FINANCIAL REPORTS – AN INSTRUMENT OF PERPETRATION AND DETECTION OF FRAUDULENT ACTIONS

Dragan Cvetković, PhD[1]
Faculty of Business Economics and Entrepreneurship, Belgrade, Serbia

Zvezdan Đurić, PhD
Belgrade Business and Arts Academy of Applied Studies, Belgrade, Serbia

Milena Škobo, PhD
Faculty of Philology, Sinergija University, Bijeljina, Bosnia and Herzegovina

Introduction

Financial reports represent a key source of information for investors, creditors, lenders, and other interested parties who base their investment and business decisions on them. Users of financial information expect reliable financial reporting as a foundation for making rational economic choices. The importance of making various business decisions related to the activities of modern business entities has necessitated the establishment of a purposeful and efficient information system geared towards satisfying the numerous informational needs of different users. An essential component of every enterprise's information system is the information contained within financial accounting. The informational significance of financial reports, as a relevant, publicly available, and comprehensive source of information for numerous stakeholders, has led to the quality of these statements becoming a current topic of crucial importance at all levels: global, national, and the level of individual reporting entities.

The issue of financial reporting is nowadays regulated by legal provisions, appropriate accounting standards, and professional regulations in the majority of countries. Despite the awareness of the importance of ensuring the quality of financial statements and all activities aimed at supporting this requirement, practical experiences with numerous financial scandals, accompanied by investor losses, have seriously shaken the confidence of investors and the accounting community in the quality and reliability of financial reporting. This has dealt a severe blow to the accounting profession, indicating that questions of the truth and reliability of accounting reports remain open. A common factor among the majority of financial scandals that have occurred in the past decades is that they arose and/or were accompanied by manipulations in financial statements, resulting from the intentional distortion of information or the exploitation of weaknesses in accounting standards and internal controls. They are characterized by various inadequate accounting techniques and by non-compliance with legal and professional accounting regulations.

When it comes to the relationship between financial statements as the ultimate product of accounting and fraudulent activities, financial statements, as well as accounting as a whole, can play a dual role. They can be used as a means/instrument for committing fraudulent activities, but they are also a very effective tool for the detection and prevention thereof. There are various types of fraud, and each of them leads to specific harmful consequences. Whether it is financial/material loss, a drop in stock

1 dragan.cvetkovic@vspep.edu.rs

prices, or the tarnishing of a company's image and reputation, these detrimental outcomes highlight the need to give special attention to fraud, particularly to the process of its timely detection and prevention. It should be emphasized that the exact amount of loss and the frequency cannot be precisely determined, because many frauds are not identified or detected.

The Association of Certified Fraud Examiners (ACFE) conducted a study and found that companies lose 5% of their annual revenues due to fraud (ACFE, 2022:4). The three key forms of fraudulent activities highlighted include embezzlement, corruption, and financial statement fraud (which could arguably be the most comprehensive classification of fraud in business). No company or country in the world is immune to any of these forms of fraud. In fact, within every company, regardless of its size, industry, or scope of operations, all three forms of fraud can occur and coexist. Financial statement fraud, also known as falsifying financial statements, is the most sophisticated and rarest form of fraud (around 9% occurrence), but simultaneously the most damaging. According to this research, as many as 12% of fraud perpetrators are employed in the accounting sector (ACFE, 2022:5).

The fact that financial statement fraud is the least detected highlights the importance of the process of detection and, particularly, prevention of this type of fraud, which individually causes the greatest financial loss. This is significant not only for business entities but also for the broader community of each country due to the potential spillover of financial losses.

The loss of trust from users of information and stakeholder groups presented in financial statements has immeasurable negative consequences on financial markets, the economy, and both the macro and micro levels of a country's economy. As a result, there is a need primarily for the state institutions, as well as professional organizations and institutions, to do everything in their power to prevent the creation and presentation of false financial statements to the greatest extent possible.

Purpose

In the light of pervasive accounting manipulations, it has become of paramount importance to develop effective tools for detecting potentially dishonest and unlawful practices in financial reporting. The far-reaching implications of accounting fraud have led to the need for increased protection of investors' and other stakeholders' interests, prompting the development of forensic accounting as a distinct type of accounting focused on preventing and uncovering fraud in financial statements.

