whole.

Corporate accounting fraud typically involves creative, complex methods aimed at overestimating revenue, underestimating expenses, overvaluing corporate assets, and/or underreporting existing liabilities. For example, creative accounting practices that constitute fraud are subject to investigations typically initiated by government authority: the U.S. Securities and Exchange Commission (SEC), the Public Company Accounting Oversight Board (PCAOB), and the Department of Justice (DOJ)[9].

The paper is organized as follows: After the introduction, it delves into examining the responsibilities of different groups (accountants, auditors, and management) regarding the occurrence of fraudulent financial reporting. The third chapter focuses on the significance of ethics in fraud prevention. Professional regulations and legal framework are the subject-matter of the fourth chapter. The fifth chapter considers the role of forensic accountants in criminal justice and civil litigations. The sixth chapter provides a brief overview of insurance fraud. Further on, there are the concluding remarks and appropriate recommendations.

## II. Responsibility of Accountants, Auditors, and Management for Fraudulent Financial Reporting

The lack of adequate supervision and implementation of financial reporting can significantly slow down the detection of fraud, seriously undermining investors' trust in capital markets and their supervisory function. On the other hand, effective implementation and supervision of auditing processes can reduce triggers and opportunities for accounting frauds[10].

According to a published survey by PricewaterhouseCoopers (PwC) on global economic crime and fraud, the results show that the average company has

[8] Van Wyk, *Fraud risk assessment: a conceptual framework for internal auditors to detect financial statement fraud*, USA, Institute of Research Engineers and Doctors, 2015.

[9] Ibrahim Badawi, "Motives and consequences of fraudulent financial reporting", in 17th annual convention of the Global Awareness Society International, 2008, May, pp. 110-123.

[10] Domenico Campa, Alberto Quagli, Paola Ramassa, "The roles and interplay of enforcers and auditors in the context of accounting fraud: a review of the accounting literature", *Journal of Accounting Literature*, 2023.

experienced 6 fraud incidents in the last 24 months[11]. An important fact is that this is the second-highest reported level of incidents in the last 20 years, which sounds truly alarming. This trend mainly stems from the dynamism of business models, changing work styles, and constant changes in technology. Perpetrators of fraud are increasingly using more direct methods to unfairly benefit from the company's clients, which leads to financial and reputational losses for organizations in various industries. Most frauds are still detected by external sources such as the police, anonymous tips, and customers. Others are discovered only by chance. This raises questions about the methods auditors employ to detect and investigate fraud, and how they cope with thousands, even millions, of transactions, and select a few that may be fraudulent[12].

The Federal Bureau of Investigation (FBI) has sought expanded collaboration with Certified Public Accountants (CPAs) in the fight against corporate fraud. The FBI believes that the roles, independence, and integrity of CPA professionals uniquely lend themselves to partnership. In other words, they see CPAs as expert third-party partners of this intelligence agency, which has jurisdiction over more than 2,000 categories of federal crimes. Collaboration is carried out in several segments: (1) addressing the scope of the problem, (2) identifying common accounting schemes, and (3) effective operation under the influence of the Sarbanes-Oxley Act of 2002 and related rules and regulations[13].

Reviewing financial statements requires accountants to inquire with management responsible for financial and accounting matters, as well as with others within the entity, as needed, about the existence of any actual fraud, suspicion, or alleged fraud. When there are indications of fraud or the potential for it to occur — the effects of which need to be considered when preparing financial statements — accountants are required to communicate this as soon as possible to the appropriate level of senior management, preferably at a level above those implicated in the suspected fraud or those responsible for governance.

Accountants should, as necessary, request from management, among other things, an assessment of the effects, if any, on the financial statements, and consider those effects, if present. Additionally, management's assessments are important for accountants to consider regarding the effects of fraud on the conclusion

[11] PwC's Global Economic Crime and Fraud Survey 2022: Protecting the perimeter: A new frontier of platform fraud, *https://www.pwc.com/gx/en/services/forensics/economic-crime-survey.html*, pristupljeno 11. 12. 2023.

[12] Md. Abdul Baten, "Conceptual study of fraud and the accounting system", International *Journal of Multidisciplinary Education and Research*, 6/2018, pp. 1-5.

[13] Norazida Mohamed, Moorison Handley-Schachelor, "Financial statement fraud risk mechanisms and strategies: the case studies of Malaysian commercial companies", *Procedia-Social and Behavioral Sciences*, 145/2014, pp. 321-329.

of the financial statements and the accountant's report, as well as to determine whether accountants have broader communication responsibilities with any parties outside the entity. Since potential conflicts with accountants' ethical and legal obligations regarding confidentiality can be complex, accountants may consult with legal counsel before engaging in any discussions with parties outside the entity. If fraud results in materially misstated financial statements or involves higher-level management, accountants are required to report directly to those responsible for governance[14].

Fraudulent financial reporting brings significant negative consequences to companies, including a decrease in stock value and a loss of investor confidence in the company. The growing need to protect capital in markets and the increasing influence of the accounting profession in effectively managing the risk of fraud emphasizes the importance of strengthening the capacity of forensic accounting through the education system on the one hand, and enhancing the skills of forensic accountants on the other.

