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Abstract

Financial statement fraud (FSF) has cost market participants, including investors, creditors, pensioners, and employees, more than $500 billion during the past several years. Capital market participants expect vigilant and active corporate governance to ensure the integrity, transparency, and quality of financial information. Financial statement fraud is a serious threat to market participantsâ€™ confidence in published audited financial statements. Financial statement fraud has recently received considerable attention from the business community, accounting profession, academicians, and regulators. This article (1) defines financial statement fraud; (2) presents a profile of financial statement fraud by reviewing a selective sample of alleged financial statement fraud cases; (3) demonstrates that â€œcooking the booksâ€ causes financial statement fraud and results in a crime; and (4) presents fraud prevention and detection strategies in reducing financial statement fraud incidents. Financial statement fraud continues to be a concern in the business community and the accounting profession as indicated by recent Securities and Exchange Commission (SEC) enforcement actions and the Corporate

Securities and Exchange Commission (SEC) enforcement actions and the Corporate Fraud Task Force report. This paper sheds light on the factors that may increase the likelihood of financial statement fraud. This paper should increase corporate governance participantsâ€™ (the board of directors, audit committees, top management team, internal auditors, external auditors, and governing bodies) attention toward financial statement fraud and their strategies for its prevention and detection. The Sarbanes-Oxley Act of 2002 was enacted to improve corporate governance, quality of financial reports, and credibility of audit functions. The Act establishes a new regulatory framework for public accountants who audit public companies, creates more accountability for public companies and their executives, and increases criminal penalties for violations of securities and other applicable laws and regulations. Given the difficulties and costs associated with deterring financial statement fraud, understanding the interactive factors described in this article (Cooks, Recipes, Incentives, Monitoring and End-Results (CRIME)) that can influence fraud occurrence, detection and prevention is relevant to accounting and auditing research.

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Keywords

Financial statement fraud; Corporate governance; Sarbanes-Oxley Act of 2002; Cooking the books; Fraud prevention and detection strategies

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