Indeed, to overcome situations where suspicions arise about the presence of fraud in financial statements, the accounting profession and regulatory bodies have deemed it necessary to identify, investigate, and penalize all instances of fraud in financial reporting through the involvement of forensic accountants. The primary goal of forensic accounting is to employ legally permissible procedures and means to investigate, prove, and initiate the process of penalizing fraud in financial statements. The responsibility of a forensic accountant includes a thorough examination of suspicious transactions within a business entity and the collection of evidence that either confirms or refutes indications of fraud. Forensic accountants utilize various methods and techniques to successfully identify fraud and detect falsified financial statements.

Apart from the introductory and concluding considerations, the paper comprises three additional sections. The first section is dedicated to discussing the importance of financial reporting. Subsequently, in the second section, the focus will be on defining the concept and types of fraud that can occur in financial statements and accounting, accompanied by illustrating the most common manipulations of financial statements through creative accounting techniques and their basic consequences. The is-

sues of detecting and preventing fraudulent activities are addressed in the third section, within which forensic tools utilized in the investigation of fraudulent activities are explained, as well as the significance of forensic accounting as a distinct branch of accounting.

Importance of Financial Reporting

Financial statements, as the ultimate outcome of the accounting information system, serve a diverse range of users, including shareholders, managers, government entities, unions, creditors, lenders, and others. Users of financial statements expect the presented financial information to be comprehensible, trustworthy, comparable, and to accurately reflect the actual state of the reporting entity within a specific time period (Higgins, 2009).

Financial statements are prepared with the aim of providing information about the financial position (balance sheet and statement of changes in equity), operating results (income statement, statement of cash flows, and statement of changes in equity), and cash flows (statement of cash flows) to a wide array of different users. Financial statements also reveal how well management has handled the resources entrusted to them by shareholders. The foundation of financial reporting worldwide consists of the balance sheet and income statement as traditional reports. In Serbia, in addition to these two reports, legal regulations prescribe some other statements.[2]

The basic goal of finance, and thus of accounting, is to make all business transactions transparent and to express their consequences for the property, financial and profitability position of the company in a clear and objective manner in the financial reports. In other words, the main goal of financial reports is to provide accounting information about the entity's financial position, the state of assets and liabilities, and the success of operations, which can be useful to a large number of different users when making financial decisions. (Cvetković & Bošković, 2018: 78).

The quality of financial reporting necessarily relies on professional ethics and education within the accounting profession, specifically professional accountants. To cater to the diverse information needs of numerous users, financial statements must possess qualitative characteristics in accordance with the provisions of the Conceptual Framework for Financial Reporting by the International Accounting Standards Board (IASB).

All the qualitative characteristics of financial statements, which are the attributes that the information contained within them must have in order to be considered useful for decision-making, are classified into two categories within the Framework: " Fundamental qualitative characteristics, including relevance and faithful representation, and Enhancing qualitative characteristics, which improve the fundamental qualitative characteristics and include comparability, verifiability, timeliness, and understandability" (Dimitrijević, 2013: 29).

Based on the aforementioned, it follows that the fundamental purpose of financial statements is to provide understandable and relevant information to a wide range of users. They have become an important and indispensable source of information for numerous investors, creditors, employees, and governments in the process of making allocation decisions. The significance of financial reporting should be viewed from a broader economic perspective, i.e., from a societal standpoint rather than solely from the viewpoint of individual users. This suggests that financial reporting, in addition to

2 According to Article 29 of the Accounting Law, financial statements include: the balance sheet, the income statement, the statement of other comprehensive income, the statement of changes in equity, the statement of cash flows, and the notes to the financial statements ("Official Gazette of RS", nos 73/2019 and 44/2021 - official consolidated text).

other relevant factors, should serve the purpose of ensuring societal well-being as the primary goal of the community.

Design/Approach

Fraud – Term, Types and Manipulations Using Creative Accounting

Defining Fraud

Fraud includes a wide variety of manifestations characterized by deliberate deception or misrepresentation, all with the aim of obtaining illegal benefit for an individual or an organization, whereby the perpetrators of the fraud can be outside or inside the organization. The term 'fraud' describes actions such as deception, forgery, extortion, corruption, theft, embezzlement, misappropriation, providing incorrect information, hiding material facts, misrepresentation, collusion, etc., which result in material benefit for the perpetrator, organization or another, and to the detriment of the organization, individuals, community, etc. In practice and literature, the following terms are used for this and related phenomena: "fraudulent acts", "criminalization of acts", "criminal acts", "illegal activities", "malfeasance", "manipulations", "deceptions", "embezzlement and irregularity", etc. (Knežević, Mitrović & Cvetković, 2019: 102).