The submission of financial reports is regulated by provisions of Articles 44 to 46 of the Accounting Law. Regardless of who signed the financial statements and other accounting documentation, "collective responsibility is prescribed for the true and fair presentation of the financial position and performance of the legal entity, namely the legal representative, the management body, and the supervisory body of the legal entity in accordance with the law, or the entrepreneur, as well as the responsible person from the Article 14 of the Law."[15]

Despite the conflict of interest between managers and owners, the fundaments of mechanism of corporate governance is the intention to protect all stakeholders. Misalignment of interests between company owners and managers sets the stage for profit manipulation, with managers likely managing profits for their gain. Managers may manipulate financial statements to achieve specific accounting goals[16] or to improve the company's financial appearance[17]. Furthermore, it is essential to note that managers can engage in financial reporting malpractices by bypassing established control procedures, entering unauthorized or inappropriate data into the books, or making modifications after the period closes (e.g., reclassification). Some forms of management behavior in financial reporting may be considered

[14] Dave Arman, "A refresher on fraud and the responsibility for its detection", *Journal of Accountancy*, 2023, September 14, AICPA & CIMA, p. 1.

[15] Regular annual financial statement, https://www.paragraf.rs/baza-znanja/knjigovodstvo/redovni-godisnji-finansijski-izvestaj-2021-apr.html, accessed on 24. 1. 2024.

[16] Michael Ettredge, Susan Scholz, Kevin Smith, Lili Sun, "How do restatements begin? Evidence of earnings management preceding restated financial reports", *Journal of Business Finance & Accounting*, 37/2010, pp. 332-355.

[17] Michael Fung, "Cumulative prospect theory and managerial incentives for fraudulent financial reporting", *Contemporary Accounting Research*, 32/2015, pp. 55-75.

unethical but not necessarily false (illegal)[18]. Therefore, it is crucial to carefully assess and evaluate management behavior in earnings management and potential frauds.

Once identified, the risks of fraud must be continuously assessed to understand their significance and to evaluate the effectiveness of fraud risk management. Audits play a crucial role in guiding economic decisions[19]. A well-established and efficient internal audit, which is a key component of the corporate governance framework within an organization, plays a vital role in effectively managing fraud risks. It can aid managers in assuming responsibility[20].

As early as 1997, the AICPA issued standard SAS No. 82: "Consideration of fraud in a financial statement audit," which distinguishes between errors and fraud. It mandates auditors to plan and execute audits to obtain reasonable assurance regarding whether the financial statements are free from material misstatements, whether caused by error or fraud. Additionally, it provides guidance on how auditors should achieve this[21]. It's essential to diligently monitor areas and categories with heightened fraud risk, and a protocol for auditors to communicate about fraud with management, the audit committee, and other relevant parties is envisaged.

## III. Ethical Aspects and Fraudulent Actions

Ethics can be discussed in the context of various professions[22]. It is well known that accountants encounter various dilemmas in their practice. The importance of ethics in accounting has greatly increased following major corporate scandals that seriously undermined trust in the accounting profession. In the accounting industry, ethics refers to a set of moral principles and rules of conduct that accountants apply in their practice. These principles encompass ideals of honesty, fairness, objectivity, and accountability in providing financial services and information. They play a crucial role in guiding accountants in the execution of their daily activities, shaping their professional decisions and actions.

Ethics in accounting can be viewed as a set of guidelines established by various accounting bodies to prevent the misuse of financial information. These

[18] Lawrence Kalbers, "Fraudulent financial reporting, corporate governance and ethics: 1987-2007", *Review of Accounting and Finance,* 8/2009, p. 195.

[19] Marko Milašinović, Snežana Knežević, Aleksandra Mitrović, „The significance of audit and audit opinions in the contemporary environment", *Revizor*, 97-98/2022, pp. 21-31.

[20] Miloš Milošević, Marija Stojiljković, Jelena Raičević, Stefan Milojević, "Obrazovanje i obuka u oblasti strateškog finansijskog menadžmenta i kontrole: u kom pravcu bi trebalo da idemo?", *Revizor,* 102-103/2023, pp. 25–36.

[21] Michael Ramos, Anita Lyons, Considering fraud in a financial statement audit: practical guidance for applying SAS no. 82, *Guides, Handbooks and Manuals (33)*, University of Mississippi, 1997.

[22] Aleksandra Mitrović, Snežana Knežević, Marko Milašinović, „The importance of ethics in the auditing profession in contemporary business", *Revizor*, 97-98/2022, pp. 73-79.

guidelines include confidentiality, integrity, and professional competence. Confidentiality requires accountants not to disclose financial information to third parties. Integrity implies that accountants be honest in their financial dealings, while professional competence requires them to be educated and experienced.

Ethics is of paramount importance in accounting because it provides guidelines on how to handle the information and what type of information is necessary. It also establishes the fundamental values and principles that accountants and auditors should adhere to. Ultimately, ethics prescribes sanctions for offenders, serving as a means to address unethical behavior. Furthermore, the significance of ethics in accounting is extremely large for several reasons. Firstly, it builds trust and credibility among stakeholders such as investors, creditors, and customers, who rely on honest practices for accurate and objective financial reporting. For example, when accountants adhere to the principles of fairness and objectivity, they ensure that financial statements reflect the true financial position of the company.

