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Usefulness of Financial Statements and Annual Reports in the process of Accounting Fraud Detection

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*Abstract. E*arly detection and subsequent prevention of accounting fraudulent activities are basic assumptions of healthy working economic environment. They are enforced by both governments and audit companies. Audit procedures, however, were not originally designed to uncover accounting frauds, but this issue has been already reflected in current audit & control procedures. The topic of financial statement misstatement has become of great interest by academic and research community. The main objective of this scientific paper is to present a comprehensive view on possible forms of fraudulent activities concerning financial statements, to examine and systemize theoretical concept of the creative accounting, aggressive accounting and fraud and to summarize or propose possible procedures to detect accounting fraud from publicly available financial statements concentrating on the assets misappropriation. The situation in fraud in the area of asset misappropriation is analysed and compared globally. Unfortunately we must conclude it has been the most occurring fraud since 2000.

Keywords: accounting creativity, fraud, errors, irregularities, earnings management

1 Introduction

Deliberate misstatement of corporate financial statements has been recently brought to the attention of broad public, media and political authorities all over the world. Such a misstatement, or in other words accounting fraud, is a manipulation with corporate financial data in order to create false picture of its financial health and position - leading various stakeholders (shareholders and investors, employees, government institutions, etc.) to incorrect risk perception regarding this particular corporation. Accounting fraud usually involves employees at highest management levels – CEOs & CFOs, top executives and senior staff, and is particularly critical because health and stability of financial markets largely depend on assumption of corporate financial statements being not fraudulent, but rather in line with existing accounting principles. Recently the term of corporate social responsibility has been introduced and its main purpose is to focus on corporate executives and chief officers and their ethical behaviour in the best interest of stakeholders, e.g. corporate shareholders, creditors and customers, and general public. On the other hand, economist Milton Friedman saw individual liberty as the greatest corporate good and claimed that „the social responsibility of business is to increase profits“ and that executive staff's responsibility towards shareholders is to make as much profit as possible. The management is responsible for true and fair picture of the company communicated to the users of the accounting information via the financial statements. The main objective of accounting and preparation of financial statements is to provide accurate information and ensure both internal and external control. Financial statements which are audited should confirm the correctness and accuracy of disclosed financial figures and other information in company's accounting. It is up to company's employees – from office workers to top management level – to provide such information, who however, might not always be willing to provide accurate and complete disclosure.

2 Creative Accounting and Fraud in Literature

Greek drama writer Sofokles knew what he was talking about, when he mentioned: Profit is sweet, coming from the fraud though.“ (Chaline, 2008, s. 256). Fraud in general could be conveyed as a deliberate deceit with the purpose of some form of personal gain. Accounting or financial fraud, the intentional misstatement and disclosure of corporate financial information for one's personal gain, has been a continuous difficulty since many years when capitalism rose in the 20th century. Prior to 1930s when first accounting standards were put in practice, what would be considered as accounting fraud or misstatement nowadays, it would have been marked as an acceptable accounting in the past. History of accounting and auditing contains long list of examples of dishonesty in disclosure of financial information. During the 21st century we may witness major growth of the banking and finance sectors meaning pressure on achieving profits and other financial targets have become more and more significant than in the past. Accounting scandals (including illicit use of derivatives and special purpose entities) have become dark part of this industry to certain extent, along with misstatement of financial figures and frauds. Hence fraud prevention has become a part of each corporate's accounting processes, methodologies and internal policies. It is difficult to measure and determine its scale, and we could only guess how many frauds go on undetected and undiscovered. According to the Association of Certified Fraud Examiners, the main way in which an accounting fraud was discovered were tips from whistle-blowers, followed by discovering fraud by accident, internal audit and control, external audit, and finally by police notification.