In the literature there are many different definitions of fraud. One of them states that "fraud is a fraudulent action in the business environment, intentional deception, misuse of company property or manipulation of its financial data in favour of the perpetrator". Fraud can also be defined as "an intentional act that results in a material misrepresentation (Knežević, Mitrović & Cvetković, 2019).

Frauds can also be defined as intentional acts committed by one or more individuals, including management, employees, or third parties, which result in the presentation of false information in financial statements and accounting records. The actions that qualify as fraud or related criminal activities include manipulation, forgery, or alteration of documents and records, misappropriation of assets, preventing or causing the misreporting of business transactions both in documentation and records, recording events that did not occur, and incorrect application of accounting policies. What is common in all these definitions is that the motive or intention of an individual in making accounting entries is not the primary focus.

A criminal activity refers to an intentional action involving the acquisition of unlawful gain and/or advantage through deception or misleading, carried out by one or more individuals from the ranks of management, supervisory board, employees, or a third party. Frauds appear in various forms and degrees of severity, and they always have a negative impact on all societies. The scale and intensity of fraud depend on the effectiveness of control mechanisms, the severity of prescribed penalties, and the ability to enforce them.

Types of Fraud

Each form of criminal activity harms or jeopardizes certain societal values. All of these values manifest through corresponding social relationships. For every type of delinquent behaviour, especially criminal behaviour, it is characteristic that it attacks specific social relationships, and by not sanctioning it, certain social relationships suffer damage, along with certain activities, processes, and values within them (Milošević & Cvetković, 2012). There are numerous classifications regarding what constitutes

fraud. An interesting classification is the one presented in a distinct format known as the "Fraud Tree," provided by the Association of Certified Fraud Examiners - ACFE. This model categorizes individual frauds into categories, subcategories, and microcategories. This division is performed through three main groupings that are further dissected. The three key groups/categories are as follows (Cvetković & Kešetović, 2018: 47):

- Corruption;
- Misappropriation of property;
- Fraudulent financial reporting.

Corruption

Corruption is a socially negative phenomenon that generally encompasses all criminal activities carried out for personal gain by abusing authority in both the public and private sectors. The term corruption (Latin) signifies spiritual and moral depravity, complete disregard for honour and dignity, offering or accepting money to neglect a duty or act against one's conscience.

Corruption often occurs without written traces in accounting and other business documentation that could provide evidence (Đurić, Cvetković & Đurić, O., 2022). According to the ACFE's "Fraud Tree," corruption can be further divided into: conflict of interest, bribery, illegal structures, and extortion. According to ACFE's research, corruption is involved in a third of all fraud cases (ACFE, 2022).

Misappropriation of Property

Misappropriation of property is this form of occupational fraud most commonly constitutes an internal fraudulent activity, carried out by employees within organizations, often in collusion with other individuals. Misappropriation of assets encompasses a variety of fraudulent activities falling within this category. A common characteristic is the theft of cash or other property from a company. The practice has shown that misappropriation of assets mostly includes: cash theft, false disbursements, inventory fraud, equipment and inventory schemes, fraudulent sales, and asset misuse. According to the ACFE's annual report, misappropriation of assets is by far the most common type of fraud, accounting for 86% of all reported cases.

All of the previously mentioned groups of fraud are subject to investigation by various forms of control (internal and external audits, forensic accounting, government tax authorities, etc.), and each form of fraud carries its own severity and resulting harm. However, within the scope of this work, greater attention will be directed towards financial statement fraud, as it is the most commonly investigated form of fraud.

Findings

Fraudulent Financial Reporting

Fraudulent financial reporting involves intentionally misrepresenting or omitting amounts or disclosures in financial statements to deceive users of the financial statements, which can result in administrative, civil, and criminal actions. False financial statements have existed as long as financial reporting itself. Frauds involving manipulative or false financial statements are not a recent phenomenon but a

longstanding issue that has escalated in recent times. Financial statement fraud, or the manipulation of financial statements, is the most sophisticated and rarest (about 9%) form of fraud, but it is also the most damaging. According to this research, as many as 12% of fraud perpetrators are employed in the accounting sector (ACFE, 2022:5).