Additionally, the ethical behavior protects companies against legal consequences. Accountants who uphold the principles of confidentiality safeguard sensitive financial information from unauthorized disclosure. However, ignoring these ethical norms can have catastrophic consequences. For instance, the scandal that befell Enron in 2001 illustrates how unethical accounting practices can lead to serious problems. Manipulation of financial data and misleading audit reports created a false picture of profitability, ultimately leading to Enron's bankruptcy and causing significant losses for shareholders.

The literature has recognized various types of organizational factors associated with the absence of fraud. Some of them include the effectiveness of the audit committee, the efficiency of internal auditing, ethical policies, and the tone set by top management team[23]. Generally speaking, ethics pertains to the principles of behavior that individuals use in making choices and guiding their behavior in situations (circumstances) involving concepts of right and wrong, and as such, it is inseparable from the issue of effectively managing the risk of fraudulent activities.

Ethics can be viewed as "agreed-upon standards of what is desirable and undesirable, and right and wrong behavior or conduct of a person, group, or entity."[24] Although ethics receives a lot of attention in public discourse, we live in a time where unethical behavior is not only more accepted but is also close to becoming the norm. Those who have the power to make decisions about investing other people's money (i.e., corporate managers and investment advisors) can manipulate investors to achieve financial gain.

[23] Philip Law, "Corporate governance and no fraud occurrence in organizations: Hong Kong evidence", *Journal of Business and Industrial Marketing*, 6/2011, pp. 501-518.

[24] Robert Cressy, Douglas Cumming, Christine Mallin, "Entrepreneurship, governance and ethics", Entrepreneurship, *Governance and Ethics*, 2/2010, pp. 117-120.

Fraudulent activities must be avoided due to their impact on company performance. Therefore, one way to address this issue is through monitoring those responsible for management, promoting a culture of respect and ethical policies that could motivate individuals not to commit fraud due to the possibility of regulators detecting and penalizing them[25]. For example, honesty and integrity in profit reporting can be devastating for managers when expectations are not met. «Cooking the books» - as unethical as it may be, improves the bottom line (company performance), instead, at least in the short term.[26] The question arises, will struggling firms in difficult times prioritize survival or ethics? Also, an important question is what role corporate governance plays in upholding ethical values? In this context, corporate governance can be viewed through ethical values and assumptions that are fundamental to a particular regime or code of corporate governance, the so-called «governance ethics,» and through the way corporations are expected or required to manage their own ethical impact, known as «ethics management.»[27]

It is emphasized that in circumstances where corporate culture is developing, it is particularly important to establish an ethical foundation.[28] Finally, respect for business ethics in modern organizations affects the creation of their business image.[29] The research findings of Ćerdić and Knežević[30] show that continuous training of employees on the adequate application of the ethical code leads to a reduction in the likelihood of financial fraud in companies. The findings of Mayhew & Murphy[31] suggest that ethical education does not necessarily lead to internalized ethical values, but it can affect the ethical behavior.

## IV. Professional Regulation and Legal Framework: Where Are We Now?

The regulatory environment in which accountants operate is quite complex. Today's accountants face many challenges in a dynamic environment. The field of

[25] Hafiza Aishah Hashim, Zalailah Salleh, Izzati Shuhaimi, Nurul Ain Najwa Ismail, "The risk of financial fraud: a management perspective", *Journal of Financial Crime*, 27/2020, pp. 1143-1159.

[26] April Knill, "The value of country-level perceived ethics to entrepreneurs around the world", *The European Journal of Finance*, 18/2012, pp. 209-237.

[27] G. J. Rossouw, "Business ethics and corporate governance: A global survey". *Business & Society,* 44/2005, pp. 32-39.

[28] Kimberly Henry, Brittany Dodson, Ethical Education and its Effect on Accounting Fraud, Working Paper, Christopher Newport University, 2009.

[29] Milena Sretić, Vuk Mirčetić, Mlađan Maksimović, Dejan Karabašević, "The impact of ethical internal communication on opinion of public menu", *BizInfo (Blace) Journal of Economics, Management and Informatics*, 10/2019, pp. 43–51.

[30] Ivan Mate Ćerdić, Goranka Knežević, "Ethical dilemma: A pathway to fraud or not?", *The European Journal of Applied Economics*, 20/2023, pp. 79-92.

[31] Brian Mayhew, Pamela Murphy, "The impact of ethics education on reporting behavior", *Journal of Business Ethics*, 86/2009, pp. 397-416.

forensic accounting adds another layer of complexity, as practitioners in this field focus on a wide range of areas of fraud, commercial disputes, and analytics.[32]

Corporate governance is, among other things, a crucial part of reform processes in public enterprises.[33] For corporate governance to ensure sustainable long-term operations, high-quality financial information is essential. Corporate financial scandals have ultimately led to several major corporate bankruptcies. Various corporate stakeholders (such as shareholders, creditors and suppliers, employees and workers, competitors, customers, retirees, state tax authorities, among others) have suffered adverse financial consequences. This has triggered an initiative for amendemnts to the legal and professional regulations in various countries.

