

Chapter 1

Understanding the Financial Fraud: An Extended Model

Georgios Loukas Vousinas

National Technical University of Athens, Greece

ABSTRACT

This chapter aims to elaborate on the theory of fraud by enhancing the existing theories that force people to commit fraud. The chapter reviews the most commonly used and widely accepted models for explaining why people commit fraud: the fraud triangle, the fraud diamond, the fraud scale, and the MICE model. The author argues that these models need to be updated to adapt to the current developments and the ever-growing fraud incidents, both in frequency and severity. The chapter identifies a major element, ego/entitlement, which plays a crucial role in compelling people to commit fraud and builds on the theoretical background to conclude in the formation of the SCORE model, which is graphically depicted in the fraud pentagon. It goes further by adding the factor of collusion for its better application in cases of white-collar crimes.

1. INTRODUCTION

While fraud is a well-known term worldwide, its features cannot be regularly recognized and not until it is too late, that's why it is considered an activity both very hard to detect and even harder to justify. There are many definitions of fraud, but for the purpose of this chapter¹ will be used the one given by the Institute of Internal Auditors (IIA), according to which fraud is any illegal act that is characterized by deceit, violation of trust or concealment and is not dependent upon the threat of violence or physical force². Fraud is committed by individuals as well as companies for many reasons, the most common of which are to obtain money, property and/or services, to avoid payment or to ensure personal and/or business benefit. Fraud includes, among others, false statement, misrepresentation or deceitful conduct.

DOI: 10.4018/978-1-7998-5567-5.ch001

The most difficult issue with combating fraud is to address its dynamic nature as it is an activity that is multi-layered and goes deep into business procedures, while the fraudsters always find new ways to perpetrate fraud and cover their traces so as not to be caught. That is the reason behind the complexity in confronting fraud activity, making it a long-last and complicated process that requires a deep understanding of the reasons why it occurs as well as the ways by which it can be mitigated. The recent global financial crisis of 2008 and the numerous corporate scandals behind it (mainly in the financial industry) brought into surface the severe negative effects of fraud and highlighted it as a major international problem. This is justified by the Association of Certified Fraud Examiners (ACFE)'s 2018 Report to the Nations on Occupational Fraud and Abuse, which calculated the fraud cost to an annual 5% of total business revenues³. This percentage may seem negligible, but if applied to that year's estimated Gross World Product (GDP) of \$75 trillion, results in a potential total fraud loss of about \$3.9 trillion worldwide.

In addition, one of the most common fraud types is financial fraud (or financial crime), which is defined as the fraud that is specifically committed against property. The term is also known as white-collar crime i.e., economic offenses committed with a combination of fraud, dishonesty and/or collusion. These types of frauds are usually committed for the personal benefit of the fraudster and encompass an illegal transfer of ownership of the property that is involved. Typical examples of such fraud incidents that emerged from the global crisis of 2008 are the cases of Societe Generale⁴ and UBS⁵. The former (Societe Generale) involved a sequence of unapproved, undetected speculative positions for over a year period and the latter (UBS) was a rogue trader scandal that caused a loss of over \$2 billion US dollars.

Some of the most common types of financial fraud are identity theft, forgery, electronic crimes, money laundering, terrorist financing, bribery and corruption and market abuse (Saeed, Mubarik & Zulfiqar, 2021; Ibrahim, 2021). These crimes are committed on a daily basis and the authorities as well as companies around the world are engaged in an endless fight against fraud incidents while continuously trying to prevent new ones. The main groups of people that commit financial fraud are listed below: `

- Organised fraudsters, including terrorists, are gradually committing large-scale frauds in order to fund their operations worldwide.
- Business leaders or senior-level executives handle accounting data so as to improve the appearance of firms' financial statements (e.g., as a mean of improving stock performance).
- Employees from junior to senior level perpetrate fraudulent actions.
- From outside the firm, fraud can be executed by customers, suppliers or even individuals without any kind of linkage to the organization.
- External fraud in most cases also includes collusion with inside employees, in order to achieve bigger as well as better results more easily.

According to the proceedings of the World Economic Forum in 2018 financial fraud was a trillion-dollar industry, and private companies spent approximately \$8 billion on anti-money laundering (AML) controls solely in 2017, as frauds themselves (detected or not) have become more frequent and costly than ever. In particular, based on accurate estimates for every dollar of fraud, organizations lose nearly three dollars, once related costs are added to the fraud loss itself⁶¹.

Banking institutions are complicated financial organizations that operate in an ever-changing business environment and deal with high levels of risk, while facing fraudulent activities on a regular basis (Vousinas, 2016). Risks for banks arise from diverse factors, including vulnerabilities to financial fraud inherent in automation and digitization, massive growth in transaction volumes, and the greater inte-

18 more pages are available in the full version of this document, which may be purchased using the "Add to Cart" button on the publisher's webpage:

www.igi-global.com/chapter/understanding-the-financial-fraud/275448

Related Content

Hybrid Artificially Intelligent Multi-Layer Blockchain and Bitcoin Cryptology (AI-MLBBC): Anti-Crime-Theft Smart Wall Defense

Murad Al Shibli (2020). *Encyclopedia of Criminal Activities and the Deep Web* (pp. 1089-1111).

www.irma-international.org/chapter/hybrid-artificially-intelligent-multi-layer-blockchain-and-bitcoin-cryptology-ai-mlbbc/248107

Firms' Characteristics and Tax Evasion

Md. Harun Ur Rashid and Anika Morshed (2021). *Handbook of Research on Theory and Practice of Financial Crimes* (pp. 428-451).

www.irma-international.org/chapter/firms-characteristics-and-tax-evasion/275473

The Victimization and Disparate Treatment of Racial and Ethnic Minorities

Rhiannon Oakes, Annie K. Oakeley and Rola Goke-Pariola (2021). *Invisible Victims and the Pursuit of Justice: Analyzing Frequently Victimized Yet Rarely Discussed Populations* (pp. 353-382).

www.irma-international.org/chapter/the-victimization-and-disparate-treatment-of-racial-and-ethnic-minorities/281365

Victimology of Predatory Crimes and Prevention Techniques: Thefts and Robberies in the Process of Building a Sense of Insecurity

Daniele Veratti (2020). *Handbook of Research on Trends and Issues in Crime Prevention, Rehabilitation, and Victim Support* (pp. 431-446).

www.irma-international.org/chapter/victimology-of-predatory-crimes-and-prevention-techniques/241486

Potential Causes of Mass School Shooting Incidents: A Look Into Bullying, Mental Illness, and Zero-Tolerance Policies

Joseph R. Budd, Jeffrey Herron and Renee Sartin (2020). *Handbook of Research on Mass Shootings and Multiple Victim Violence* (pp. 176-192).

www.irma-international.org/chapter/potential-causes-of-mass-school-shooting-incidents/238574