

THE NEW FRAUD TRIANGLE THEORY - INTEGRATING ETHICAL VALUES OF EMPLOYEES

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ABSTRACT

Technological advancements and the continual evolution of the global business environment provide both enhanced tools and additional challenges for perpetration and concealment as well as the prevention, detection and investigation of employee fraud. Increasingly external auditors and forensic accountants are being asked to play an important role in helping organizations prevent and detect employee fraud. Detecting employee fraud is not an easy task and requires thorough knowledge about the nature of fraud, how it can be committed and concealed. This paper aims at broadening knowledge of external auditors, forensic accountants and other stakeholders on employee fraud and why it occurs. It explains Cressey's fraud theory of opportunity, pressure, and rationalization and shows its significance, presents the other fraud models and relates them to Cressey's model, and proposes a new fraud triangle model integrating ethical values of employees that could consider when assessing the risk of employee fraud.

Key words: Employee Fraud, Opportunity, Pressure, Rationalization, Ethical Values

INTRODUCTION

Fraud and financial crimes generally, although complex, have existed since time immemorial, evolving over the centuries and becoming more complex and difficult to investigate causing catastrophic consequences to businesses and the economy of a country. Detecting fraud is not an easy task and requires thorough knowledge about the nature of fraud, why it is committed and concealed (ACFE, Report to Nations, 2016). The fraud triangle developed by Cressey in 1953 is a model for explaining the factors that cause someone to commit occupational fraud. It consists of three components which, together, lead to fraudulent behavior: Perceived unshareable financial need, Perceived opportunity and Rationalization (Cressey, 1973). Cressey's fraud theory explained why trust violators commit fraud and was widely used by regulators, professionals and academics.

Many companies expect more return from its employees to maximise its scarce resources for wealth maximization of organizations. It also contributes to an employee ability to rationalize the behaviour even if that employee realizes that the behaviour is about to engage in unethical, illegal or fraudulent, ultimately leading to occupational frauds in organizations (Kassem and Higson, 2012). The Association of Certified Fraud Examiners (ACFE) estimated that 5% of business revenue is lost due to fraud and fraudulent behaviour lasts a median of 18 months before being discovered. The total loss caused by the cases estimated to \$ 6.3 billion, with an average loss of case \$ 2.7 million. Furthermore, most discoveries occur more by whistle-blowers tips than pre design internal control systems providing evidence that 39.1% of fraudulent activities are discovered by employee tips (Report to the Nation, 2016).

The nature of fraud means that much of its cost is hidden. Because concealment is an intrinsic component of most fraud schemes, some frauds are never uncovered; further, of the cases that are detected, many are never measured or reported. In addition, most frauds carry substantial indirect costs, including lost productivity, reputational damage and the related loss of business, as well as the costs associated with investigation and remediation of the issues that allowed them to occur. The result is the equivalent of a financial iceberg; some of the direct losses are plainly visible, but there is a huge mass of hidden harm that we cannot see (Report to Nations, ACFE, 2014).

In the current paper, Cressey's fraud theory is explained and its significance is highlighted. The paper also assesses the fraud triangle in light of other fraud models, and proposes a new fraud triangle model that should be considered by external, internal auditors, forensic accountants and other stakeholders in assessing fraud risk.

LITERATURE REVIEW

The literature review systematically explained fraud triangle theory, fraud diamond theory, and new fraud models developed by the researchers in order to design the most applicable model to this study. The comprehensive literature review provides the necessary substance for the overall research findings.

FRAUD TRIANGLE

Cressey, working on his PhD in criminology (1953), he decided to his dissertation would focus on embezzlers. To serve as a basis for his research, Cressey interviewed about 200 people who had been interacted for embezzling funds. It was formulated the hypothesis as follows; "Trusted persons become trust violators when they conceive of themselves as having a financial