The basic principle of audit emphasizes that financial failures, or incorrect financial representations, are more likely to occur when internal controls are ineffective (SAS No. 55, AICPA 1988[34]; SAS No. 78, AICPA 1997[35]; SAS No. 110, AICPA, 2006[36]). The Sarbanes-Oxley Act was enacted in response to the expected impact of the relationship between internal control and the quality of financial reporting[37], as well as the increase in accounting errors[38]. This law represents a comprehensive effort to enhance the quality of financial reporting in the United States, stemming from serious corporate accounting frauds (financial scandals) that occurred in the late 1990s and early 2000s.

The prevalence of fraudulent financial activities, along with the lack of standards in defining auditors' responsibilities regarding fraud detection, has supported the emergence of the Association of Certified Fraud Examiners - ACFE, which grants the CFE license[39]. Although regulators and authorities have issued a series of guidelines aimed at achieving transparency, preventing fraud, and improving the

32 Jeanette Van Akkeren, Sherrena Buckby, Julie-Anne Tarr, "Forensic accounting: Professional regulation of a multi-disciplinary field". *Australian Business Law Review*, 44/2016, pp. 204-215.

33 Valentina Mirković, Goran Perić, Aleksandar Jokić, "Possibilities for corporate governance in public enterprises in Serbia", *BizInfo (Blace) Journal of Economics, Management and Informatics*, 1/2010, pp. 23–29.

34 American Institute of Certified Public Accountants (AICPA), The Auditor's Considerations of Internal Control Structure in the Financial Statement Audit. Statement on Auditing Standard (SAS) No. 55, New York, NY, AICPA, 1998.

35 American Institute of Certified Public Accountants (AICPA), Consideration of Internal Control in a Financial Statement Audit: An Amendment to Statement on Auditing Standards No. 55. Statement on Auditing Standard (SAS) No. 78, New York, NY, AICPA, 1997.

36 American Institute of Certified Public Accountants (AICPA), Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained. Statement on Auditing Standard (SAS) No. 110, New York, NY, AICPA, 2006.

37 U.S. House of Representatives, The Sarbanes-Oxley Act of 2002, *Public Law*, 107-204 [H. R. 3763]. Washington, DC: GPO, 2002.

38 Yuping Zhao, Jean Bedard, Rani Hoitash, SOX 404, auditor effort, and the prevention of financial report misstatements, *Auditing: A Journal of Practice & Theory*, 36/2017, pp. 151-177.

39 Zabihollah Rezaee, James Burton, "Forensic accounting education: insights from academicians and certified fraud examiner practitioners", *Managerial Auditing Journal,* 12/1997, pp. 479-489.

quality of financial reports, cases of fraud in organizations continue to rise. Approximately 47% of organizations have reported cases of fraud in the last two years, representing the second-highest level of fraud in the past two decades, despite the implementation of laws and regulations[40]. Small businesses have been ranked highest in terms of fraud frequency in the ACFE report in the country from 2002 to 2022, with combined averages showing that the frequency of fraud in small businesses is at 28% compared to larger organizations at 22-26%[41].

One of the significant questions in effective fraud risk management is determining which companies should provide financial data to regulatory agencies. It is known that many private companies worldwide are not legally obliged to submit financial data to regulatory agencies (e.g., the Securities Exchange Commission - SEC in the United States). Therefore, when considering ethical issues, it is essential to carefully monitor companies according to their legal form of organization. For example, some studies have shown that entrepreneurs are generally more ethical than managers of public companies.[42][43]

In Serbia, the Accounting Law[44] covers the economic approach related to accounting issues, i.e., financial data (financial reporting). According to Article 57, "a legal entity shall be fined with a monetary fine ranging from 100,000 to 3,000,000 dinars for an economic offense if it: processes data on a computer and does not provide accounting software that enables the functioning of internal accounting control systems and prevents the deletion of booked/posted business transactions (Article 8, paragraph 4); does not prepare and present financial statements in accordance with this law (Articles 23-26); does not prepare financial statements in accordance with this law (Articles 29 and 31); does not conduct an audit of financial statements (Article 33). Moreovdr, for actions referred to under the paragraph 1 of the Article hereof, the responsible person in the legal entity shall be fined with a monetary fine ranging from 20,000 to 150,000 dinars."

Taking into account the recent amendments to the Criminal Code related to tax evasion, "tax evasion is treated as a criminal offense if the taxpayer avoids paying or calculating taxes to the amount of one million dinars, and if the evasion is up to one million dinars, it is considered an economic offense or misdemeanor."[45]

[40] PwC's Global Economic Crime and Fraud Survey. 2020, https://www.global-screeningsolutions.com/industries/global-economic-crime-and-fraud-survey-2020, accessed on 11. 12. 2023.

[41] Current fraud statistics, Business Fraud Prevention, Inc. (BFP), *https://businessfraudprevention.org/about-us/*, 2002, accessed on 14. 12. 2023.

[42] Elisabeth Teal, Archie Carroll, "Moral reasoning skills: Are entrepreneurs different?", *Journal of Business Ethics*, 19/1999, pp. 229-240.

[43] Branko Bucar, Rober Hisrich, "Ethics of business managers vs. entrepreneurs", *Journal of developmental entrepreneurship*, 6/2001, pp. 59-83.

[44] Accounting Law, *Official Gazette of the Republic of Serbia*, 73/2019 and 44/2021, Article 57.

