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COMBATING FINANCIAL STATEMENT FRAUD – AN ANALYSIS AND MODEL FOR THE REPUBLIC OF BULGARIA

This paper presents a research performed on financial statement fraud in the Republic of Bulgaria. The results of the questionnaire used to collect information have helped prepare a model applicable to the country. The model considers the role of different stakeholders in the organization, namely management, internal audit, board/directors and external audit and parties in the outside environment in the face of government and supporting institutions. Moreover, the main issues that have been identified in regard to each party have been summarized and linked with potential solutions that can be implemented in practice. Namely: more independence of board members and audit function in organizations, limited non-audit services by external auditors, increasing the consequences from such fraud and leveraging the benefits of professional organizations.
JEL: G00, G30

Introduction

Financial statement fraud is a global phenomenon with negative consequences for organizations and society. Such type of fraud perpetrated by a high level of management. The official definition by the American Association of the Certified Fraud Examiners is „the intentional, misstatement (or omission) of material facts or another type of data which when considered with other publicly available information would make the user of the information change or alter his/her's judgment. (ACFE, 2018) It is one of the three branches of occupational frauds used by the ACFE together with corruption and asset misappropriation.

The National Commission on Fraudulent Financial reporting (1987) states that fraud in the financial statements is reckless conduct by act or omission that is likely to result in materially misleading financials. Other definitions vary but the common thread is that it involves a deliberate misleading or omitting of information in the financial statement in order to misinform misdirect and „injure" the users of this information (investors, creditors, auditors and other stakeholders). Gravitt (2006) presents several schemes that are involved in financial statement fraud: 1) manipulation or falsification of the financial information and any supporting documents; intentional misuse of procedures, policies and relevant

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accounting principles used in the preparation of the financials and deliberate omissions or alteration of events and transactions that have relation to the reporting of the financial position of the company. Razaee (2002) expands on the schemes of financial statement fraud by including: the use of aggressive accounting techniques via illegal earning management and using loopholes in the accounting standards that allows the entities to conceal the real situation of the entity.

Financial statement fraud has been defined as financial crime. According to the Financial Services and Market act of 2000 passed in the United Kingdom it includes three aspects: 1) a fraud or dishonest action, 2) that includes misconduct or misuse of information that related to the financial markets, or 3) handling the proceeds of such crime. The UK fraud act of 2006 further reinforces the notion and definition of such crime acknowledging that such fraud incorporates 1) false numbers and/or representation; 2) inaccurate information that might lead to failure to disclose the correct information and 3) involvement on the side of the organizations' management or directors.

Studies from around the world have focused on analyzing the issue of financial statement fraud from different angles – examination and clustering of a variety of red flags (Murcia and Borba, 2007), investigating the factors affecting financial statement fraud in the light of the fraud triangle (Hogan et al., 2008) etc. This research uses a questionnaire to gather data based on which conclusions are reached for the context of interest.

Research Approach

Research approaches are generally divided into two main streams – deductive and inductive. Deductive begins with a theory which is then posed to a test in the light of the empirical findings whereas the inductive sets out with the observation of reality and then develops a theory based on the findings. However, no approach is better than the other. Vidal (2013) questions the practicality of using one approach over the other by suggesting that the division made is highly extreme and stylized. This is due to the fact that in real practice, researchers find themselves moving forth between both the approaches especially in the light of qualitative research where data collection and analysis are intertwined together. This research agrees with this proposition and follows Vidal's viewpoint thus allows for theory and research questions to improve and adjust as more analysis is done and data collected in the course of the research.

Research design

Qualitative research is the best method given the exploratory nature of the research (Ghauri and Gronhaug, 2005). It provides for a detailed presentation of the current conditions, opinions and processes within the field of interest. Methods associated with qualitative research allow for thorough detailed descriptions of the research topics since they are flexible and do not have to follow a predetermined path allowing for exploration of various aspects of the research topic Although some critics argue that qualitative research is less rigorous than quantitative-based one (Bernard, 2000) and applied statistical methods are very useful for systematization, presentation and analysis of such data (Pavlova, 2016), qualitative methods used by in this study have allowed the researcher extract deeper meaning and understanding and contextualize the results in the light of the objectives. This is of crucial importance since the research encompasses factors that are impossible to quantify but rather require a qualitative analysis.

Data Collection Method

When undertaking research, data can be grouped into either primary or secondary depending on whether it comes from the original source or is collected and represented by someone else. The current research relies on primary data collected via questionnaires, since it is in many cases one of the best data collection methods when a response is required from a large number of individuals, together with a predetermined theme for exploration. The aim of questionnaires is to gain a general understanding of the chosen topic which is obtained only by using qualitative data. A semi-structured questionnaire is chosen as the optimal research strategy given the fact that it is particularly suited to the questions posed that require an understanding of processes relating to the phenomena studied together with analysis of the context in which the issues under question exist (Cassel and Symon, 2004). Moreover, the questionnaire allows for collecting data from a large number of individuals, where it is impractical to collect it using other more resource-intensive methods. Moreover, respondents can fill in the questionnaire in their own leisure which takes off the pressure element. Semi-structured questionnaires allow for insight into explanations for what is the participants' opinion, attitudes and perceptions in regard to the problems on hand.

According to Yin (2002) one of the main criticisms regarding qualitative methods of data collection is the difficulty of generalizing the empirical findings. This fact further reinforces the chosen method for study which allows for information collection that is comparable allowing for a better standardization of the findings. Although it is difficult to conduct a qualitative study of this kind due to the high rate of participation required, the benefits of doing so outweigh the drawbacks (Merriam, 1998). Moreover, such a holistic approach can enrich the user's experience and knowledge. Another limitation of qualitative research methods posed by Schaffier and Stebbins (1991) is that the personal bias of the researcher could steer the course of the data gathering process. However, this is eliminated in the current study since there is no face to face contact or interaction between the researcher and the respondents when the data is collected. Based on this discussion the author believes that the semi-structured questionnaire is the best way to tackle the research objectives of this paper.

Respondent Selection

The selection of respondents is based on a fundamental element of the purpose of this research – analysis of the financial statement fraud in Bulgaria. All respondents were approached by the researcher via email, phone, in person or using networking from professional bodies such as universities and organizations like the Institute of Internal

Auditors Bulgaria and the Association of Certified Fraud Examiners Bulgaria. Respondents come from both public and private intuitions including audit firms, banks consulting firms, governmental bodies and universities. Adequate comparability between the respondents is ensured. All of them have extensive experience in the financial statement fraud area and have dealt with a variety of cases concerning such fraud. Respondents were motivated by reminding them of the importance of the research theme and the benefits it could provide in their work to shed light on financial statement fraud in Bulgaria. Out of the 80 questionnaires distributed 50 responses were collected.

Questionnaire

According to Lincoln and Guba (1989) it is important the participants are able to understand the concepts and topics of the research investigation. Therefore, the questionnaire was sent to individuals having the needed knowledge and experience and able to shed light on the research themes. It was designed using Google forms and distributed in electronic format via a link which takes the user to the online form. The questionnaire's questions are written in English however an option was given to the respondents to fill in the open-ended questions in Bulgarian for convenience. Furthermore, following the recommendations of Bryman and Bell (2003) it was recommended to the participants the questionnaire to be completed in „calm circumstances" where the risks of interruption and/or distraction are minimized. The expected time for completion is about two and a half hours with a 10-minute break in-between. The location and time for completion of the questionnaire was a personal choice of the respondents. All respondents were given at least a couple of weeks to complete the questionnaire before no more responses were taken for the research. In case any of the respondents had any concerns or questions the researcher had given his email and telephone number and remained open for contact.

Sampling

Non-probability sampling was used since sample units were chosen deliberately, not randomly as no statistical representativeness is required but particular features of the units are sought (Ritchie, 2003). The main criterion was knowledge and experience in regard to the topics in question. Nevertheless, a range of different experts were contacted in order to cover as many institutional aspects of the industry as possible. Although non-probability sampling was used the number of collected responses – 50 is representative proportionate to the number of total experts in the area of interest. Theoretical sampling, was not used, meaning that further interviewees and other data sources were not chosen in the research process when provisional concepts had been developed and the need for furthers questions identified (Boeije, 2002). The reason behind this is that in order to ensure comparability between each answer of the questionnaire needs to be the same for every participant in the research.

Questionnaire Structure

The questionnaire has been structured in an alignment with each topic of interest by the research. As already mentioned, the questionnaires sent to the potential respondents are identical to ensure comparability and facilitate the summary of the findings. All questions represent one idea each and avoid unnecessary jargon and abbreviations. All leading questions are avoided besides the one based on specific theoretical frameworks. The questionnaire consists of both open and close-ended questions.

The following structure gives a detailed description of the topics covered by the 137 questions in the questionnaire. Those questions can be summarized into few categories regarding a common denominator concerned about the relevant aspects of the research. Questions are asked clearly thus no need for further clarification is necessary and are based on relevant theories and concepts discussed in the literature review.