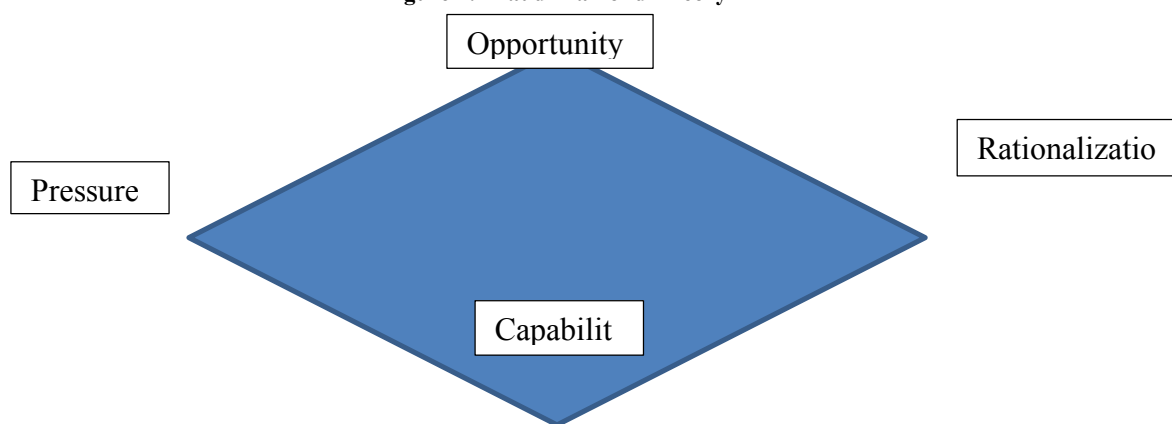
the fraudster's motivations and improve the anti-fraud community's ability to prevent, deter, detect, investigate, and remediate fraud, researchers and practitioners have offered insights beyond the Fraud Triangle.

Free (2015) reviewed popular frameworks used to examine fraud and earmarks three areas where there is considerable scope for academic research to guide and inform important debates within organisations and regulatory bodies. The article reviews published fraud research in the fields of auditing and forensic accounting, focusing on the development of the dominant framework in accounting and fraud examination, the fraud triangle. From this review, specific avenues for future research are identified. Three under-researched issues are identified: rationalisation of fraudulent behaviours by offenders; the nature of collusion in fraud; and regulatory attempts to promote whistle-blowing. These topics highlight the perspective of those directly involved in fraud and draw together issues that have interested researchers in other disciplines for decades with matters that are at the heart of contemporary financial management across the globe.

FRAUD DIAMOND THEORY

Wolfe and Hermonson (2004) argued in their research that perceived pressure or incentive might exist along with an opportunity and a rationalization to commit fraud, fraud is unlikely to take place unless the fourth element is present; capability (capacity). In other words, potential perpetrators must have the skills and ability to actually commit a fraud. Hence, Wolfe and Hermonson (2004) in their study, added additional variable; Capability to the conventional fraud triangle developed by Cressey in 1973. Figure 2, below presents the complete set of elements of fraud diamond theory.

Figure 2: Fraud Diamond Theory



The authors believe 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, the researchers four sided "fraud diamond" also considers as an individual's capability; personal traits and abilities that play a major role in whether fraud may actually occur even with the presence of the other three elements.

CAPABILITY

A person's position or function within a company may give him or her the ability to create or exploit an opportunity for fraud not available to the others. According to Wolfe and Hermonson (2004) fraudster also has the necessary traits and abilities to be the right person to pull it off and that this person has recognised this particular fraud opportunity and can turn it into reality. Wolfe and Hermonson identified important observable traits related to individuals' capacity to commit fraud. Those threats include; (a) authoritative position or function within the organization (b) intelligence to exploit the accounting and internal control system (c) ego and confidence (d) capability to effectively deal with stress.

Abdullahi et al., (2015), noticed that many of the world's most prominent organizations have experienced large-scale frauds. These frauds have had disturbing effects on the world's economy in addition to contributing unnecessary suffering and increased unemployment for the low and middle class. With the aim of further understanding the fundamental motivations of fraud, this paper takes an in-depth look at the convergent and divergent of two classical fraud theories which are: (i) fraud triangle theory; and (ii) fraud diamond theory. This comparison is important to assist anti-graft bodies and organizations in formulating a practical strategy to prevent and investigate organizational frauds. The paper takes a conceptual approach by first examining the concept of fraud, then discussing the convergence of the two classical theories, and finally differentiating them. By doing so, the similarities and differences between them are highlighted and appreciated for fraud prevention purposes. The study uses secondary sources of information obtained from journal articles, textbooks and the internet. The discussion of the two theories contributes to the understanding of frauds especially by forensic accountants, auditors, fraud examiners and other anti-fraud bodies. The study also serves as guidance for further fraud related research.

ETHICAL VALUES

Ethics can be defined as the agreed on standards of what is desirable and undesirable and of right and wrong conduct or behavior of a person, group, or entity (Cressy et al., 2010). Laczniak (1993) referred to ethics as acts that guide employees on the basis of moral and behavioral principles. Moreover, Ambrose et al. (2008) viewed ethical values as overall values embraced by individuals and organizations. Individual ethical values are influenced by behavior and what is thought to be right or wrong. Meanwhile, Irianto et al. (2009) referred to ethical values as being honest by following company policies and procedures. With

ethical values present within themselves, any fraudulent activity may be restricted given that employees strongly believe in what is wrong and right. Mathenge (2014) examined ethical values among enforcement employees, who are found to be easily exposed to corruption. Hence, high ethical values (competence, confidence, and professionalism) will reduce the likelihood of fraudulent activities by employees in performing their job.