[45] Law on Criminal Proceedings, *Official Gazette of the Republic of Serbia*, nos. 85/2005, 88/2005 – as ammended, 107/2005 - as ammended, 72/2009, 111/2009, 121/2012, 104/2013, 108/2014, 94/2016 i 35/2019.

The question arises whether the prescribed penalties are a strong deterrent. The answer to this question requires extensive research based on data from various agencies, services, and institutions.

## V. Role of Forensic Accountants in Criminal Justice and Civil Litigations

Managing a business, managers are often in a position to understand the potential dangers associated with fraudulent activities. However, there are practical steps that can be taken to protect one's business from financial malfeasance. Involving experts in forensic accounting is crucial for detecting any financial abuses and fraud. Forensic accounting, as a branch of accounting, involves detailed investigation and analysis of financial information to uncover fraud or financial manipulations. Forensic accountants are often engaged in preparing for legal disputes in cases involving divorces, embezzlement, fraud, skimming, insurance, insolvency, and other forms of financial fraud.

In addition to traditional accounting techniques, forensic accountants apply various tools and software for investigating and analyzing financial data. These tools include data analysis software, computer forensic tools, data mining software, and predictive analytics. The result of the work of forensic accountants are the forensic reports used by the requester of the forensic accounting analysis. These reports present their findings, including the nature of the abuse and fraud, individuals involved, and financial impact. Fraudulent activities need to be specified according to the industry in which they occurred. Specifically, financial forensic experts need to have sufficient knowledge of the industry in which a corporate fraud occurred. Finally, financial forensic accountants may be called upon to provide expert testimony in court, presenting their findings and explaining complex financial topics to support the legal process. A large number of financial forensic accountants are experienced in testifying as expert witnesses for various financial cases in banking, insurance, tax issues, and many others.

In recent years, the complex nature of modern fraud has spurred the growth of forensic accounting, a niche area often referred to as investigative accounting. Three areas of forensic accounting are tied to practice: as already mentioned, litigation support, expert witness testimony, and finally, fraud examination. Forensic accountants play a very significant role in criminal justice and civil litigation, and it is therefore important to establish an adequate connection with practice.[46] Attorneys most commonly use forensic accountants in cases involving financial statements,

[46] Snežana Knežević, Stefan Milojević, Marko Špiler, „Edukacija o forenzičkom računovodstvu i veza s praksom", *Revizor,* 95-96/2021, pp. 35–49.

economic damages, and fraud.[47] Resolving complex cases of financial fraud or other unlawful activities requires interdisciplinary knowledge of forensic accountants who translate financial and non-financial measurements, analyses, and economic concepts into material that others with less experience and knowledge can understand.[48]

Standard SAS 99 (replacing SAS 82) does not require the use of forensic experts, but it recommends critical thinking, increased professional skepticism, and unpredictable audit tests.[49] Specifically, SAS 99 defines fraud as "an intentional act that results in a material misstatement in the financial statements subject to audit." Certified forensic accountants will still be sought to complement the efforts of internal and external auditors in identifying fraud. Due to the multidisciplinary and technically intensive nature of the profession, forensic accountants are at significant risk of conflating ethics with legal compliance.[50]

Forensic accountants are expected to act ethically and in the public interest as professionals. The role of forensic accountants in criminal proceedings is becoming increasingly important, and there are various roles they can play – financial forensic expert, expert witness, and expert advisor. It is important to note that "the role of the expert advisor of the accused or the injured party as the prosecutor is defined by the Criminal Procedure Code, but not that of the financial forensic expert, who is an expert assistant to the prosecutor."[51] Namely, during the main hearing, a forensic accountant as a court expert may appear in the role of a witness. The skill of objectively communicating complex issues is a key skill for experts in the field of forensic accounting in legal proceedings.[52]

## VI. Insurance Frauds

It is impossible to ensure the efficient functioning of insurance companies and maintain an adequate level of their financial stability without establishing and implementing an effective system for detecting and combating insurance fraud. Such frauds have negative consequences not only for the companies themselves but

[47] Charles Davis, Ramona Farrell, Suzanne Ogilby, *Characteristics and skills of the Forensic Accountant,* American Institute of Certified Public Accountants, 2010, pp. 11-26.

[48] James DiGabriele, Lester Heitger, Richard Riley, Jr., „A synthesis of non-fraud forensic accounting research", *Journal of Forensic Accounting Research*, 5/2020, pp. 257-277.

[49] Statement on Auditing Standards - 99 (SAS 99), Auditing Standards Board of the American Institute of Certified Public Accountants (AICPA), October 2002.

[50] Bryan Howieson, "What is the 'good' forensic accountant? A virtue ethics perspective", *Pacific Accounting Review*, 2/2018, pp. 155-167.

[51] Bojan Janković, Snežana Knežević, Stefan Milojević, „Uloga računovodstvenog forenzičara u krivičnom postupku", *Revizor*, 101/2023, p. 6.

[52] Madeline Ann Domino, Matthew Stradiot, Mariah Webinger, "Factors which may bias judges' decisions to exclude accounting expert witnesses testimony", *Accounting Research Journal*, 28/2015, pp. 59-77.

also for their clients, other contracting parties, and the insurance market as a whole, and even for the state. Insurance frauds are becoming an increasingly significant problem with substantial financial and social impacts. The continuous occurrence of fraud, if not controlled, will seriously affect the liquidity of insurance companies, further negatively impacting their financial performance.