Section 1 (questions 1-9)

The questions are aimed at getting important information about the respondent – what type and sector he/she works in, professional qualifications, years of experience and general opinions regarding similar research.

Section 2 and 3 (questions 10-22)

Here the questions are aimed at getting a general picture on a financial statement fraudster in Bulgaria based on the same characterless used by the American Association of the Certified Fraud Examiners in their surveys. Moreover, it enquires about which parties have primary roles in deterring detecting and preventing such fraud.

Section 4 (questions 22-94)

This section is the largest one with questions concerned with financial fraud case experiences that the respondents have as well as general ones regarding characteristics of the firms most susceptible to fraud in the financials.

Section 5 (questions 94-116)

Questions in this section concern the roles of the fraud prevention and detection bodies in organizations and what prevents them from being able to achieve their roles effectively.

Section 6 (questions 116-137)

Questions in section 6 wrap up the research together with an enquiry about recommendations for future research that would be helpful for Bulgarian context.

Data Coding and Analysis

The data from the questionnaires was collected after the access to them was cancelled. The data was coded and categorized into themes based on each topic of interest of the research in order to reach the aim of managing organizing and focusing on the most meaningful bits of qualitative data (Malhotra and Birks, 2007). Coding process proposed by Lofland et al. (2006) was used in order to organize the gathered data into various categories and themes that emerged from the literature which later were the basis of the summary. The main focus was the constant comparison between the theory and data (Boeije, 2002) to ensure adequate comparability of the findings and research conclusions. The questionnaire structure was designed to complement this by making a clear distinction and seamless transition from one theme to the next. The answers from the questionnaire were first processed by the software provided by Google forms and then exported to Excel where additional analyses were done.

Ethical Considerations

Considerations regarding the qualitative nature of the study were addressed in terms of voluntary participation, informed consent together with anonymity and confidentiality (Vaus, 1996). All participants were informed about the purpose of and benefits of study and given a deadline before which they can withdraw their response. General issues of anonymity and privacy of the participants and storage and collection of data were negated making the questionnaire totally anonymous – only the date of completion and respondent's answers are kept. No names of institutions or cases were mentioned. Thus, no information could be linked to a particular individual or company. All of the participants agreed to participate provided they remain anonymous and no traceability to the company they work for could be found. Permission to use the data for this research was granted after each person has accepted to complete it.

Credibility and Authenticity of the data

Concepts like Credibility and Authenticity are of extreme importance when doing qualitative research (Bryman and Bell, 2003).

Credibility: the researcher made sure that credibility is achieved by ensuring concepts such as transferability, dependability and confirmability of the data. There is a distinction between transferability in quantitative and qualitative research. The former will be broader in nature with findings easier to put in general terms whereas the latter will be more detailed and narrowly focused (Bryman and Bell, 2003). The researcher believes that the number of responses taken was enough to give a more complete picture of the issues covered.

Dependability is achieved by a total transparency in the research process and steps taken. Furthermore, it is reinforced by the explanation of the research at the beginning of the questionnaire and topics covered by it.

Confirmability – it is impossible to reach complete objectivity in qualitative research (Bryman and Bell, 2003). The author gives assurance that all the research was done in the most bias-free and objective way possible.

Authenticity: the question of whether the researcher gives an adequate representation of the information gathered using the questionnaire. To ensure this is so we have made sure no misunderstandings were made in the data analysis as well that the data is accurately summed up.

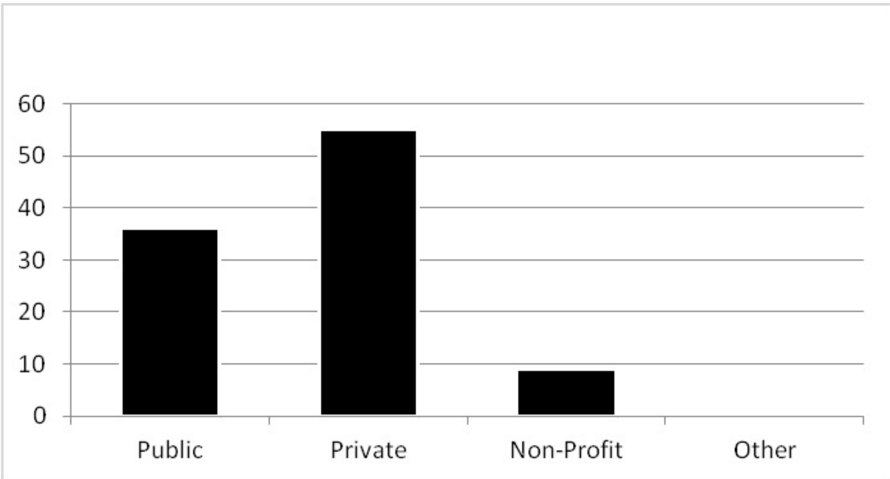
Empirical Findings of the questionnaire

Out of the 80 questionnaires sent out 50 responses were received in the period of response collection, which makes a 62.5% response rate. An acceptable rate gave the nature of the study and the time needed to respond to all questions in the questionnaire.

Respondents come from different types of institutions covering the public, private and non-profit sectors. 55% of the respondents work in the private sector, 36% in the public and 9% in the non-profit one (Figure 1). The distribution indicates the fact that the problem with financial statement fraud is a major concern primary to the private and public sectors in Bulgaria. The most represented areas are: financial (banking, investment intermediaries), audit (internal and external both for public and private institutions), education and consulting.

Figure 1

Type of Institution



Source: questionnaire.

Respondents have an average of eighteen years of experience in their respective fields ranging from four in two of the cases to forty years in one case. Given the general fact that about 10000 hours are needed to become knowledgeable in a field, the amount of experience that the respondents possess indicates that the answers provided to the questions set forth in the questionnaire are reliable. Moreover, about 60% of the respondents are affiliated with a professional organizations such as the Association of Chartered Certified Accountants (20%), Institute of Internal Auditors (10%), Association of Certified Fraud Examiners (20%), other (20%). Those respondents not only are affiliated with such organizations but also possess or are working towards professional and other qualifications including – FCCA, ACCA, CFE, EFE, CPA, CIAPS, Ph.D., CIA, CGAP. Only 20% do not possess any certificate relevant to the topics of interest in the research. 40% possess two or more different certifications (Figures 2 and 3).

Figure 2
Respondents; Affiliations

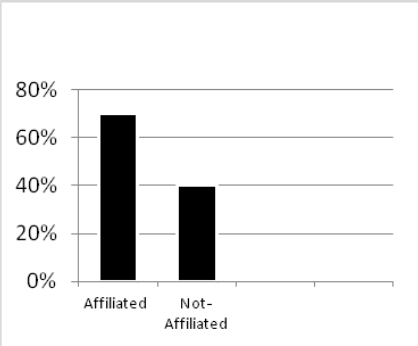
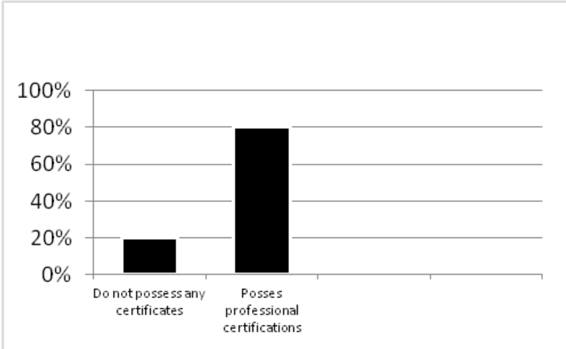


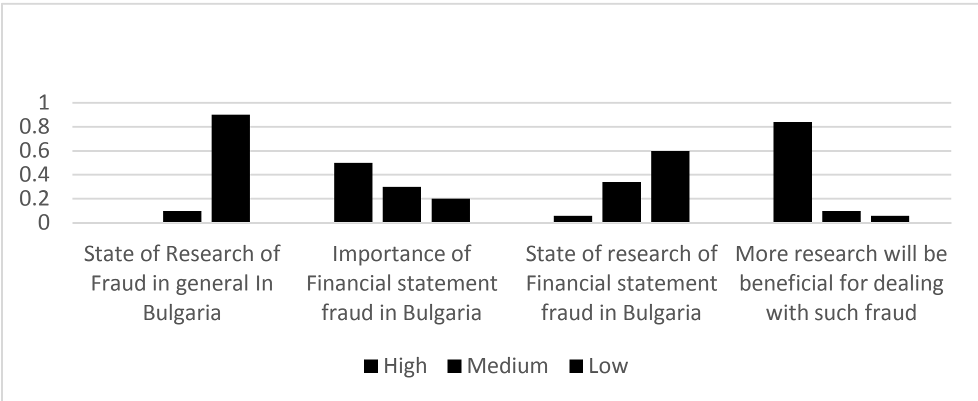
Figure 23
Respondents' Qualifications



Source: questionnaire.

90% of the respondents believe that the state of research on the topic of fraud in general in Bulgaria is not enough.

