

CORPORATE FRAUD, AUDIT PREVENTION AND DETECTION

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Abstract

This paper deals with corporate frauds, their forms and the ways in which they are detected. The paper explained the function and role of professional accountants in the prevention and detection of this phenomenon, that is, internal audit, external audit and the internal function of accounting were placed in connection with fraud. The volume and type of fraud were investigated in the regional dimension on a global scale and the indicators were analyzed. Tendencies in the last four years were tested and overviews related to Serbia were given.

Key words: *Corporate fraud, internal audit, external audit, accounting, prevention.*

Introduction

Corporate fraud is a multidimensional topic that has the potential to harm not only the financial stability of a company, but also the trust and confidence of its stakeholders, including shareholders, employees, and the general public. This paper will delve into the various aspects of corporate fraud, the role of auditing in preventing and detecting fraud, and the measures that can be taken to mitigate the risk of fraud within corporate entities.

The first step is to understand the corporate fraud. Corporate fraud encompasses a wide range of illegal activities carried out by individuals within or associated with a corporation, with the aim of deceiving others for financial gain. These activities may include financial statement fraud, misappropriation of assets, bribery and corruption, insider trading, and other forms of so-called white-collar crime. Corporate fraud can have devastating consequences, leading to financial losses, reputational damage, and in some cases, the collapse of the affected organization.

Audit plays a significant function role in the prevention and detection of corporate fraud. External auditors are responsible for examining the financial statements of a company to provide an independent opinion on their accuracy and fairness. Through the process of auditing, potential red flags or irregularities that may indicate fraudulent activities can be identified. Internal auditors, on the other hand, are tasked with evaluating and improving the effectiveness of risk management, control, and governance processes within an organization. They play a key role in implementing measures to prevent and

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detect fraud within the company. The third pillar in this process is accounting function in the corporation with its established internal controls.

Preventing corporate fraud requires a comprehensive approach that addresses various aspects of corporate governance, internal controls, and ethical conduct. One of the fundamental measures is the establishment of a strong ethical culture within the organization, where integrity and accountability are valued and promoted at all levels. This can be achieved through the implementation of a code of conduct, ethics training, and the enforcement of disciplinary actions for misconduct. By group of authors in the book “inside Arthur Andersen - Shifting Values, Unexpected Consequences”, culture in the environment can be main trigger to conduct the fraud or justify it. On the other hand, from formal point of view, we have to put main attention to basic rules rather than concrete specific rules which can be in collision with main principles. The aim of this paper is not to go in psychological facts and to reveal that side of the reason of the fraud.

Additionally, the implementation of robust internal controls is essential in preventing fraud. This includes segregation of duties, regular monitoring of financial transactions, and the implementation of systems and procedures to detect and prevent unauthorized activities. Whistleblower hotlines and anonymous reporting mechanisms are important tools for early detection of fraudulent activities within the organization. We will show their significancy.

Despite preventive measures, corporate fraud may still occur. In such cases, the timely detection of fraudulent activities is crucial in mitigating the impact of fraud. Auditors and internal control mechanisms play a vital role in detecting fraud through the examination of financial records, transactional data, and other relevant information. Data analytics and forensic accounting techniques are increasingly being used to identify patterns and anomalies that may indicate fraudulent behavior.

Whistleblowers who report fraudulent activities within the organization can provide valuable insights and evidence that may lead to the uncovering of fraudulent schemes. Therefore, it is important for companies to establish a culture that encourages and protects whistleblowers from retaliation.

The regulatory and legal framework surrounding corporate fraud is designed to provide a deterrent to fraudulent activities and to hold individuals and organizations accountable for their actions. Governmental bodies are different in different legal environments and countries. One of the most famous is in USA and that is Securities and Exchange Commission (SEC) and the Department of Justice (DOJ) have the authority to investigate and prosecute cases of corporate fraud. The Sarbanes-Oxley Act of 2002, for example, introduced stringent requirements for corporate governance, financial disclosure, and the accountability of corporate officers, with the aim of preventing and detecting fraudulent activities.