According to international audit standards, financial statement fraud is a criminal act characterized by the intentional misrepresentation or omission of specific data or disclosures in financial statements (Škarić-Jovanović, 2011). ACFE defines financial statement fraud as "the intentional misrepresentation of material facts or accounting data that leads to incorrect decisions by users of financial information presented in financial statements" (Zabihollah, 2002:2). The American Institute of Certified Public Accountants (AICPA) defines financial statement fraud as "intentional inaccuracies or omissions of amounts or disclosures in financial statements to deceive users of the financial statements" (Dimitrijević, 2015:139).

In this type of fraud, financial statements are not presented fairly and accurately in accordance with the generally accepted accounting principles and the framework for financial reporting. Financial statement fraud can involve the following situations (Soltani, 2009:534):

- Manipulation, forgery, or alteration of accounting records and supporting documentation on which the preparation of financial statements is based.
- Misrepresentation or intentional omission of business transactions or other significant information in financial statements.
- Intentional misuse of accounting principles related to amounts, classification, presentation, or disclosure.

Financial statement fraud is most commonly committed by managers within organizations in both the public and private sectors, often in collusion with other individuals. Therefore, the responsibility for preparing false or fraudulent financial statements lies with the organization's management.

The objective of financial statement fraud is to deceive users of financial statements and gain benefits for the company at the expense of investors, creditors, and other users of the financial statements by presenting inaccurate financial and performance positions of the company. In other words, financial statement fraud occurs to achieve financial gain, concealment, or improper appropriation of funds or to satisfy stakeholders' interests under various circumstances.

From the perspective of researching financial statement fraud, special importance lies in the concept of "creative accounting", which represents another side of accounting. Creative accounting involves the use or abuse of accounting techniques and principles to present financial results that intentionally deviate from a fair and truthful representation (Oregan, 2006).

In practice, creative accounting generally carries a negative connotation: "ironing out" taxes, "window dressing" profits, "falsifying" financial statements, "cosmetic" accounting, or financial engineering (Knežević et al., 2013). The term "creative" is used to highlight the opposite of "consistent" and "conservative" in accounting principles, often used as a kind of cynical remark for managers who secretly enhance financial statements by not adhering to established accounting practices and norms (Ling-Feng et al., 2005).

It can be said that creative accounting involves practices and methods that utilize accounting knowledge from accounting standards and principles to manipulate balance sheet positions and their values as presented in financial statements in order to achieve various objectives. As a result, there may or

may not be a violation of legal and professional regulations. If there is a violation of legal and professional regulations, then we can say that creative accounting evolves into financial statement fraud.

The intention to deceive users of financial statements, primarily existing and potential investors, creditors, and the government, in order to influence decisions that benefit the management and the company while being harmful to those stakeholders, is carried out by the management through presenting false or, more commonly, manipulated financial statements. The techniques used for manipulating financial statements are collectively referred to as "creative accounting," and in the literature, they are described as follows (Belak, 2011:146):

a) Earnings Management involves actively manipulating earnings to achieve a predetermined and desired amount set by the management, based on predictions provided by managers, accountants, or analysts, in order to maintain a sustainable trend in earnings.
b) Aggressive Accounting involves the deliberate selection and application of accounting principles and procedures to achieve a desired outcome, usually the presentation of higher earnings, regardless of whether these procedures comply with standards and professional rules. A significant portion of aggressive accounting falls within the realm of financial statement fraud. Common practices of aggressive accounting include aggressive capitalization and overstated revaluation. Additionally, this category may encompass tactics such as inflating expenses by offsetting fictitious items on the debit side, reducing reserve items to boost income, and fictitiously offsetting customer and supplier accounts without a basis in actual business events.
c) Earnings (Income) Smoothing involves manipulating earnings to achieve consistent profit amounts across consecutive time periods. This is achieved by not recognizing a portion of profits in profitable periods, instead deferring them as latent reserves to be used and distributed in periods when desired profits are not achieved.
d) Fraudulent Financial Reporting involves intentionally misrepresenting or omitting amounts or disclosures in financial statements to deceive users of financial statements, potentially resulting in administrative, civil, and criminal actions. Examples of fraudulent financial reporting can include creating false invoices, off-the-books sales, charging expenses to assets or inventory, fictitious sales to related entities, falsifying expense reports, hidden profit distributions, misusing company funds for personal purposes, and more.