Figure 4
Opinions



More than 80% of the respondents find the problem of financial statement fraud on Bulgaria to be of a high importance (giving it either a 4 or a 5 on a five rating scale, the remaining 20% give it a 3 out of 5). 94% of the respondents believe that the state of research of financial statement fraud in Bulgaria is between 1 and 3 on a 5 rating scale. Only 6% believe that more research will not be helpful for improving the situation in regards to fraud in the financial statements (Figure 4).

A general profile of a financial statement fraudster

The general profile is based on the experience of the respondents in the following characteristics: gender, marital status, education level, age, position at the entity, time that the fraudster has worked in the organization. The dominant answers were picked from each category. Based on the responses the profile of a financial statement profile is: a male, married, with a master's degree, between 30 and 40 years taking a management position in the organization that he has worked for 5 to 10 years. This profile fits the general profile of fraudsters. A more detailed view on the top responses in each category is found in Table 1.

Table 1

Profile of Financial statement fraudster

Gender	74% – male, 26% – female
Marital status	48% – married, 22% – single, 14% – divorced
Education level	68% – Master's degree; 20% – Bachelors, 10% – Doctoral, 2% – other
Age Level	46% – between 30 and 40 years, 36% – between 40-50, 10% – less than 30 years, 8% – between 50 and 60 years
Position at the entity	62% – Management level; 22% – Mid-level employee 16% – Executive level
Time worked for the organization	62% – 5 to 10 years; 28% – 1 to 5 years;10% 10 to 15 years; 0% – more than 20 years

The results indicate that in the majority of the cases the perpetrators of financial statement fraud in Bulgaria appear to be male which follows the global tendency that males are most commonly engaged in fraudulent activities for various reasons especially when it concerns high value monetary fraud such as the financial statement one. The tendency continues with the marital status and education level – in the majority of responses the financial statement fraudsters are married possessing higher education. In the case of financial statement fraud, the majority of them have a master's degree showing that good education is correlated with the amount and magnitude of the fraud. Although individuals at any age can resort to fraud in the case of financial statement fraud in Bulgaria the tendency is that about 90% of the perpetrators are above 30 years old indicating the point that in order to pull of such level of fraud a critical amount of knowledge and skills are needed. Moreover, the majority of fraudsters in private entities have spent between 5 and 15 years in the organization which has allowed them to raise to higher positions giving them access to the needed knowledge of organizational controls and other tools that have allowed them to resort to financial statement fraud. Over this period the fraudster has established relationships outside the entity which have helped them such relationships are the ones established with: suppliers (46% of the cases), customers (40%), regulators (36%) and auditors (20%). The time worked in public institutions tends to be smaller between 5 and 10 years. Last but not least important the percent of people that commit financial statement fraud as first-time violation is about 25% which shows that the majority of such fraudsters have engaged in other types of fraudulent activities in the past. It has to be mentioned that the type of violations matters. In case of minor frauds, the percentage is lower which shows that the fraudster has made a transition from smaller caliber fraud before engaging in high caliber financial statement one.

General conclusions in regard to financial statement fraud in Bulgaria

In the Bulgarian context the three biggest consequences from financial statement fraud cases according to the respondents are:

First it jeopardizes the integrity and objectivity of the auditing profession especially that of auditing firms (the efficacy of financial statement audits)- Since they are considered to be the party that oversees companies in making sure that the financial information is free from any material misstatements due to error or fraud it is very it places them in a difficult situation when a large scale fraud case happens. The public confidence takes a hit whenever an alleged financial statement fraud case appears. This is especially true when the company is of a public interest and the auditor has a long history and reputation. Those two factors beg the question of whether financial statement fraud can be prevented at all for medium-sized companies using small audit firms.

Second it has a negative effect on Bulgaria's economic growth and prosperity by diminishing the confidence in the market and the financial information produced – the Bulgarian market participants' confidence (including investors, creditors and employees) is adversely severely affected but such fraud which leads to movement of capital outside the country in areas where the financial information transparency and stability are increased. Moreover, potential investors from outside Bulgaria are unwilling to invest capital inside the country and its financial system because they are afraid of being a potential victim of such fraud.

Third – the final but not least important reason is that such fraud not only causes operating problems of the entity experiencing it, but it has a ripple effect on other entities and individuals. These entities include suppliers, vendors, etc. – all that depend on the normal operations of the company. Given the size of the Bulgarian economy this appears to be especially true for financial institutions given the interconnectedness in Bulgaria's economic system.

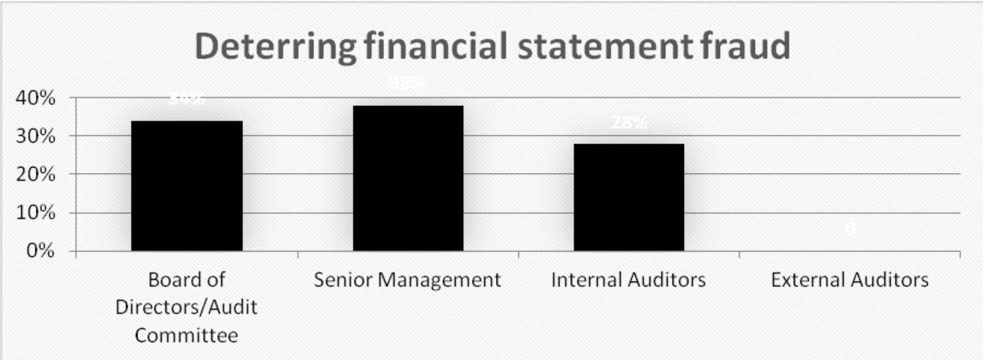
Financial statement fraud in Bulgaria findings summary

The results indicate that, in general the main reasons or combination thereof that allow financial fraud to occur are: most commonly acting fraudulently regardless of controls put in place in the organization (54%), weak internal controls present (40%), unclear rules of conduct and behavior in the entity, collusion to circumvent good controls (14%). In some of the situations such as collusion good controls can do little to prevent financial statement fraud. In the cases when the fraudster has acted fraudulently regardless of controls, he/she usually has established relationships most commonly with regulators followed by auditors.

On the opposite side of the fraudster are the parties responsible for coping with financial statement fraud in terms of deterring, preventing and detecting it. The results indicate that in those different aspects different parties have taken primary roles. In the case of deterring such fraud the Board of Directors/Audit Committee and senior management are perceived to have the primary role followed by the internal audit function (Figure 5). It has to be noted that external auditors were not even selected once as having the primary role which indicates that deterring such fraud should be in the hands of organizations themselves rather than relying on an external party.

Figure 5

Deterring financial statement fraud



When the focus is changed to detecting the fraud, the primary role falls on the internal audit function (66%) followed by approximately equal percentages going to external auditors, board of directors and senior management. Interestingly the perception of major prevention role again is taken by the internal audit function (34%) (Figure 6) given the fact that the internal auditors are merely making sure that the organizational processes are followed as prescribed by management. Following are the board of directors and the senior management which are typically allotted the primary role in the prevention of organizational fraud no matter the caliber. This is so because they are the parties responsible to the shareholders to ensure that fraud does not occur in organizations. Detecting all caliber of fraud is a duty to everyone in the organization not to a particular party. Combinations of different aspects of each party's responsibilities towards ensuring a fraud-free environment are the way to effectively prevent deter and detect financial statement fraud.

When we talk about financial statement fraud, in particular the private institutions are the most susceptible by a large margin – 72% followed by the public and non-profit organizations with 14% respectively. When the focus is changed to industry level the results show a proportionate division between: all kinds of industry (with a particular emphasis on the publicly traded ones), financial services (banks), and construction/ manufacturing and governmental (including European funds) (Figure 7).

Figure 6

Prevention of FS fraud

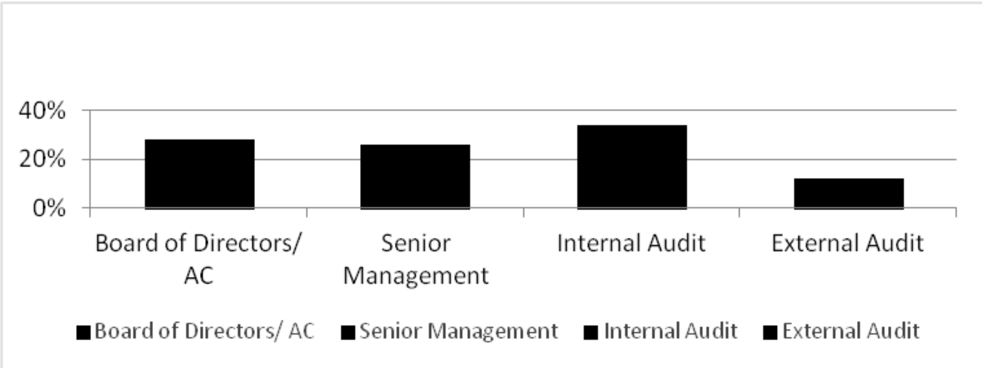
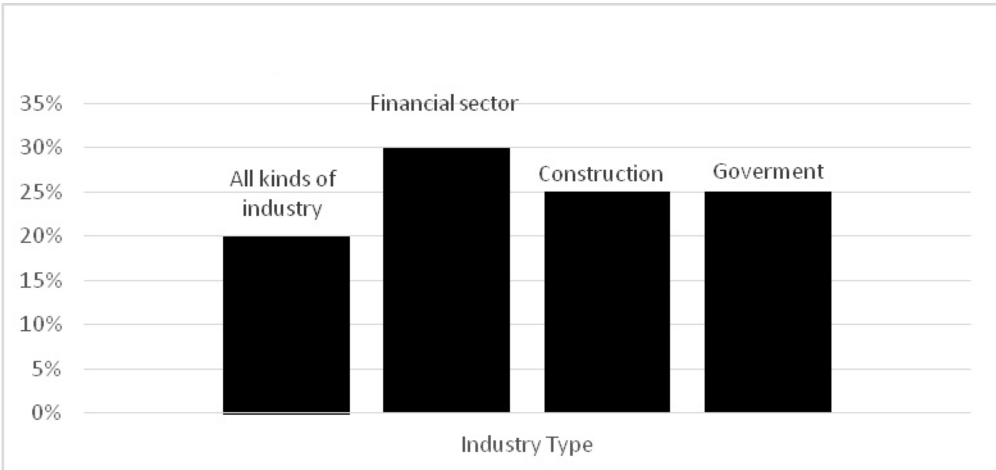