In addition to regulatory measures, it is recommendable for companies to implement anti-fraud policies and procedures to comply with legal requirements and to ensure transparency and accountability in their operations. This may include conducting regular risk assessments, enhancing internal controls, and providing ongoing training to employees on fraud prevention and detection.

Methodology

In this study, the statistical method was used as the primary method. The scope of the research covered two periods for worldwide parameters, and these are frauds occurred in 2020 and four years later in 2024. For Serbia, due to slow reporting, middle year, 2022 was analyzed.

For analyze is taken number of cases, percentage of cases in each region, main fraud forms and main detection instruments.

The research hypothesis reads:

The volume and importance of corporate fraud is directly correlated with the established internal control and audit systems.

The hypothesis will be considered logical if there is lower number of fraud cases from year to year and if more of them are detected by management review and audit engagement.

Research results

On the yearly basis Association of Certified Fraud Examiners (further: ACFE) is issuing Report to the Nations. The aim of the paper is to compare results of the newest report in 2024 with the report from four years ago. Fraud types that are researched in the ACFE Report are: Corruption, Billing, Expense reimbursements, Noncash, Check and payment tampering, Payroll, Skimming, Financial statements fraud, Cash on hand, Cash larceny and register disbursements. Detection methods Report is covering are: Tip, Management review, Internal audit, By accident, Account reconciliation, Document examination, External audit, Monitoring, Notification by law enforcement, Confession, IT controls and Other.

For the purposes of this paper and the topic, leading three types of fraud are considered and main three types of detection methods.

Table 1. ACFE Report to the Nations 2024

2024				Fraud type			Detection			
Region	Number of cases	%	Median loss USD	Corruption	Billing	Financial statements	Tip	Management review	Internal audit	External audit
Asia-Pacific	183	11%	200.000	56%	21%	6%	48%	16%	13%	4%
Eastern Europe Western/ Central Asia	66	4%	200.000	71%	18%	5%	56%	9%	15%	6%
Latin America, the Caribbean	93	6%	250.000	55%	25%	4%	53%	15%	11%	5%
Middle East and North Africa	119	7%	163.000	55%	11%	8%	34%	11%	23%	2%
Southern Asia	124	8%	100.000	74%	22%	4%	49%	8%	14%	2%
Sub-Saharan Africa	299	18%	128.000	59%	21%	4%	49%	12%	10%	3%
USA and Canada	623	38%	120.000	35%	29%	3%	35%	16%	15%	3%
Western Europe	117	7%	181.000	53%	21%	7%	46%	15%	10%	3%
	1.624	100%								

Table 2. ACFE Report to the Nations 2020

2020				Fraud type			Detection			
Region	Number of cases	%	Median loss USD	Corruption	Billing	Financial statements	Tip	Management review	Internal audit	External audit
Asia-Pacific	198	10%	195.000	51%	15%	14%	44%	11%	15%	7%
Eastern Europe Western/ Central Asia	95	5%	133.000	61%	17%	10%	51%	9%	14%	2%
Latin America, the Caribbean	101	5%	200.000	51%	18%	19%	55%	9%	12%	4%
Middle East and North Africa	127	7%	100.000	52%	8%	7%	46%	9%	17%	3%
Southern Asia	103	5%	117.000	76%	17%	12%	48%	5%	18%	3%
Sub-Saharan Africa	301	15%	100.000	56%	19%	11%	48%	11%	14%	4%
USA and Canada	895	46%	120.000	33%	26%	10%	37%	15%	14%	4%
Western Europe	128	7%	139.000	37%	15%	11%	39%	12%	17%	3%
	1.948	100%								

General conclusion is positive impression due to decrease in the number of all cases. In both compared periods the highest number of cases is in region USA and Canada, but also decreasing from 895 in 2020 down to 623 in 2024 Report. Improvement in mentioned region is not only nominal, but also share of cases is decreasing from 46% down to 38%. It is also visible that there is increase in awareness of the fraud damage on the internal level, therefore in this region is increased percentage of detected frauds by management and internal auditors. It means that internal controls are improving and using potential to protect business entity from this negative phenomenon.

On the other side, the only region in which is detected growth in number of fraud cases is Southern Asia. The number of cases increased from 103 in the report for 2020 up to 124 in 2024 Report.