In general, insurance frauds can be divided into three categories, relating to the perpetrator (insider or outsider), the stage of fraud (contracting or claims), and the nature of fraud (soft or hard).[53] Insider fraud is by far the most widespread type of fraud, and concerning the United States, premium diversion is the most common type of insurance fraud. Interestingly, there is a greater likelihood that insurance companies will be defrauded by their employees or business insiders than by their own clients.

A particular challenge is posed by financial products that provide insurance against potential life or market events in the relatively distant future, such as pension savings plans or life insurance. Since the benefits of such products only become clear after a long period from the transaction's inception, assessing their usefulness to the buyer involves much speculation and estimation. Sellers often use deceptive promotional materials, pressure sales tactics, and insufficiently accurate or suggestive statements to overemphasize favorable scenarios while downplaying less favorable ones for buyers. In many cases, sales agents fail to adequately investigate the client's risk profile, do not manage to explain the risks adequately, provide overly optimistic projections of future performance, or fail to transparently disclose fees and commissions. On the other hand, there is a possible scenario in which parties in need of insurance may misrepresent the true state of affairs to obtain better terms for acquiring insurance policies.[54]

In principle, according to previous research, there are two types of insurance fraud: opportunistic insurance fraud and planned insurance fraud, with opportunistic fraud being more common.[55] Opportunistic insurance fraud refers to an individual's *post hoc* realization that an insured event can be exploited for personal gain by providing false information or exaggerating legitimate claims. Planned insurance fraud involves a deliberate attempt to fabricate a risky event that would be covered by an insurance policy.[56]

Accounting fraud in insurance encompasses manipulative practices by insurers, policyholders, or other stakeholders used to gain illegal benefits through

---

53 Insurance fraud: issues and challenges, *The International Association for the Study of Insurance Economics*, 2014.

54 Arjan Reurink, "Financial Fraud: A Literature Review", *Contemporary Topics in Finance,* 2019, pp. 79–115.

55 Sharison Tennyson, "Insurance experience and consumers' attitudes toward insurance fraud", *Journal of Insurance Regulation*, 2/2002, pp. 35-56.

56 Richard A. Derrig, Valerie Zicko, "Prosecuting insurance fraud – a case study of the Massachusetts experience in the 1990s", *Risk Management and Insurance Review,* 2/2002, pp. 77-104.

manipulation of financial data. Such frauds include reserves manipulation, deception in reinsurance, underreporting of losses, and generating fictitious insurance policies. These insurance frauds are causing growing concern because they compromise the reliability of financial reporting and trust in the financial sector, ultimately negatively affecting the confidence of investors, creditors, and other stakeholders. International Financial Reporting Standard 17 - Insurance Contracts (IFRS 17) represents an important step in combating these frauds in the insurance industry. This standard includes requirements for transparent reporting on the company's financial position and risk and demands significant changes in insurers' accounting practices.

Improving measures for measuring, detecting, and preventing insurance fraud is achieved through the application of statistical models and intelligent technologies on extensive databases to ensure effective identification of fraudulent activities. Additionally, strategic analysis is applied to situations related to property insurance, liability, and health insurance.[57] In this context, it is important to mention the significant role of internal audit and internal control as two pillars for effectively managing the risk of abuse and fraud in insurance companies.

## VI. Conclusion

Ethical financial reporting and accounting practices are vital as they address the basic needs of the public and employees, building credibility and trust among them. Ethics in accounting exists to protect the public from unethical corporate practices. Companies have ethical and legal responsibilities regarding financial management. Unfortunately, some accountants sometimes conceal or manipulate information. Most accounting scandals arise precisely from false financial reporting, when company management presents inaccurate information in financial statements.

Fraud has an adverse and far-reaching impact, affecting millions of individuals, companies, and their clients across various industries, and the negative consequences are often difficult for the affected parties to recover from. Incorrect financial representation in financial accounting, both at the external and internal levels, can have undesirable effects on the integrity and accuracy of an organization's financial reporting and its overall corporate image.

It is observed that a large number of studies in the field of fraud risk management provide a snapshot of the situation, many of which are methodologically weak and generally provide only limited information on the effectiveness or costs of measures taken against fraud. When it comes to insurance, this is even more pronounced. In this context, there is a need to intensify "sharper" research in this area. Furthermore, by preventing fraudulent activities in the real environment, the value of the accounting profession's services is increased.

57 Richard Derrig. Insurance fraud. *Journal of Risk and Insurance*, 3/2002, pp. 271-287.

It is necessary to further strengthen internal control systems and ethical policies that will discourage fraud and reduce its occurrence in companies. In many cases of financial crime, forensic accountants work together with investigators, lawyers, and judicial authorities to provide relevant data and analyses that support criminal proceedings. Their contribution can be crucial for delivering fair judgments. Moreover, it is significant to carefully consider and evaluate the qualifications of experts when it comes to new technologies, noting that traditional forensic accounting techniques can be used as checks of reasonableness in relation to outcomes obtained through artificial intelligence (i.e., machine learning), which is expected to be the case in practice as well. Therefore, if the licensing of forensic accounting experts is established in Serbia, this will be one of the relevant matters to address.