Figure 7

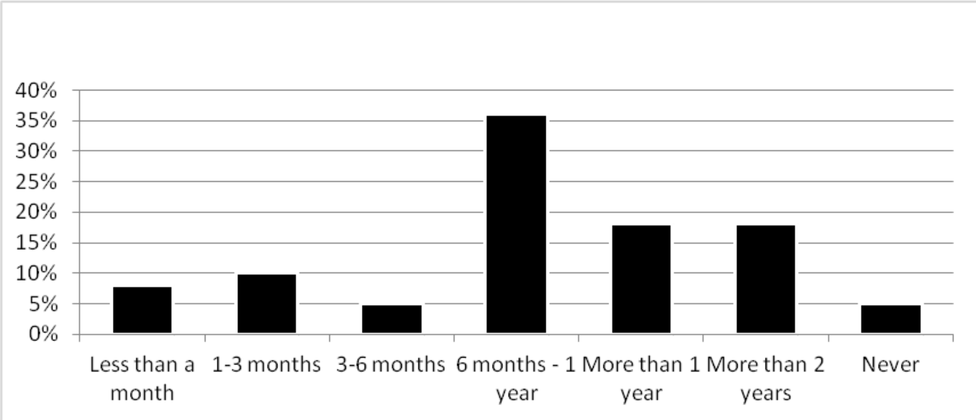
Susceptibility to Financial statement fraud



When talking about the size of the entities medium (between 50 and 250 employees) and large enterprises (more than 250 employees) account for 80% of the cases when compared to small (less than 50 employees) and micro (less than 10 employees) with 14% and 6% respectively. Usually, financial statement fraud in Bulgaria seems to be discovered early – in 36% of the cases it has been discovered between 6 months and 1 year after is has occurred. In 18% of the time it took more than 2 years before such fraud was detected (Figure 8).

Figure 8

Time before detection



The time before discovery varies depending on the industry with construction and governmental sectors needing most time before such fraud is discovered. In the case of the financial sector, it all depends on the specifics of the fraud.

In terms of the loss from the fraud many of the respondent's answers could not be used to determine an exact average estimate. The variance is from 50,000 BGN to 3 million depending on the size of the firm. Smaller firms have an average loss of 50,000 BGN to 200,000 BGN whereas bigger firms tend to suffer higher losses in between 1 million and 3 million depending on the sector. Finance and constriction sectors tend to suffer the highest median loss which could go as high as 15% of the revenue. Most commonly it is between 1 and 20%, especially in the financial sector. Construction companies tend to suffer around 2 to 15% revenue loss in case financial statement fraud occurs in the organization. Government institutions are estimated to suffer between 200,000BGN and 250,000 BGN loss from such fraud.

For individuals responsible in 78% of the cases a combination involving individuals from mid and high management was needed to perpetrate the fraud. In 56% the top management was involved – especially true for fraudulent financial reporting resulting in higher value frauds. Usually a collusion of at least between 5 to 10 employees (in 86% of the time) is needed to commit such fraud. Although anyone can potentially „help" financial statement fraud to occur in an organization, the major cases are made with the help of personnel with more decision/execution power. In private organizations the fraudsters include directors, chief accountants, payable managers, whereas in public institutions mostly the management and experts are involved. For smaller caliber frauds affecting the financial statements cashier, sales personnel and low-mid management are the main perpetrators.

The most common methods that result in fraudulent financial reporting across all sectors in above 90% of the time according to responses are:

Concealed liabilities and expenses are the first popular method for engaging in financial statement fraud in Bulgaria. This method is believed to be much easier to commit since missing transactions are generally harder to detect than improperly recorded ones since they do not leave any trail behind them. The most common techniques for doing so are omissions of liability/expenses and capitalizing expenses. The omission of liability/ expenses is easily done by simply failing to record them as such – invoices could be thrown away or shredded, in many cases the individuals hiding those try to compensate for the omitted items in future periods. The other common technique is to capitalize revenue-based expenses indirectly increasing the income and assets because of the bonus of amortization over a period of years rather than being expensed in one period (this however leads to an underestimation of income in subsequent periods as assets are depreciated). The opposite occurs as well – expensing capital expenditures. Some of the respondents have indicated that in some organizations, fraud has been done in order to minimize the net income due to tax and other considerations. The most common red flags that were present in companies that have engaged in concealment of liabilities and expenses are: unusual increases in gross margins in comparison with the industry average, assets, liabilities and other items being based on significant estimated that involve subjective judgments that are difficult to confirm.

Revenue manipulation is another method for that Bulgarian fraudsters use in order to commit financial statement fraud in order to make their financial position look better. This method is often (82% of the time) connected with establishing shell companies in Bulgaria or abroad those companies are then used to make fictitious transactions which included the payment of funds for assets while the same amounts were returned to the „parent company" as sales receipts. Another frequent technique listed by the respondents is the so-called sales with conditions where sales are booked even though the terms that are required to complete the sale are not completed. Recording expenses in the wrong period is popular for Bulgarian companies that were following strict budgets – the pressure to meet the expected goals makes them expense certain costs into periods other than the ones they should be expensed in. Last but not least frequently used technique is the premature revenue recognition where collectability cannot be reasonably assured – or in other words is dependent on some future events or the customer does not have the ability to pay (either because it has financial difficulties or is a shall company which does not have enough assets to justify the transaction). Most popular red flags for Bulgarian context are – unusual increases in ratios relating to margins, number of day's in receivables in relation to peer companies.

Improper disclosures – the management has the inherent obligation to make disclosures of all significant information. Improper disclosures relating to financial statement fraud in Bulgaria most commonly involve hiding of related-party transactions, liability omissions and management fraud. Related party transactions occur most commonly when a company does business with another entity whose management and other operating decisions can be significantly influenced by the former. In Bulgaria the financial interest between companies is not always transparent. Moreover, such related transactions are not always material to the financial statement as a whole, especially true for bigger companies, but represent a form of financial fraud nonetheless. Second is disclosure of management fraud – management of the organizations have an obligation to disclose significant acts of fraud committed by officers, executives or other employees in key positions in an organization. In Bulgaria withholding such information from the auditors appears not to be an isolated incident. The third place is tied between omissions of liabilities and failing to discourse all accounting changes in terms of estimates and reporting entities. Typical omissions include the failure to disclose material contingent liabilities or loan covenants of the business. Typically the most common red flags given concerning this type of financial statement fraud by the respondents are: a history of violations of national laws and other regulations of the entity, its senior management of board members, significant bank accounts, operations of related parties of the company beyond Bulgaria's borders especially in tax-haven jurisdictions and formal or informal restrictions on the auditors that limits their access to people or needed information.

Improper asset valuation. The improper asset valuation schemes in Bulgaria fall in one of three categories – schemes with inventory valuation, schemes with accounts receivable and schemes with misrepresenting the nature of the assets. Inventory valuation fraud techniques involve failing to write down inventories or inflating the number or prices of different items. Those schemes typically involve the creation of fake documentation which includes reports and inventory count sheets. One of the respondents has shared that in of the cases involving inventory valuation fraud the company employees even have tempered with the generated computer inventory counts in order to misguide the auditors. Another way that Bulgarian fraudsters use to manipulate the financial statements is via accounts receivable – either by failure to write them down and accrue losses on their non-collectability or acknowledging fictitious account receivable in the cases where the bonuses of management are tied with sales figures. The majority of the respondents agree that the fraudsters tend to provide false confirmations of the balances of accounts receivable in case such fraud occurs in the organization in question. Improper asset valuation is often connected (44% of the time) with other assets such as the fixed assets – the most popular technique being misrepresenting the asset value (not recording at cost). In 14% of the cases connected with such fraud involve reporting fixed assets at market value or using fake valuations to support their value. Most frequent red flags in the above-mentioned scenarios are similar to the revenue recognition methods plus an unusual change in the fixed assets and depreciation.