Fraudulent financial reporting is often manifested in the following five interconnected forms (Wells, 2004:359): fictitious revenues; false timing differences; concealment of liabilities and expenses; improper disclosures; and other techniques of fraudulent financial reporting.

Recognizing the use of inappropriate procedures in the preparation of financial statements requires both understanding their nature and their interconnectedness. While all practices of creative accounting ultimately result in inaccurately presenting a company's net assets and results, some of them could be considered less harmful, even benign, while others constitute actual fraud.

Manipulation of Financial Statements Using Creative Accounting and Its Consequences

False financial reporting arises as a result of inaccurately presenting data in financial statements. Past practices have shown that most manipulations in financial statements occur by manipulating expenses and revenues in the Income Statement and manipulating liabilities and assets in the Balance Sheet. Through false financial reporting, management can influence (Dimitrijević, 2013:69):

- the amount of reported profit, i.e., the income statement;
- the amount of reported net assets, i.e., the balance sheet;
- the amount of reported net cash from operating activities.

False financial reporting can manifest in two directions: presenting a worse asset-financial position and a lower financial result, or presenting a better asset-financial position and a higher financial result.

The basic forms of accounting manipulation are:

1. Revenue recognized before service is provided; revenue recognized before the customer confirms receipt of goods; revenue recognized even when the customer has no payment obligation; sale of invoiced goods to a branch; offsetting an obligation with a customer and booking the offsetting entry as revenue.
2. Cash received from credit recorded as revenue; investment gains recorded as revenue.
3. Boosting profit by selling undervalued assets; including investment gains as part of revenue; reducing costs by showing investment gains; creating profits by rearranging balance sheet positions.
4. Segmenting normal operating costs; changing accounting policies to show current costs as prior-period costs; slow amortization of costs; avoiding writing down value or disposing of unused assets.
5. Omitting expenses and obligations that should be recognized; decreasing obligations by changing accounting assumptions; showing doubtful reserves as revenue; creating fake discounts; recognizing revenue when cash is received even though future obligations remain.
6. Creating reserves and showing them as revenue in the next period; improperly holding back revenue before finalizing an acquisition.
7. Inflating the amount of special costs; misrepresenting research costs related to restructuring the company.

The mentioned forms of fraud result in significant direct losses suffered primarily by investors, but also in an irreparable loss of trust, from which the accounting profession and the financial reporting system are still recovering. Regardless of the specific form of occurrence, fraud typically involves several essential elements:

1. Incorrect presentation of facts essential for making business decisions.
2. Awareness of individuals that the presented data is false.
3. Recipients of the information treating it as reliable and relevant for business decisions.
4. Occurrence of harm in business operations as a consequence of the above elements.

The application of creative accounting almost always leads to a decrease in the market value of the business entity. The damages arising from presenting false financial statements encompass losses due to misguided decisions and a loss of trust from investors, creditors, and other users of financial statements. Possible negative implications include (Petrova, 2008):

- Reduced reliability, quality, transparency, and integrity of the financial reporting process.
- Risk to the integrity and impartiality of the auditing profession, auditors, and auditing firms in particular.
- Diminished confidence of the capital market in the reliability of financial information.
- Decreased credibility of the capital market.
- Negative impact on national economic development and prosperity.
- High legal costs.

- Ruined careers of individuals involved in false financial reporting.
- Bankruptcy and significant economic losses for companies engaged in false financial reporting.
- Need for regulatory intervention.
- Disruption of normal operations and activities of accused companies.
- Serious doubts about the effectiveness of financial statement audits.
- Diminished public credibility and trust in the accounting and auditing profession.

The fact is that false financial reporting, although less frequent in terms of cases, inflicts disproportionately greater damage on users compared to those caused by misappropriation of assets. It harms investors, creditors, lenders, and society as a whole by eroding trust in financial reporting, thereby increasing the cost of capital, slowing the development of financial markets, and consequently impeding overall economic growth.

In the previous discussion, the use of financial statements and accounting as a means of perpetrating and/or concealing fraudulent activities (such as falsifying financial statements and misappropriating assets) was presented. In the upcoming section of the paper, financial statements and accounting documentation will be demonstrated as an effective tool in detecting fraudulent activities.