Ratio of detected frauds by management review is increasing during observed period. Namely, maximum share in 2020 Report was 15% and four years later there are two regions in the world where this share is 16%. This is not radical and significant growth but pointing out the importance of internal controls as detection and prevention process.

Similar trend is also noticeable with internal audit. In the report for 2020 maximum ratio of detected frauds by internal audit is 18% and it increased up to 23% in the 2024 Report.

Primary aim of external auditors is to express opinion on financial statements, not to deal with potential frauds. That is illustrated through ratio of detected fraud by external auditor with maximum share of 7%.

This information indicates that the hypothesis is logical, and that fraud detection and prevention is correlated with internal controls integrated in management, financial management or accounting function, and with internal audit as additional instrument.

Republic of Serbia is part of region Eastern Europe and Western/Central Asia and follows trend of the region. In that region number of cases decreased from 95 to 66 and in concrete county, Serbia, from 14 to 2. Based on the register which is maintained by Serbian Chamber of Certified Auditors as local member of IFAC there are (as of June 2024) 379 certified auditors and 178 certified internal auditors. This number is growing on continuous basis and can be said that it is improving reporting systems and, same as in other parts of the world, these professionals are contributing to the detection and prevention of corporate frauds.

If we make deeper insight of criminal charges in Serbia based on commercial cases, the report for 2022 as the newest one is providing the following data:

Table 3. Announcement of the Republic Institute of Statistics No. 184 of 14.7.2023

Criminal offenses (year 2022)	Total	Percentage
Against the economy	1.921	100%
Falsification and misuse of payment cards	485	25,2%
Tax evasion	397	20,7%
Illegal trade	184	9,6%
Insurance fraud	160	8,3%
Abuse of the position of a responsible person	135	7,0%
Unauthorized use of someone else's business name	88	4,6%
Counterfeiting money	85	4,4%
Embezzlement in the performance of economic activity	83	4,3%
Money laundering	62	3,2%
Fraud in the performance of economic activity	53	2,8%
Disclosure of trade secrets	35	1,8%
Unauthorized production	34	1,8%
Concluding restrictive agreement	18	0,9%
Abuse of trust in the performance of economic activity	15	0,8%
abuse in connection with public procurement	12	0,6%
Damage to creditors	12	0,6%
Smuggling	12	0,6%
Abuse of power in the economy	12	0,6%
Forgery of securities	11	0,6%
Non-payment of withholding tax	9	0,5%
Accepting bribes in the performance of economic activity	5	0,3%
Disabling control process	4	0,2%
Damage to business reputation and creditworthiness	4	0,2%
Causing bankruptcy	3	0,2%
Falsification of signs	2	0,1%
Forging signs for value	1	0,1%

Conclusion

In conclusion, corporate fraud poses a significant threat to the integrity and stability of organizations, as well as the broader financial system. The prevention and detection of corporate fraud require a multifaceted approach that involves ethical leadership, robust internal controls, effective auditing, and a strong regulatory framework. By implementing measures to prevent and detect fraud, and by fostering a culture of integrity and accountability, companies can mitigate the risk of fraudulent activities and uphold the trust of their stakeholders. It is imperative for organizations to remain vigilant and proactive in addressing the challenges posed by corporate fraud, in order to safeguard their reputation and long-term sustainability.

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KORPORATIVNE PREVARE, SPREČAVANJE I OTKRIVANJE REVIZIJE

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Apstrakt

Ovaj rad se bavi korporativnim prevarama, njihovim pojavnim oblicima kao i načinima na koji su otkrivene. U radu su objašnjene funkcija i uloga profesionalnih računovođa u prevenciji i detekciji ove pojave, odnosno u vezi sa prevarom su stavljane interna revizija, eksterna revizija i interna funkcija računovodstva. Obim i vrsta prevara su istraživani u regionalnoj dimenziji na svetskoj razmeri i analizirani su pokazatelji. Testirane su tendencije u poslednjih četiri godine i dati su pregledi vezani za Srbiju.

Ključne reči: *Korporativna prevara, interna revizija, eksterna revizija, računovodstvo, prevencija.*

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