Chapter 1
Understanding the Financial Fraud:
An Extended Model

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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 chapter[1] 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 force[2]. 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.

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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 revenues[3]. 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 Generale[4] and UBS[5]. 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 itself[61].

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-