Discovery and Prevention of Fraud – Forensic Accounting Aspect

Forensic Tools in Fraud Detection

In response to the numerous accounting frauds and their consequential impacts on enterprises, companies, and society as a whole, forensic accounting has emerged as a distinct branch of accounting. Various instances of financial scandals in the past have highlighted the deficiencies and limitations of traditional auditing in detecting fraudulent activities, thus necessitating the adoption and further development of forensic accounting. This expertise has become crucial in the investigation and discovery of various forms of fraudulent activities. The main reasons contributing to the emergence of forensic accounting are the protection of existing assets and the identification of methods used in committing criminal acts. It is evident that forensic accounting has evolved as a separate discipline in response to various historical instances of fraud.

Forensic accounting involves the application of accounting expertise to prevent and uncover various forms of fraudulent activities within businesses, as well as to gather evidence that will be admissible in legal proceedings. The evidence is collected through forensic analysis in such a manner as to be acceptable in court for prosecuting offenders. As a result, forensic experts and their specialized knowledge become an integral part of enhancing and making the fight against financial crime even more effective.

Among the various definitions existing in the professional literature focused on forensic accounting, the most widely accepted and comprehensive is the one endorsed by the Association of Certified Fraud Examiners (ACFE). According to ACFE, forensic accounting entails the use of accounting skills in actual or potential civil or criminal litigation, including the application of generally accepted accounting and auditing principles, to determine lost profits, income, assets, or damages, assess the effectiveness of internal controls, uncover fraud, or perform other activities that require the integration of accounting expertise into the legal system (Čudan & Cvetković, 2019:43).

Detecting false financial reporting can be challenging but not impossible. While prevention of fraud is undoubtedly a better solution, it is important to consider appropriate activities and measures that

can aid in uncovering such fraudulent activities. During the investigation of potential fraud, forensic accountants are confronted with a vast amount of data that needs to be collected, compared, and analysed. Forensic accountants leverage their accounting knowledge along with audit techniques, investigative skills, and other expertise to detect fraud.

During the investigation of possible fraud, forensic accountants employ various techniques to analyse the relationships among elements of financial statements. These analyses are used for a more in-depth examination of business transactions if the initial analysis of financial statement elements indicates the possibility of fraud. Analytical procedures in forensic accounting are typically applied in phases, ranging from the most general to the most direct. Each segment of analysis has its specific objectives, such as (Grupa autora, 2021:24):

- *Preliminary Analytical Procedures*: These are the most general procedures used to identify areas of high fraud risk, gain insights into the nature and timing of manipulations, and assess the level of necessary forensic procedures for their substantiation.
- *Independent Analytical Procedures*: These procedures are used to gather evidence through comparisons and reconciliations of specific data, verifying the credibility (accuracy) of documentation, bookkeeping, and calculations.
- *Final Analytical Procedures*: These are the most direct procedures used to draw conclusions about the impact of problematic transactions on financial statements.

Detecting financial manipulations represents a complex challenge, which has led to the development of various models and methods for identifying potentially dishonest practices in financial statements. The most common techniques employed by forensic accountants are based on different financial analysis or data analysis techniques presented in financial statements, such as:

- Horizontal Analysis: This method involves comparing items in financial statements from the current period to the same items from the previous period.
- Vertical Analysis: This approach compares the percentage shares of individual items in financial statements.
- Comparing Detailed Items: Forensic accountants compare specific items in financial statements to the same or similar items from previous periods.
- Ratio Analysis: This technique involves analysing financial statement ratios in areas such as profitability, liquidity, solvency, activity, and value creation.

Forensic accounting, in addition to the mentioned techniques of traditional accounting used in the process of investigating fraud in financial statements, also extensively employs specific techniques:

- *Benford's Law*: This law demonstrates the likelihood of a specific digit appearing in the correct position within a number. The essence of Benford's Law is that certain digits occur more frequently than others in datasets.
- *Beneish Model:* This model is used to assess the potential degree of fraud in financial statements based on eight variables (indexes). The model measures the probability that a company manipulated reporting by calculating various indexes that indicate the degree of change between different positions in financial statements. A higher M-Score value indicates a higher likelihood of financial statement manipulation.
- *Computer-Assisted Audit Techniques (CAATS)*: CAATS represent the practical application of information technology in forensic audit tasks related to financial statements.