The pressure is the main driver that leads to the occurrence of financial statement fraud in Bulgaria. Pressures come from a variety of factors including frequent changes in legislation, investor/market expectations, low salaries, bad business environment, loss of job, medical bills, greed, poor financial performance, requirements of regulatory authorities, debt with most common being the personal pressure factors that lead the individual to commit the fraud. In terms of rationalization one of the most common answers include a variation of the following statement – „everybody is stealing and no one is held accountable" or „in Bulgaria everybody does it why not me? Am I the biggest „shmatka" (loser). As mentioned beforehand weak internal controls play an important role in providing an opportunity to commit financial statement fraud in Bulgaria. Interestingly in many of the respondents answers the minimal sanctions by legislation and weak policy enforcement were listed as opportunity factors. Moreover, the social standards of behavior reinforced by the examples of the most recognizable highly positioned at every level play an intricate role in the rationalization aspect of the financial statement fraudsters. This is clearly reinforced by the fact that in 68% of organizations that have experienced such fraud in Bulgaria had a written code of ethics for business conduct. In the rest of the cases 50% respondents do not believe that such code would decrease the probability of such fraud this is especially true for the public sector. Moreover, in half of the organizations that have experienced fraud in the financials no ongoing fraud awareness training was carried out periodically such training would decrease the probability of such fraud according to 82% of the respondents. More than half of the respondents indicate that new employees are made aware of the organization's view on fraud and fraud-related activities. Such onboarding is likely to have a positive impact on decreasing the probability of fraud occurring according to 86% of responses.

When financial statement fraud is concerned one of the most important impact factors is the example of management. Bulgaria is no exception. More than 60% of the respondents believe that management has not set an example and enforced a zero-tolerance approach to fraud issues in the organization. More than 88% believe such example would decrease the risk of financial statement fraud occurring in these organizations. This is even more important than the corporate mission statement where the majority of organizations had one (64%) and even so financial statement still occurred in the entity. Nonetheless, corporate mission statement is still found to be an impotent preventive measure in fighting financial statement fraud in Bulgaria since it guides not only the management but ordinary employees to commit to ethical leadership and actions.

In 72% of the organizations that have experienced financial statement fraud the corporate culture supported ethical behavior on the workplace, however, the results show that the culture could be improved by: regular meetings and awareness programs in regard to ethical values and principles. The topic of manifestation of fraud intolerance is key for decreasing the risk of financial statement fraud. Moreover, those principles need to be embedded in preventive controls such as constant monitoring and rotation of persons occupying certain positions. All in all it is a combination of factors corporate culture alone cannot eliminate the risk of financial statement fraud in Bulgaria it should be a combination of establishing a responsible corporate governance, vigilant board of directors and audit committee, diligent management, as well as adequate and effective internal audit functions using an alert, skeptical external audit function, responsible legal counsel, adequate and effective internal control structure, and external regulatory procedures implementing appropriate corporate strategies for correction of the committed financial statement fraud, elimination of the probability of its future occurrences, and restatement of confidence in the financial statement process. When these strategies are performed properly and effectively, the opportunity for financial statement fraud is substantially reduced.

Background checks of new hires were a common practice in organizations that have experienced financial statement fraud in Bulgaria. Although the majority of the respondents believe that indeed such checks are helpful in decreasing the risk of fraud in organizations (e.g. recommendations and other information provided by the potential applicant may contain false information) only 26% believe that they are helpful in decreasing the risk of financial statement fraud. This is not only due to the fact that this type of fraud is committed by the higher levels of management but to the fact that the many major financial statement frauds were committed by highly educated people with impeccable references.

Background checks are relevant to low-value fraud such as misappropriation of assets but not to fraud in the financials.

The results indicate that reporting is an issue in 42% of the organizations that have experienced financial statement fraud. The employees did not know how to report a suspected occurrence of such fraud. Fifty-six percent of the responses indicate that there were no adequate monitoring controls in place to identify any red flags. Even in the case that monitoring controls were in place in only 68% of the organizations those controls were enforced strictly by the management and supervisory staff – the lack of authorization mechanisms and making unilateral decisions beside formal separation of functions are two key issued that were identified. In many cases, the segregation of duties was not an efficient means to prevent financial statement fraud because the individuals were in collusion. The most effective monitoring controls pinpointed which are effective in deterring financial statement fraud are having a permanent independent internal control function throughout the year (with sufficient personnel to enforce the internal guidelines), regular external audits as well as real-time operation monitoring with correlation analysis and indebt oversight approach consisting of multiple analytical technicians and tools.

The attitude of management and its inability to display and communicate an appropriate stance on internal control and financial control process was the key to the occurrence of the fraud in the financials in organizations – true in 72% of the time. The most common failure was due to management being dominated by a single/small group of individuals followed/in combination with disregard of regulatory rules, inadequate monitoring of significant controls and failure to correct material internal control weaknesses. In case of intentional manipulation resulting in financial statement fraud internal controls are ineffective if the management in charge has the ability to override them.

High turnover of management, legal advisers or board members in a short period of time before the fraud was discovered took place in 66% of the organizations. Although financial statement fraud was discovered in 56% of the cases no strained relationship existed between the management and the current/previous auditor of the company. In the majority of the cases, the relationship was described as good and even friendly.

In Bulgaria financial statement fraud is the first incident of fraud on organizations in 48% of the time. Other types of fraud preceding were but not limited to – embezzlement, occupational fraud, loan granting, bribes, corruptions, supply chain fraud, theft of assets. In 50% of the time, the governing bodies of such organizations were explicitly involved. In 56% of the cases the bonus and incentive structure in the organization was such to foster the risk of fraud. It has to be noted that in only 46% of the time organizations resorting to financial statement fraud were in imminent threat of bankruptcy or foreclosure. Other threats to the entities were: pressure to win governmental or other contracts, revocation of license, competition, needing to deal with loans and debt.

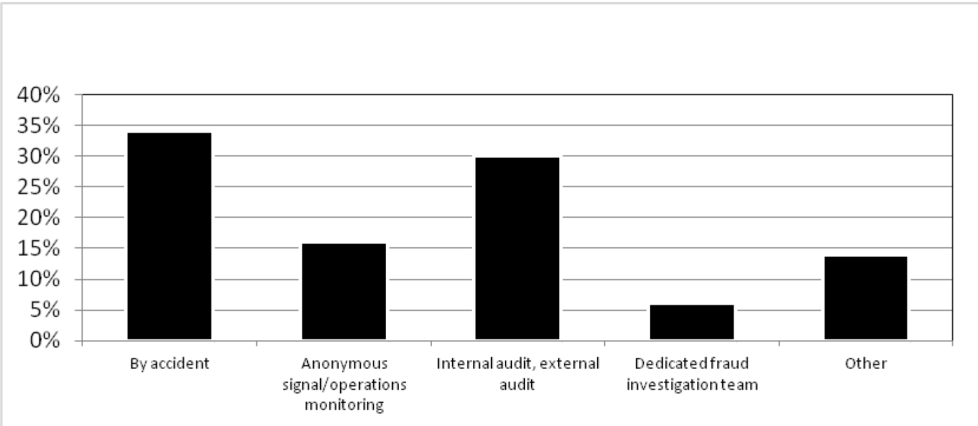
Although that an established fraud risk management program was in place in 60% of organizations that have experienced financial statement fraud in Bulgaria it was still not able to deter the occurrence of the fraud. According to the respondents it was due to a variety of factors prominent of which is that in many organizations such risk management program is only formal and is subject to override of controls by management in the entity.

The most common internal control framework used in those organizations was COSO which 30% of the respondents believe that is the most effective system to prevent and detect fraud in the financials in organizations. Second place is taken by COBIT due to its orientation towards business processes application of a holistic approach.

Most commonly financial statement fraud in Bulgaria was discovered by accident or in a case of bankruptcy of the organization (the organization could not continue to hide the fraud for much longer) (Figure 9). There were red flags present in before the discovery of the fraud in 58% of the cases. Most red flags are case-specific with few common ones including unused leave, lavish lifestyle, lack of segregation duties(one person performs different conflicting operations), unexpected revenue streams, too big/low profits accompanied with unusual activities, behavioral anomalies of employees, accounting anomalies involve irregularities in the accounting system, analytical anomalies, operational anomalies and other readily noticeable internal control weaknesses.

Figure 9

Discovery of Financial statement fraud



After the incidence of financial statement fraud measures were taken in order to prevent such fraud from occurring again. Those measures include new controls over the financial reporting process, improved rules and policies over procedures, rotation of job responsibilities and tasks, and more effective monitoring over the organization. Thirty percent of the respondents believe that these measures were not enough to prevent the incidence of financial statement fraud in the organization in future, 40% believe that the measures can indeed help in doing so whereas the rest have taken the stance that they can decrease the risk of such fraud but doubt that the measures will be enforced in the organization. Eighty-five percent of the respondents believe that in order such fraud to be prevented in future a more holistic change in regulations is needed besides just optimizing the process of fraud risk management and establishing new procedures controls and monitoring mechanisms.