2.1. Fraud definition

Fraudulent activities are very harmful for each company; they have a malign impact on an enterprise development. Nor do they cause direct financial losses, but their other negatives are the loss of business partners, deterioration of business relations, departure of best employees or collapse of the company's morale. According to the one of the first definitions of researchers Davia, Coggins, Wideman and Kastantin (1992) „fraud always involves one or more persons, who, with intent, act secretly to deprive another of something of value, for their own enrichment.“ Authors state that the fraud involves essentially five elements presented in Table 1:

Table 1: Definition of Fraud

FIVE ELEMENTS OF THE FRAUD				
Physical existence of a person - fraud executor.	Existence of fraudster‘s deliberately harmful behaviour	Existence of object that has been seized by somebody	Existence of the belief the seized object is only borrowed temporarily	Existence of benefits for a fraudster
„There is a perpetrator.	The perpetrator acted with intent.	Someone has parted with something of value	The person who has parted with something of value does not realize at the time that he or she has done so	The perpetrator has benefitted from the act.“

Adapted by authors from the source (Davia et al., 1992)

Corporate fraud means activities undertaken by an individual or company that are done in a dishonest or illegal manner, and are designed to give an advantage to the perpetrating individual or company. Fraud is widely defined as a deliberate, dishonest and deceitful activity which results in direct and indirect losses of various forms to an organisation (Saxunova, 2012) and therefore we may distinguish two cases of fraud (focusing on the perpetrator's intent):

a) when a fraudster acts since the first moment deliberately in order to obtain something valuable for himself/herself, or

b) when a person believes that something valuable is only borrowed temporarily and will be returned back without being noticed in the organization, but he/she fails to return it.

As defined in ISA 240.6 (Revised) the term "fraud" refers to an „intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage“. According to KPMG Forensic Malaysia (KPMG, 2005) fraud is defined as „deliberate deceit planned and executed with the intent to deprive another person of his property or rights directly or indirectly, regardless of whether perpetrator benefits from his/her actions“. Weirich and Reinstein (Bunget, 2009) also define fraud as „intentional deception, and they further add that it is cheating and stealing, too“. Pollick defines fraud as a „deliberate misrepresentation, which causes one to suffer damages, usually monetary losses“ (Bunget, 2009) and as well as, he states “it involves complicated financial transactions conducted by white collar criminals, business professionals with specialized knowledge and criminal intent”.

Fraud comprises both 1) the use of deception to obtain an unjust or illegal financial advantage and 2) intentional misrepresentations affecting the financial statements by one or more individuals among management, employees, or third parties. The second part actually conveys fraudulent financial reporting which Beasley, Carcello and Hermanson (1999) characterize as „intentional material misstatement of financial statements or financial disclosures or the perpetration of an illegal act that has a material direct effect on the financial statements or financial disclosures.“ Mulford and Comiskey (2002) see that as intentional misstatements or omissions of amounts or disclosures in financial statements, done to deceive financial statement user, that are determined to be fraudulent by an administrative, civil or criminal proceeding.“ In a simplified perspective the fraud may involve: a) falsification or alternation of accounting records of other documents; b) misappropriation of assets or theft; c) suppression or omission of the effects of transactions from records or documents; d) recording of transactions without substance; e) intentional misapplication of accounting policies or f) wilful misrepresentation of transactions or of an entity’s state of affairs“.

We may conclude that majority of authors consider fraud as intentional deed by the person and they do not admit in their definitions the 4th feature defined by Davie et al. (1992) that perpetrator is not aware of committing a crime first apologizing himself or herself in front of himself/herself, and promising to return it later, but not having being seen or caught he keeps the object previously seized and by the repetition of similar situation that tempts the perpetrator again in order to take something what does not belong to him changes his unintentional action into intentional deed. As Slovak proverb says: the thief is made by the opportunity.