Fraudulent activities in insurance not only cause real losses for insurance companies but also significantly affect consumers, as the costs of detecting fraud and expected losses are passed on through insurance premiums. Therefore, it is important to introduce adequate control mechanisms and ensure compliance with procedures in organizations involved in insurance activity.

## Literature


- Abdoulaye N'Guilla Sow, Rohaida Basiruddin, Siti Zaleha, Abdul Rasid, Maizaitulaidawati Md Husin, "Understanding fraud in Malaysian SMEs", *Journal of Financial Crime*, 25/2018, pp. 870-881.
- Mitrović, A., Knežević, S., Milašinović, M., „The importance of ethics in the auditing profession in contemporary business", *Revizor*, 97-98/2022, pp. 73-79.
- American Institute of Certified Public Accountants (AICPA), Consideration of Internal Control in a Financial Statement Audit: An Amendment to Statement on Auditing Standards No. 55. Statement on Auditing Standard (SAS) No. 78, New York, NY, AICPA, 1997.
- American Institute of Certified Public Accountants (AICPA), Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained. Statement on Auditing Standard (SAS) No. 110, New York, NY, AICPA, 2006.
- American Institute of Certified Public Accountants (AICPA), The Auditor's Considerations of Internal Control Structure in the Financial Statement Audit. Statement on Auditing Standard (SAS) No. 55, New York, NY, AICPA, 1998.
- April Knill, "The value of country-level perceived ethics to entrepreneurs around the world", *The European Journal of Finance*, 18/2012, pp. 209-237.
- Arjan Reurink, "Financial Fraud: A Literature Review", *Contemporary Topics in Finance,* 2019, pp. 79–115.

- Janković, B., Knežević, S., Milojević, S., „Uloga računovodstvenog forenzičara u krivičnom postupku*", Revizor*, 101/2023, pp. 1–9.
- Bucar, B., Rober Hisrich, "Ethics of business managers vs. entrepreneurs", *Journal of developmental entrepreneurship*, 6/2001, pp. 59-83.
- Brian Mayhew, Pamela Murphy, "The impact of ethics education on reporting behavior", *Journal of Business Ethics*, 86/2009, pp. 397-416.
- Bryan Howieson, "What is the 'good' forensic accountant? A virtue ethics perspective", *Pacific Accounting Review*, 2/2018, pp. 155-167.
- Charles Davis, Ramona Farrell, Suzanne Ogilby, *Characteristics and skills of the Forensic Accountant,* American Institute of Certified Public Accountants, 2010, pp. 11-26.
- Current fraud statistics, Business Fraud Prevention, Inc. (BFP). *https://businessfraudprevention.org/about-us/,* 2022, pristupljeno 14. 12. 2023.
- Dave Arman, "A refresher on fraud and the responsibility for its detection", *Journal of Accountancy*, 2023, September 14, AICPA & CIMA, p. 1.
- Domenico Campa, Alberto Quagli, Paola Ramassa, "The roles and interplay of enforcers and auditors in the context of accounting fraud: a review of the accounting literature", *Journal of Accounting Literature*, 2023.
- Donald Cressey, *Other People's Money*, Montclair, NJ, Patterson Smith, 1953.
- Elisabeth Teal, Archie Carroll, "Moral reasoning skills: Are entrepreneurs different?", *Journal of Business Ethics*, 19/1999, pp. 229-240.
- G. J. Rossouw, "Business ethics and corporate governance: A global survey". *Business & Society,* 44/2005, pp. 32-39.
- Hafiza Aishah Hashim, Zalailah Salleh, Izzati Shuhaimi, Nurul Ain Najwa Ismail, "The risk of financial fraud: a management perspective", *Journal of Financial Crime*, 27/2020, pp. 1143-1159.
- Ibrahim Badawi, "Motives and consequences of fraudulent financial reporting", in 17th annual convention of the Global Awareness Society International, 2008, May, pp. 110-123.
- Insurance fraud: issues and challenges, *The International Association for the Study of Insurance Economics*, 2014.
- Ćerdić, M.I., Knežević, G., "Ethical dilemma: A pathway to fraud or not?", *The European Journal of Applied Economics*, 20/2023, pp. 79-92.
- James DiGabriele, Lester Heitger, Richard Riley, Jr., „A synthesis of non-fraud forensic accounting research", *Journal of Forensic Accounting Research*, 5/2020, pp. 257-277.
- Jeanette Van Akkeren, Sherrena Buckby, Julie-Anne Tarr, "Forensic accounting: Professional regulation of a multi-disciplinary field". *Australian Business Law Review*, 44/2016, pp. 204-215.