Financial statement Fraud Prevention and Detection in Bulgaria

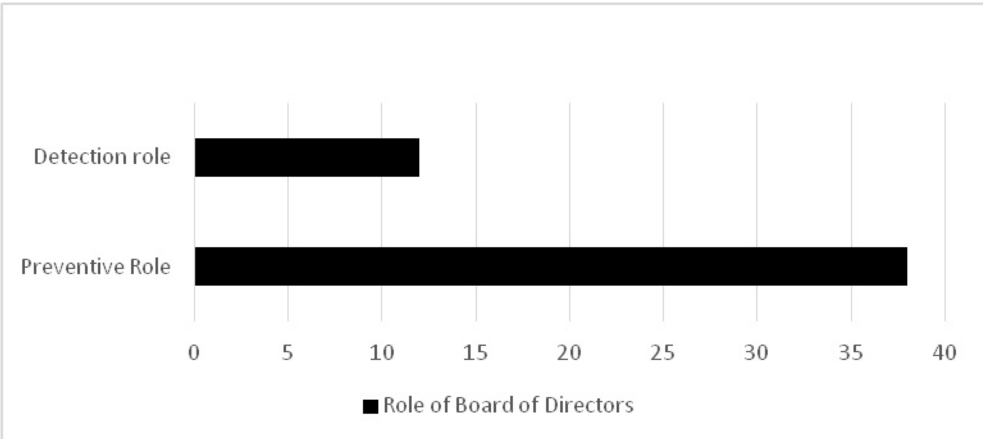
This part of the analysis takes into account the answers to the questions aimed at understanding the role of the major parties that play a role in the prevention and detection of financial statement fraud in Bulgaria. The most important considerations according to the respondents in order parties to successfully prevent and detect such fraud in general is to be able to correctly identify characteristics of fraudulent behavior in organizations together with addressing the risks that could lead to a material misstatement in the financial statements. Moreover, this section includes recommendations for improvements for each party based on the results of the study that would help their ability to combat financial statement fraud more effectively.

a) Board of Directors Role (including Audit Committee)

The results from the questionnaire indicate that the role of the board of directors plays a bigger role in the preventive measures against such fraud rather than being the body that detects it in Bulgarian context. A comparison can be found in Figure 10. The most important quality of the board of directors in combatting financial statement fraud is to establish proper tone in the organization which is then reflected in the policies and procedures adopted for daily operations of the entity. It is the party responsible for reducing the rationalization of such fraud by establishing a strong ethical context in the organization.

Figure 10

Role of the board of directors



There are several main reasons that are preventing the board of directors from combating financial statement fraud in organizations effectively. Leading is their inability to see and observe the day to day operations of the company and together with insufficient staff to make sure that all procedures and internal controls are monitored effectively. When a purposeful financial statement manipulation is done the board of directors is unlikely to prevent it since its members have most likely participated in committing the fraud. In order this to be improved and the board to be truly capable of decreasing the risk of financial statement fraud the answers indicate three big areas of improvement that should be focused upon in organizations that wish to remain free from such fraud. The first area is the selection of the board members – since the board is one of the parties responsible for establishing the organizational culture it is important that the members have a clean history, relevant experience in the industry and zero tolerance for fraud. This includes any conflicts of interest that each board member might have. The question of whether the member of the board makes his/her decision for the better of the stakeholders' needs to be in focus. Second – board members need to implement financial and other penalties in order to motivate management, which is closer to daily operations, to develop and systematically apply models tailored to the organization aimed at preventing fraud in the financials. The third area is the role of the board of director to educate not only the organization but society about the importance of fraud-free environment and the benefits deriving from it. Thus, the community will become intolerant to fraud and will demand responsibility for fraudsters taking part in such fraud.

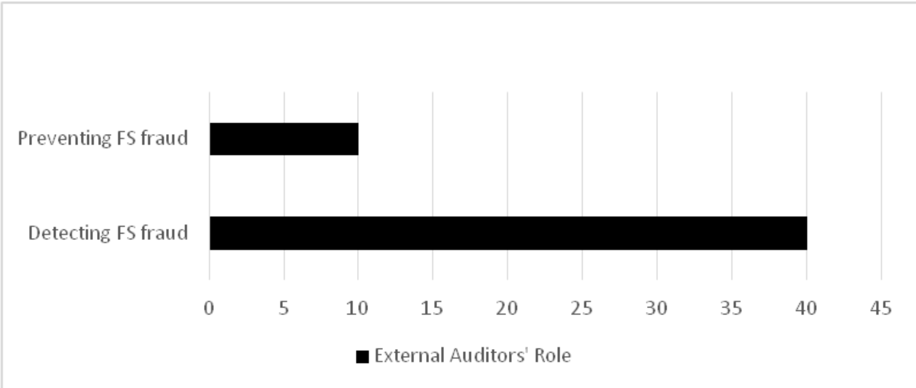
Similar are the results of the role of the Audit Committee – it plays a larger role in the prevention of financial statement fraud. It together with the board of directors plays an important role in establishing the governance principles, values, ethical culture in the organization which some of the respondents argue that are the topmost factor in the prevention of such fraud in Bulgaria. Willingness to comply with the law is a preceding factor which applies to an effective role of the board of directors and audit committees of companies in Bulgaria. Audit committees in Bulgaria are in communication with individuals on key management positions, what they are lacking is a direct and open way of communicating with one or two levels below senior management. This would certainly facilitate the transition of suspected wrongdoing in the organization by bringing it to the attention of the audit committee. Moreover, the role of the audit committees in Bulgarian companies seems to be lacking the initiative and empowerment to investigate any alleged fraud in the organization. Around 20% of the respondents believe that the members of the audit committees need to possess more knowledge and experience in fraud prevention and managing the risk of such. Moreover, both the board of directors and audit committee members should more openly declare their responsibility to the users of financial statement information and their role in the prevention and detection of any fraud related.

b) External Auditors' Role

The external auditors are expected to play a different role than the board of directors in the prevention of detection in financial statement fraud (Figure 11). 10% of the respondents believe that external audit is not necessary for organizations.

Figure 11

Role of the external auditor



The two most important characteristics that an external auditor needs to possess in Bulgaria in order to combat financial statement fraud effectively are: exercising professional skepticism (or the mindset that acknowledges that fraud could be present in the organization) together with the ability to make inquiries to management and other parties in the organization about how the risk of financial statement fraud is addressed. The latter includes questions about whether management has knowledge of fraud or suspected fraud occurring in the organization and how management communicates to employees its stance on appropriate ethical and business conduct. It is very important for the external auditors not only to be able to identify how and which financial statements items might be susceptible to fraud in the specific organization but know-how management could try to conceal this.

Half of the respondents believe that the size of the external audit firm has an effect on its ability to detect financial statement fraud. The slogan „bigger is better" is true given the fact bigger firms possess higher capacity by possessing/having access to more expertise and knowledge. However, the size of the firm will not matter in cases where the auditors are helping in the financial statement fraud. Another common response which prevents the external auditors from combatting effectively fraud in the financials is that the market in Bulgaria is quite small. This leads to a stance that „a client is always right" which results to an inherent limitation of the external audit and non-diligent performances of its duties and even collusion with the fraudsters in cases where the fraud is significant (many of the respondents were referring to a recent financial institution that went bust).The inherent lack of independence of the external auditors (they are paid by the firm) together with unfamiliarity with specifics of certain businesses (more relevant to smaller audit firms) is another common problem. In regard to the necessary analytical procedures – usually they are performed on account level where only the significant deviations are delved into. 60% of the respondents believe that more detail on the analytical producers could be a way of detecting financial statement fraud in Bulgarian firms. Moreover 30% of the respondents believe that the use of predetermined checklists/procedures could be dysfunctional because it limits the auditor's ability to expand their critical thinking beyond them- especially when making adjustments to audit plans as a result of higher fraud risk assessment in the organization. External auditors are rarely trained in investigation (they are not forensic accountants) which undermines their ability to react accordingly after detection of such fraud. Last but not least many of the audit firms are following specific budgets for each engagement which in some cases can lead to understaffing which puts pressure on the engagement team which might lead to missing or overlooking important information.

Respondents believe that many of the aforementioned problems can be solved on a governmental level including changes in regulation and/or creating an agency to act between the companies and external auditors leading to higher independence. The independence will be greater as well whenever the external auditors provide as few as non-audit services to the client. Respondents agree that some of the non-audit services can affect the independence of the auditor distracting them from their main role which is giving an opinion on the correctness of the financial statements. The lack of knowledge regarding certain industries can be solved by allowing only auditors specializing in the relevant industry to be able to audit those sectors or hiring outside specialists. The problem with understaffing can be easily solved by sacrificing profit margins in order to hire additional staff. For an external auditor it crucial to prioritize efficiency of the work rather than trying to squeeze extra profit.

