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Fraudulent financial reporting in a nutshell

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Fraudulent financial reporting can be defined as the intentional misrepresentation of a firm's financial statements with the aim to give investors a mistaken impression about the firm's operating performance and profitability. From the review of previous literatures, among the earliest definition of fraudulent financial reporting was defined by Elliot and Willingham (1980). According to them, fraudulent financial reporting is a deliberate fraud committed by management that injures investors and creditors through misleading financial statement. Approximately thirty decades later, Association of Certified Fraud Examiners (ACFE) (2008) described fraudulent financial reporting as "the intentional misstatement or omission of material information from the organization's financial reports whereby fraudulent financial reporting cases often involve the reporting of fictitious revenues or the concealment of expenses or liabilities in order to make an organization appear more profitable than it really is. (p. 10)

In practice, fraudulent financial reporting is predominantly committed through distorting financial statements, for instance, overstating assets, sales and profit, or understating liabilities, expenses, or losses. The occurrence of fraudulent financial reporting could be attributable to personal incentives, pressures from the market, lack of ethics, deliberate compliance with the projections of financial analysts and attempts to affect the price of stock. Fraudulent financial reporting often starts with a small misstatement (Beasley, Carcello, & Hermanson, 1999) or earnings management (Ball, 2009) of quarterly financial reports that is presumed not to be material but eventually grows into full-blown fraud and yielding materially misleading annual financial statements.

Fraudulent financial reporting is a global phenomenon (Albrecht & Albrecht, 2002). It has enticed attention of the business and financial community, regulatory bodies and the public because of the significant consequences it may have on the organization and also on the public confidence in capital markets. Among the consequences are: -

1. It makes the capital market less efficient.
2. It threatens the integrity and objectivity of the auditing profession, especially auditors and auditing firms.
3. It undermines the quality and integrity of the financial reporting process.
4. It tapers the confidence of the capital markets, as well as market participants in the reliability of financial information.

5. It ends the careers of individuals involved in fraudulent financial reporting.
6. It causes destructions in the normal operations of the fraudulent company.
7. It gives rise to bankruptcy of the alleged company.
8. It results in huge litigation costs.
9. It encourages undue regulatory intervention.
10. It unfavourably affects the nation's economic growth and prosperity.

In history, among the most recalled fraudulent cases in the USA are Enron, Xerox, HealthSouth, Global Crossing, and WorldCom (Frieswick, 2003). In Europe, companies such as Parmalat, Adecco International, Ahold NV and Vivendi Universal are among the companies that were involved in fraudulent financial reporting. Finally, Malaysia is of no exclusion with the first case which arose in 1995 involving Ganad Corporation Bhd. Most fraudulent financial reporting cases in Malaysia were committed between 2000 and 2004 and the latest one occurred in 2011 involving Silver Bird Group Bhd. These periodic notoriety cases of fraudulent financial reporting raise concerns about the credibility of the financial reporting process and call into question the roles of auditors, regulators, and analysts in financial reporting.

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