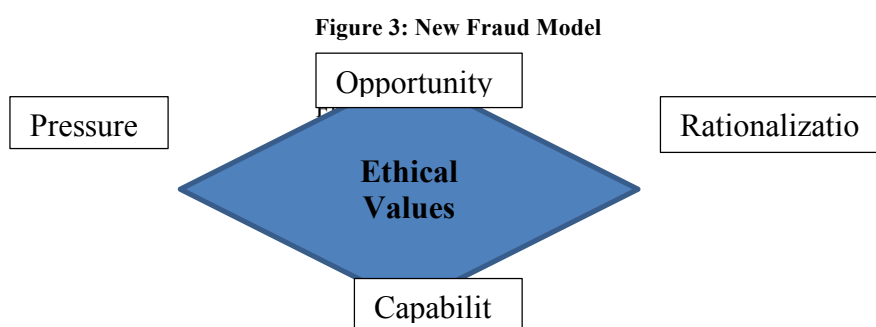
Shafer et al., (2016), the purpose of the article is to document relationships between accountants' socioeconomic beliefs and attitudes and their professional commitment and ethical decisions in a domain-specific context. Specifically, it investigates the relationships among Chinese tax accountants' level of belief in the importance of corporate ethics and social responsibility, affective/normative professional commitment and ethical judgments /intentions in a case involving client pressure to commit tax fraud. The study employs a survey of tax practitioners employed by public accounting firms in China. The data are analyzed using linear regression and structural equation modelling.

The stakeholder view, representing both normative and practical support for the importance of corporate ethics and social responsibility, was strongly and positively associated with professional commitment among tax practitioners. The stakeholder view also exhibited a strong negative association with intentions to engage in tax fraud. Tax accountants who possessed higher levels of professional commitment judged tax fraud as more unethical, and such ethical judgments were associated with a lower likelihood of intending to engage in fraud.

The study performed by Said et al., (2017) attempts to integrate ethical values into the fraud triangle theory in the context of Malaysian banking industry. The findings revealed that ethical values were negatively related to employee fraud, and two elements of fraud triangle theory, namely, opportunity and rationalization, were positively related to employee fraud. This implies that high ethical value is crucial to mitigate employee fraud. To minimize employee fraud, the banking industry should reduce opportunities and employee negative rationalization through strong internal control. This study contributes to literature on the occurrences of employee fraud, which is not widely discussed, especially in the context of the banking industry in developing countries.

FINDINGS

In fact, it is important for auditors and forensic accountants to consider all fraud models to better understand why fraud is committed. Hence, the above all models should also be regarded as an extension to Cressey's fraud triangle model and should be integrated in one model that includes motivation, opportunity, ethics, and fraudster's capabilities as shown in figure 3 below.



CONCLUSION

The current paper aims at broadening external auditors, forensic accountants and other stakeholders' knowledge about employee fraud and why it occurs. It explains Cressey's fraud triangle model and shows its significance, presents the other fraud models and relates it to Cressey's model, and proposes a new fraud triangle model that external auditors, forensic accountants and other stakeholders should consider when assessing the risk of fraud. A thorough literature review was undertaken to achieve the paper's aim.

Accordingly, the current study further validates the Cressey's fraud triangle model and Wolfe's fraud diamond model and its significance to combat the employee fraud. Moreover, the current study highlights the significance of incorporating the ethical values of the employees to those grounded theories based on the empirical evidences. As such, many researchers emphasized that the high level of ethical values of the employees reduce the likelihood of fraud in business entities. Hence, there should be a tone at the top to instil ethical culture among the employees of the business entities strategizing top down approach.

The current study develops the new fraud triangle model based on the empirical findings and therefore, the outcomes are limited to the findings of the other researchers. Consequently, it is suggested to explore the future studies on the significance of ethical values of employees to mitigate fraud risk in business entities.

MANAGERIAL IMPLICATION

Prevention of corporate frauds reduces anxiety, improves corporate image and builds up confidence of the investors, which is essential for resource channeling in financial markets. As such, the study addresses on the determinants of corporate fraud and how to combat against fraud in an entity. The study confirms the applicability and validity of fraud triangle theory and identified developments incorporated to Cressey's original model by various researchers. Accordingly, the study suggests to incorporate ethical values of employees to the fraud triangle. Therefore, the study recommends to inculcate ethical values among the

employees of the entity to combat the employee fraud. Hence, the managers, shareholders and other stakeholders should consider ethics of employees are very important aspect of managing fraud risk in an entity. Further, it is the responsibility of the management to instil the ethical culture within the entity to reduce employee fraud in business entities.

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