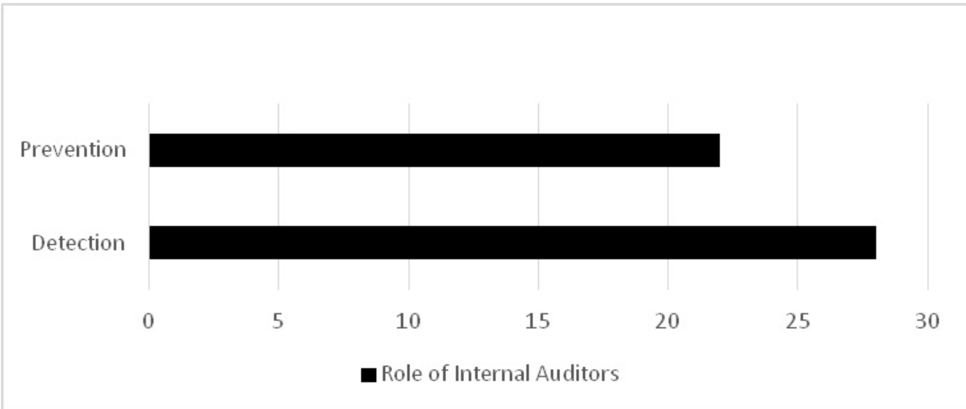
c) Internal Auditors Role:

Internal auditors appear to have a split role in financial statement fraud prevention and detection in the Bulgarian context (Figure 12). Sixteen percent of the respondents have indicated that it is not a job of internal auditors to audit the financial statements of the company (this statement relates to internal audit expectation gap). Although it is not their explicit purpose to audit the financial statement of the organization an argument can be made that internal auditors play a key role in accessing operating procedures, regulations and standards that relate to the process of putting together the financials of an organization. The most important qualities of the internal audit function in order to combat financial statement fraud efficiently are the ability to be able to question management decisions and especially those that motivate the employees of the company with what attitude to perform their day to day activities.

The majority of the respondents believe that there are three main problems that prevent internal auditors from being fully capable of combating the financial statement fraud in Bulgarian companies. The first one is a lack of independence (same problem but different context as the external audit) or too much dependence on upper management when determining the scope of the engagements. The second discussed in 40% of the time is the lack of experience and knowledge over the financial reporting process. In 34% of the cases a solution is given to correct this by establishing a Subdivision of internal control in larger organizations specifically aimed at giving assurance for the correctness of the financial statements. Third – the results indicate that mostly the internal audit function in Bulgaria is concerned with testing controls that relate to ensuring that the financial statement process is operated accordingly. However, this does not provide assurance of the accuracy in the financial statements. The role of the internal audit function is significant in decreasing the risk of financial statement fraud thus the increased need for substantive tests alongside the internal auditing process are desired. Those tests could involve detailed testing of transaction and account balances and/or analytical procedures. That is not to say that the internal audit is not capable of preventing different types of fraud, in fact they are more likely to catch smaller caliber frauds and noncompliance with the internal policies than external audits. This is due to the fact that external auditors typically use specific materiality in their procedures which in many cases is quite high which decreases the risk of catching small frauds, which although are „immaterial" are still fraud. Although the major responsibility of the auditor is not to prevent and detect financial statement fraud it is closely connected to it by making sure that the financial statements are reliable. After all the internal control is a process that is affected by the board of directors, management and other personnel which aims at providing reasonable assurance in three areas: achieving effectiveness and efficiency in operations, compliance with laws and regulations and reliable financial reporting. Fraud in the financials jeopardizes the latter two which decreases the role of internal control as a whole.

Figure 12

Role of Internal audit



d) Mid to top Management role:

The role of management is important not only for committing financial statement fraud but also in the opposite direction. Management is the only body believed to have equal role in financial fraud prevention and detection due to three reasons given by the respondents 1) they are the ones that are closest to daily operations 2) they are the ones that communicate the right ethical tone and set the standards of behavior in the organization to the rest of employees. 3) In smaller and mid seized companies' owners are part of the management of the company – they have an inherent interest to keep such fraud outside the company unless they are the ones committing it. Without the support of the management no fraud can occur in organizations. Most commonly what prevents them from effective prevention and detection of financial statement fraud in Bulgaria is the fact that in many of the organization where such fraud occurred the management had engaged in related party transactions where some form of vested interest was present which lead to transactions which purpose was not to follow the correct policies which are established in the organization but to bend them for specific reasons. For higher caliber fraud, higher levels of management are involved. Management, in general, is the party that follows the directions of the board of directors and executive directors – if they do not have the correct raw model of how to conduct business accordingly, they cannot be expected to prevent and/or detect financial statement fraud in Bulgaria effectively. It is worth noting that in the majority of the cases it is up to management to implement any corrective measures after an incidence of fraud in the organization which further bolsters their organizational role in combating financial statement fraud.

e) Roles of parties outside the organization

Results indicate that last but not least important role goes to parties outside the organization. Those organizations include governmental, professional organizations and other:

i) Government – the respondents believe that it is the player that can influence the external organizational environment the most when talking about fraud in the financials. In order to do so the government needs to work in three areas: First, it needs to increase its sanctions towards companies and individuals that engage in such fraud. More than 60% of the respondents believe that increased sanctions in terms of fines and jail time are needed for its successful prevention. Those fines should not be limited only to parties in the organization but to all related parties that have allowed it to happen including the external auditors and other organizations. Some of the respondents have compared the consequences of such fraud in western counties like the USA where all involved including the board of directors and external auditors have faced tremendous penalties. More than two-thirds of the respondents believe that to some degree the current level of law enforcement resources directed at financial reporting are deficient and should be increased. This not only includes faster adoption of the latest international regulation in regard to reporting but also soft preventive controls like propagating the theme of the importance of the correctness in the financial statements and the consequences to the society and economy of Bulgaria. These consequences do not only include erosion of the confidence in the ability of different institutions to enforce the law and detect such a fraud but the decreased willingness to businesses and investors to move to Bulgaria where environmental factors such as the labor force and low tax rate provide the opportunity for increased margins. Last but not least is the problem of whistleblowing, which has been found to be one of the most frequent ways of detection financial statement fraud. There is a lack of means that individuals can use to report suspected fraud of such caliber together with lack of confidence that there will be a follow-up inquiry into the signal.

ii) Role of professional organizations – the results indicate that the potential ability of professional organizations is underused in Bulgaria. Those organizations due to the combined expertise of their members, not only can help the government implement new more efficient regulation but can act as a source of information/ education to individuals from all organizational levels for fraud and fraud-related issues. In Bulgaria such independent organizations are the chapters of the Institute of Internal Auditors and the American Association of Certified Fraud Examiners. Members from these intuitions may provide invaluable assistance to organizations in terms of fraud prevention and detection due to their extensive knowledge and experience that might not be otherwise found in-house. Moreover, they can provide a more objective input into management's evaluation of the risk related to financial statements (especially when involving parties such as senior management/board of directors) and assist the audit committee and board of directors in the evaluation of the measures implemented by management. Certified fraud examiners may conduct independent examinations to resolve allegations or signals of suspected fraud by reporting either to the appropriate level in the organization or outside it. The major reason why entities are not seeking help from such professionals are privacy concerns. Those privacy concerns can easily be eliminated with non-disclosure agreements.

iii) Media – 54% of the respondents believe that media can play a preventive role when financial statement fraud is concerned. Newspapers shows, programs devoted to financial statement fraud and other fraud in general- can create buzz around the problem and with constant exposure prevent potential fraudsters in engaging in such fraud.

iv) Educational establishments – last but not least as mentioned the majority of the respondents believe that the state of research in financial statement fraud and fraud in general is not enough. Researchers need to focus their efforts and share their studies on different means of fraud prevention and detection with governmental institutions and professional organizations.

Model for financial statement fraud prevention and detection for Bulgaria

A new research a model is proposed which takes into account both the findings of this study hoping to shed light and help on prevention and detection of financial statement fraud's ecosystem in Bulgaria. A visual simplification of the model containing one entity is found on Figure 13.

The model takes into account the environment both on organizational and environmental levels. The organization level is represented by a triangle in the center of which is the management of the organization since they are the party that is involved in committing financial statement fraud. For fraudulent financial reporting it is the mid-high management, for misappropriation of assets it is the mid-management that is usually involved. However, they are the party that is most efficiently being able to detect and prevent provided with proper motivation due to their daily interactions with the operations of the company and making sure that the prescribed policies are followed. The three apexes of the triangle represent the three other parties that play, to a different extent, role in the prevention and detection of financial statement fraud, that need to keep management in check – the board of directors/audit committee, internal audit function and external audit. Board of the directors/audit committee set the foundation in the organization in terms of not only tone and ethical culture but prescribing actions to detecting and deterring fraud in the financials in organizations. The internal audit function not only has the responsibility to question the decisions of management but also make sure that all processes in the organization are adhered and followed. The external audit is the outside assurance that vouches for the correctness of the financial statements. A special focus needs to be paid on concealed liabilities/expenses, revenue manipulation techniques improper disclosures, improper assets valuations and the red flags associated with them. Table 2 summarizes the main points found by the research that prevents the parties from achieving their role.