- *Data Mining Techniques:* These techniques are designed to automatically search through large volumes of data to find information that aids in fraud detection. By utilizing data mining techniques, forensic accountants can conduct in-depth examinations of irregularities within all data, not just samples.
- *Ratio Analysis:* Ratio analysis plays a significant analytical role in forensic investigation. Each ratio serves as a reliable clue in uncovering potential fraudulent activities. Ratio indicators from different reporting periods visible in the balance sheet and income statement can signal potential issues. The results pinpoint areas where the most likely problem lies, making ratio analysis useful for detecting fraudulent activities in financial statements.
- *Altman Z-Score Model:* This model combines multiple financial indicators to assess the likelihood of a company's bankruptcy. Although different from the Beneish M-Score model, both models share the common goal of identifying potential risks based on financial indicators.
- *DuPont Analysis*: DuPont analysis breaks down the overall return on equity into various components to identify key factors contributing to financial performance. This method can help uncover inconsistencies and potential manipulations in financial statements.
- *Statistical Methods*: Statistical methods, such as anomaly detection and regression analysis, are also used to detect potential financial manipulations. These methods can identify irregularities in relationships between different financial indicators.
- *Accounting Audit Procedures:* Accounting audit procedures, including trend analysis, ratio analysis, and testing for materiality, are part of the standard procedures employed by accounting auditors to identify potential manipulations.

The approach to investigation and the selection of forensic tools and techniques depend on whether it is a preventive investigation or an investigation into an already detected fraud. In the former case, forensic experts conduct proactive examinations to uncover possible irregularities. If unusual trends are identified through a general review, the forensic analyst proceeds to test suspicious balance positions and conducts detailed investigations to gather relevant evidence that would support or dismiss suspicions of fraud. On the other hand, investigating suspected fraud entails a more direct approach, focusing immediately on searching for evidence in a precisely defined area.

It is important to note that forensic methods and financial statement analyses, by themselves, do not incriminate anyone or prove the existence of accounting fraud and manipulations. They merely serve as indicators of potential financial irregularities in one or more business areas. They are not definitive proof of manipulation; instead, they provide indications of potential fraud in financial statements.

Fraud Prevention

Fraud is best detected in details, as it exploits vulnerabilities in the organization's control systems. Therefore, the serious impact of fraud on profitability, corporate reputation, and ethics requires the identification and implementation of effective mechanisms to eliminate such fraudulent practices. The goal of every mechanism for fraud prevention is not only its detection, as most experts in the field of fraud research agree that, in the long run, preventing fraud in financial statements is a better solution than detecting it. While detecting fraud is important, it is evidently better to mitigate or minimize fraud – in other words, to prevent it to the greatest extent possible. Detection is inevitably linked to fraud prevention, and both aspects together provide a system for fraud control. To aid in preventing fraud in financial statements, top management should establish a positive control environment.

Studies have shown that organizations with a strong control environment are less susceptible to false financial reporting.

To establish such an environment, members of the board of directors and the audit committee need to express and communicate the correct attitude toward internal control and the financial reporting process, including demonstrating high integrity and positive ethical values. This also requires active involvement in the company's day-to-day operations and frequent meetings dedicated to reviewing ongoing activities and the company's performance. An effective system of internal control implies, or includes, a reliable accounting system, adequate control policies and procedures, and policies to ensure proper asset protection. It also requires well-defined accounting and financial reporting policies (Stefanović, 2000:9).

Completely eliminating or even reducing to an acceptable level all risks of criminal activities might necessitate implementing extensive or complex controls, which could be unjustified in terms of costs or hinder smooth business processes (Đurić & Cvetković, 2022). The most common forms of control used by internal control in its work are: preventive control - focused on safeguarding the company's assets and financial data in an attempt to prevent fraud; investigative control - aimed at investigating fraud as soon as possible; corrective control - includes activities aimed at finding a solution to detected fraud to prevent future fraud. The effectiveness of internal control depends on several factors, the most important ones being: a developed control environment, a developed accounting system, control activities, regular monitoring, and a developed system of communication among employees.

The control environment is established by the management through its authority, organizational capabilities, and communication with employees, and it represents the overall image of the company. This component is crucial in establishing a good system of internal control. One of the elements of preventing fraud in business is creating a so-called fair business environment, in which employees adhere to ethical principles, where the company's objectives, not personal ones, are the priority for the management, and where employees' work is valued and respected, with constant monitoring of their work and behaviour.