- Kimberly Henry, Brittany Dodson, Ethical Education and its Effect on Accounting Fraud, Working Paper, Christopher Newport University, 2009.
- Krivični zakonik, *Sl. glasnik RS*, br. 73/2019 i 44/2021.
- Lawrence Kalbers, "Fraudulent financial reporting, corporate governance and ethics: 1987-2007", *Review of Accounting and Finance,* 8/2009, pp. 187-209.
- Madeline Ann Domino, Matthew Stradiot, Mariah Webinger, "Factors which may bias judges' decisions to exclude accounting expert witnesses testimony", *Accounting Research Journal*, 28/2015, pp. 59-77.
- Milašinović, M., Knežević, S., Mitrović, A., „The significance of audit and audit opinions in the contemporary environment", *Revizor*, 97-98/2022, pp. 21-31.
- Md. Abdul Baten, "Conceptual study of fraud and the accounting system", International *Journal of Multidisciplinary Education and Research*, 6/2018, pp. 1-5.
- Michael Ettredge, Susan Scholz, Kevin Smith, Lili Sun, "How do restatements begin? Evidence of earnings management preceding restated financial reports", *Journal of Business Finance & Accounting*, 37/2010, pp. 332-355.
- Michael Fung, "Cumulative prospect theory and managerial incentives for fraudulent financial reporting", *Contemporary Accounting Research*, 32/2015, pp. 55-75.
- Michael Ramos, Anita Lyons, Considering fraud in a financial statement audit: practical guidance for applying SAS no. 82, *Guides, Handbooks and Manuals (33)*, University of Mississippi, 1997.
- Ilić, M., Anđelić, S., "The role of computerized accounting information system in detecting accounting errors and accounting fraud", *BizInfo (Blace) Journal of Economics, Management and Informatics,* 8/2017, pp. 17–30.
- Sretić, M., Mirčetić, V., Maksimović, M., Karabašević, D., "The impact of ethical internal communication on opinion of public menu", *BizInfo (Blace) Journal of Economics, Management and Informatics*, 10/2019, pp. 43–51.
- Milošević, M., Stojiljković, M., Raičević, J., Milojević, S., "Obrazovanje i obuka u oblasti strateškog finansijskog menadžmenta i kontrole: u kom pravcu bi trebalo da idemo?", *Revizor,* 102-103/2023, pp. 25–36.
- Norazida Mohamed, Moorison Handley-Schachelor, "Financial statement fraud risk mechanisms and strategies: the case studies of Malaysian commercial companies", *Procedia-Social and Behavioral Sciences*, 145/2014, pp. 321-329.
- Philip Law, "Corporate governance and no fraud occurrence in organizations: Hong Kong evidence", *Journal of Business and Industrial Marketing*, 6/2011, pp. 501-518.

- PwC's Global Economic Crime and Fraud Survey 2022: Protecting the perimeter: A new frontier of platform fraud, *https://www.pwc.com/gx/en/services/forensics/economic-crime-survey.html,* pristupljeno 11. 12. 2023.
- PwC's Global Economic Crime and Fraud Survey. 2020. *https://www.global-screeningsolutions.com/industries/global-economic-crime-and-fraud-survey-2020,* pristupljeno 11. 12. 2023.
- Redovni godišnji fianansijski izveštaj, *https://www.paragraf.rs/baza-znanja/knjigovodstvo/redovni-godisnji-finansijski-izvestaj-2021-apr.html,* pristupljeno 24. 1. 2024.
- Richard A. Derrig, Valerie Zicko, "Prosecuting insurance fraud – a case study of the Massachusetts experience in the 1990s", *Risk Management and Insurance Review,* 2/2002, pp. 77-104.
- Robert Cressy, Douglas Cumming, Christine Mallin, "Entrepreneurship, governance and ethics", Entrepreneurship, *Governance and Ethics*, 2/2010, pp. 117-120.
- Sharison Tennyson, "Insurance experience and consumers' attitudes toward insurance fraud", *Journal of Insurance Regulation*, 2/2002, pp. 35-56.
- Knežević, S., Milojević, S., Špiler, M., „Edukacija o forenzičkom računovodstvu i veza s praksom", *Revizor,* 95-96/2021, pp. 35–49.
- Statement on Auditing Standards - 99 (SAS 99), Auditing Standards Board of the American Institute of Certified Public Accountants (AICPA), October 2002.
- U.S. House of Representatives, The Sarbanes-Oxley Act of 2002, *Public Law*, 107-204 [H. R. 3763]. Washington, DC: GPO, 2002.
- Valentina Mirković, Goran Perić, Aleksandar Jokić, "Possibilities for corporate governance in public enterprises in Serbia", *BizInfo (Blace) Journal of Economics, Management and Informatics*, 1/2010, pp. 23–29.
- Van Wyk, *Fraud risk assessment: a conceptual framework for internal auditors to detect financial statement fraud*, USA, Institute of Research Engineers and Doctors, 2015.
- Webster's Dictionary, 1828, *https://webstersdictionary1828.com/Dictionary/fraud,* pristupljeno 5. 1. 2024.
- Yuping Zhao, Jean Bedard, Rani Hoitash, SOX 404, auditor effort, and the prevention of financial report misstatements, *Auditing: A Journal of Practice & Theory*, 36/2017, pp. 151-177.
- Zabihollah Rezaee, James Burton, "Forensic accounting education: insights from academicians and certified fraud examiner practitioners", *Managerial Auditing Journal,* 12/1997, pp. 479-489.

- Zakon o krivičnom postupku, *Službeni glasnik RS*, br. 85/2005, 88/2005 - ispr., 107/2005 - ispr., 72/2009, 111/2009, 121/2012, 104/2013, 108/2014, 94/2016 i 35/2019.
- Zakon o računovodstvu, *Službeni glasnik RS*, 73/2019 i 44/2021, čl. 57.


*Translated by:* ***Bojana Papović***