Figure 13

New model for dealing with FS fraud

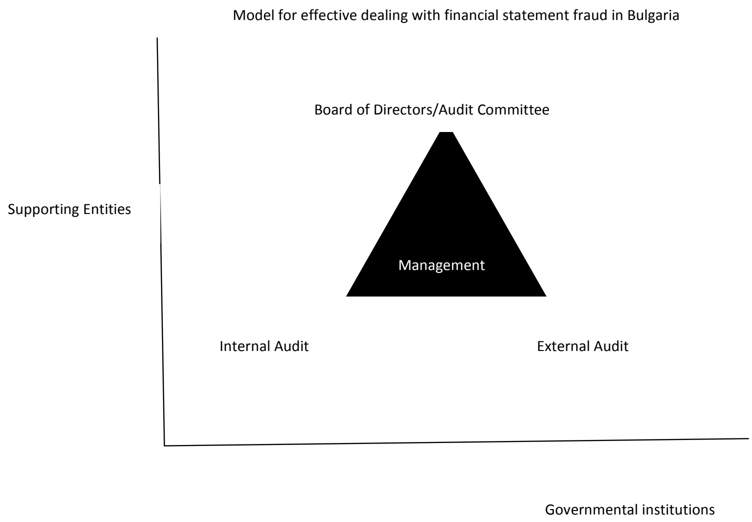


Table 2

Issues and Solutions

	Board of Directors/Audit committee	Internal Audit Function	External Auditors
Issues	Participants in the fraud, lack of participation in daily operations, lack of knowledge and experience in managing fraud risks	Lack of independence, lack of experience and contact with the financial reporting process, do not provide assurance of the accuracy of the financials	Lack of independence, „Client is always right stance", collusion in fraud, rarely trained in investigation, understaffing
Potential solutions	Independent board members with no vested interest, set an example both in and outside the organization on high integrity and educate the community in regard to the benefits of fraud-free environment. Make communication easier between them and lower organizational levels.	More independence on the audit function, establish a subdivision that is concerned with the accuracy of the financials, more training on detecting fraud. Ways to report high caliber fraud outside the organization. Red flag detection trainings, Periodic reviews and risk assessments.	Limit non-audit services provided to audit clients, indebt analytical procedures, training in fraud detection and risk assessment, hire more staff. Red flag detection training

In the case that all three parties take their role accordingly the management's pressure, opportunity and rationalization to commit fraud in the financials are severely limited.

The outside environment of the model is comprised of the government (and related bodies) on the X axis and supporting institutions on the Y axis. The government is the party that influences the external organizational environment the most, it establishes the foundation and regulations on which firms operate in Bulgaria. The supporting institutions include professional organizations and the media. Professional organizations can not only be a used as a means for education on prevention and detection methods of financial statement fraud in organizations but help the governmental ones establish a better legislation and requirements over the financial statement process. Moreover, they can be used as a means to share experience among different organizational levels and provide training on issues concerning the risk and importance of financial statement fraud prevention. Last but not least specialist from such organizations can be brought in organizations to provide independent valuation and assistance in the prevention of such fraud in companies. The role of the media needs to be taken into serious consideration as well – individuals representing different stakeholders in the problem of financial statement fraud can propagate this problem into the community. Table 3 summarizes the main points taken from the research:

Table 3

Issues and solutions – parties outside the organization

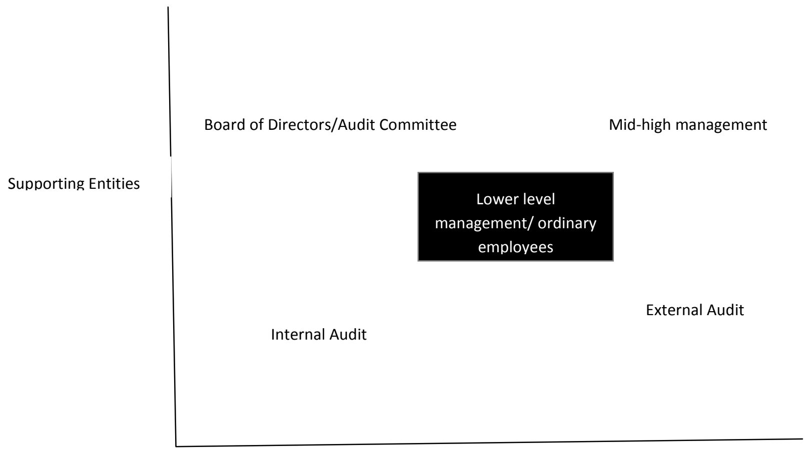
	Government	Supporting Institutions
Issues	Lack of consequences for financial statement fraudsters, more enforcement measures, low public confidence in governmental institutions	Not enough involvement by organizations in Associations, not enough leveraging associations' resources in terms of experience and knowledge in dealing with the problem. The media needs to play a higher preventive role. More research needed on the problem
Solutions	Increases sanctions (monetary jail, license revocation), faster and clear adoption of changes in the international accounting standards, taking an affirmative stance on the problem, establishing channels for efficient whistleblowers and follow up action mechanisms. Partnerships with the supporting institutions and collaboration with them with the goal of dealing with the problem. Proposing insurance for organizations in case such fraud occurs in them (similar to auditor assurance of mistake in the opinion)	Foster participation and sharing of experience in professional organizations including red flags and risk management techniques. Using them as a source of information and independent consultation even in case where an investigation is needed. Education the community by talking about the problem in shows, articles and other means of communication more research on the problem by researchers. Act as an in-between intermediary between government and organizations

For misappropriation of assets the model can be adapted by altering the center of the organization aspect (see Figure 14). Here again, the parties that participate in such fraud are in best role to prevent and detect such fraud. The other elements of the model remain the same.

Figure 14

Adapted model

Model for combating with asset misappropriation in Bulgaria



As seen by the findings combating financial statement fraud in Bulgaria is a group effort needing several parties to keep the risk of such fraud in check. The more tighten up the ecosystem is and the critical mass of factors in place the more likely financial statement fraud is to be detected and most importantly prevented in Bulgaria.

Research implications

The contribution from this study research has direct implication for further research in several general directions:

i) First, it enriches the academic literature by shedding light on the state of the financial statement fraud in Bulgaria – its occurrence (perpetrators, most popular ways of financial manipulations), detection (red flags other means) and prevention (potential problems and solutions). Moreover, it proposes a model for a way of looking into the problem of financial statement fraud in Bulgaria plus relevant recommendations based on the research results.

ii) Second, it provides the parties in organizations responsible for fraud detection and prevention of financial statement fraud recommendations based the, analysis of the results, on what to improve in order to be more efficient in dealing with the problem.

iii) Third, is the implication to the external organizational environment represented by government and supporting institutions that desire to decrease the risk of financial statement fraud. Issues were identified and factors that can be influenced the most identified that need to be taken into account in order to successfully prevent financial statement fraud in Bulgaria

iv) Forth, it provides potential topics of interest which researchers can use as the basis for future research in the area of financial statement fraud and fraud in general in Bulgaria.

Limitations of the research

There are also a number of limitations of this research. The first limitation of the research is the questionnaire used – it gives a picture on the problem of financial statement fraud and does not delve into more details in each theme as other methods. However, the scope of research would limit this. Moreover, the research has been conducted only in Bulgaria. Both of these reasons impede the exploratory research from ensuring that the data is comparable and suitable for generalizations in different contexts.

The second limitation concerns the underlying qualitative nature of the research and the nature of the results. All necessary steps have been taken to limit this risk, but enduring total credibility and authenticity of the data and analysis based on it is hard to be achieved due to the variety of factors that could potentially influence the results.

The third limitation is the fact that the research mainly was steered to fraudulent financial reporting fraud rather than on fraud resulting from misappropriation of assets. Moreover, it does not aim to resolve a specific financial statement fraud case/method but rather analyses the overall situation of such fraud in Bulgaria.

Conclusion

Financial statement fraud has been an important focus of research due around the world due to its negative impact on organizations, regulators and other stakeholders. This research has provided analysis on financial statement fraud in the Bulgarian context – its occurrence, detection and prevention – using information gathered from different viewpoints on the problem.

Issues related to parties inside (board of directors, internal audit) and outside (external audit) have been identified and potential solutions presented based on the information collected. The role of the government and supporting institutions in the prevention of financial statement fraud has been emphasized as a major factor of prevention of such fraud. Although that, there are many steps to be taken which will reduce the risk of fraud in the financials the risk of collusion and override of controls (both preventive and detective) still persists.

The research is only the first step out of many towards the successful combating of financial statement fraud in Bulgaria. It establishes the basis which should be used by the relevant parties that play a key role in the prevention of such fraud in order to reduce the risk of this phenomenon occurring by proposing a model and potential solutions to the identified problems.

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