Creating a business environment that prevents fraud begins with establishing policies and procedures within the company. Based on these policies, internal control is set up in the company, and it is established which actions and transactions are not ethical.

Continuous training of employees about the dangers of fraud is also an important preventive component, primarily aimed at developing employees' awareness of what is considered acceptable moral behaviour and what is unacceptable. Employees, especially those working with financial information, need to be trained to recognize signs of possible fraud and know how to act in such situations. Employees should be familiarized with types of fraud, fraud indicators, methods of preventing fraud, and reporting detected fraud. The goal is to raise employees' awareness of the negative repercussions of fraud and to make employees understand that preventing fraud is important for them as individuals as well as for the company as a whole.

In addition to the aforementioned general preventive measures to prevent fraud, many organizations also employ other specific preventive measures, such as video surveillance, continuous monitoring, legal/disciplinary procedures, conducting frequent and unannounced audits (e.g., independent audit of financial statements by authorized auditors provides an additional layer of credibility and helps detect potential fraud), background checks, and more (Singleton et al., 2006:186).

Conclusion

The aim of preparing, presenting, and auditing financial statements is to provide clear, understandable, reliable, and comparable information about the financial position and performance of a company, primarily to protect the interests of investors and creditors. Despite continuous efforts at both domestic and international levels, the possibilities of fraud committed through financial statements and accounting have not been completely eliminated.

Fraudulent activities such as corruption, misappropriation of assets, and falsified financial statements exist in all countries. Factors such as underdeveloped financial markets, inadequate institutions for overseeing the quality of financial reporting, and low living standards largely contribute to the prevalence of these types of fraud.

Corruption, often referred to as the "cancer of society," and a phenomenon that directly hampers a country's development, usually does not involve financial statements. Financial statements and accounting can only provide indications that corruption may exist, but complete transparency in a company's operations, which accounting certainly contributes to, can influence its reduction.

Misappropriation of assets, the most common form of fraudulent activity, is often concealed with the help of financial statements and other accounting products. At the same time, financial statements, as the primary output of accounting, serve as a powerful tool for detecting misappropriations. Given that this form of fraud primarily harms the company where the criminal activity occurs, management and owners have a strong motivation and interest in establishing proper organization that prevents conflicts of interest, timely prescribed procedures for all activities, a well-developed quality internal control system, and careful employee selection to minimize or eliminate this type of fraud.

False financial reporting is a significantly less common form of fraudulent activity, as shown by ACFE research, but the damage to stakeholders is disproportionately greater compared to misappropriations. False financial reporting causes harm not only to the company engaging in creative accounting, but also to investors, creditors, lenders, business partners, and the society at large. This type of fraud leads to a loss of trust in financial reporting, which raises the cost of capital, hinders the development of financial markets, and consequently slows down overall economic growth. As a result, preventing and detecting financial statement fraud is imperative for regulatory bodies, professional accounting and auditing organizations at the national level, as well as various international organizations.

Financial statements are crucial tools for detecting fraud in business. Although the statements themselves cannot directly uncover fraud, they can provide indications and warnings about potential irregularities that might signal fraudulent activity. They serve as forensic tools for identifying suspicious activities or irregularities, and it is necessary to conduct detailed analysis and additional forensic accounting procedures to confirm suspicions and provide evidence of fraud. In such cases, the involvement of forensic accountants can be extremely useful in identifying potential fraud.

Based on the above, it can be concluded that financial statements and accounting can have a dual role. On one hand, they can be used as a means of executing and/or concealing fraudulent activities (falsifying financial statements, misappropriation of assets). On the other hand, they can be used as effective instruments for detecting fraudulent activities (financial analysis, Beneish's model, Benford's law, Altman Z-Score model, etc.).

In general, financial statements represent a snapshot of a company's health. They showcase the company's ability to grow and continue its operations successfully. Simultaneously, they highlight areas of

concern that require specific business decisions to overcome challenges and achieve business goals. They also serve as a valuable resource in the fight against financial manipulations. Hence, further research and enhancement of forensic models and techniques are needed to contribute to more precise detection of financial manipulations. Transparent financial reporting and the active application of such tools can significantly contribute to protecting investors and upholding the integrity of the capital market.

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