2.2 Creative accounting

Creative accounting has been defined by many researchers e.g. from “ outright fraud” to the “imaginative use of accounting numbers” (O’Regan, 2016, p.443). Creative Accounting is in *Oxford dictionary of English explained as* „the exploitation of loopholes in financial regulation in order to gain an advantage or present figures in a misleadingly favourable light.“ It is defined in a similar way also by *Chartered Institute of Management Accounting (2008) as* „ a form of accounting which, while complying with all regulations, nevertheless gives a biased impression (generally favourable) of the company’s performance.“ *Mulford and Comiskey (2002) add* that creative accounting is perceived as „any and all steps used to play the financial numbers game, including the aggressive choice and application of accounting principles, both within and beyond the boundaries of generally accepted accounting principles, and fraudulent financial reporting. Including also steps taken toward earnings management and income smoothing.“ Gherai and Balaciu (2011) write that enterprise stake is at risk when it indulges in practices of creative accounting. The best definition of creative accounting is presented by O’ Regan as “the use and abuse of accounting techniques and principles to achieve financial results which intentionally, do not provide a true and fair view." (2016, p. 443). Fraud unlike creative accounting is in *Black's Law Dictionary* defined as a knowing misrepresentation of the truth concealment of a material fact to induce another to act to his or her detriment." and by *Auditing Standards Board (2008)"*. The main difference between creative accounting and fraud is that creative accounting means working within the current regulatory framework. On the other hand, committing a fraud means reporting outside current regulatory framework – it involves breaking the law and regulatory framework violation. As per individual fraud, this may involve theft of certain assets like cash or inventory. For management, though, fraud means preparation of misleading financial statements with the intention to mislead certain parties.

In Romania scholars confirmed in the research that the most frequent situations of creative accounting practices occurring were the evaluation and recognition of risk provisions, the amortization and depreciation of assets, revaluation of tangibles, inventory and receivable accounts tested for impairment and the least – R&D costs and financial assets. Most of the auditors (44%) consider financial statements prepared by companies not to be transparent enough, 68% of them consider accounting manipulation as a frequent procedure encountered in practice and 68% of the respondents in Romania believe that the stakeholders' interests can be affected by using creative accounting; 72 % of the investigated auditors consider that a consolidated control can diminish the tendency to use creative accounting (Balaciu, Bogdan Mester and Gherai, 2012). The similar problem exists in Slovakia, Slovak companies have improved the process of financial statements, but the notes to the financial statements are still not sufficient for the external users for appropriate interpretation.

2.3 Aggressive Accounting

Some consider aggressive accounting the same as creative accounting. There is a small difference between them. Company's aggressive accounting when managing its earnings uses constantly the approach by overestimating the assets and underestimating liabilities to the maximal extent to achieve the highest net income possible. Working under creative accounting it means for the company to use accounting standards in order to deliver certain set of financial statements results. Creative accounting manipulates with estimates, with the choice of the accounting methods etc. still in compliance with the approved accounting standards to achieve either the best results possible, as aggressive accounting, but on the other hand, or the lowest result possible or the results which are considered suitable for the company for the particular reasons which are known to the top management. It includes deliberate choice of such a figures to achieve specific objective – target numbers, increased earnings trend, instead of reporting true and realistic financial view. As O'Ragan (2016, p.446) says "earnings management and accounting scandals are linked", earnings management is implemented to meet market expectation of creditors and investors, to guarantee fat bonuses for management or simply just for critics made them being silent. Thus, companies are expected to report certain levels of earnings although many companies accomplish that by managing the numbers using aggressive and creative accounting practices. Nowadays, it is a significant feature of many corporations' activities.

3 Errors & Irregularities in Financial Reporting

Incorrect and not actual statement of financial information, so called accounting irregularity, can occur due to an error or a fraud. According to Kamal Gupta (2005) an accounting error means to misstate financial data unintentionally, examples are summarized in table 2.

On the other hand, fraudulent financial reporting, which is often considered according to Kwok (2005) as the major kind of accounting irregularity, consists of intentional misstatement of financial information or omission of particular financial information from financial statement in order to mislead the users of financial statements. Such reporting can include examples as presented in table 2, in the second part. Table 2 and 3 focuses on the main discrepancies between accounting error and irregularities or frauds, as outlined by Michael Young (2013).

Table 2: Errors versus Irregularities

ERRORS: **Unintentional** misstatements or omissions of amounts or disclosures in financial statements, such as: a) mistakes in gathering or processing accounting data from which financial statements are prepared b) incorrect accounting estimates arising from oversight or misinterpretation of facts c) mistakes in the application of accounting principles relating to amounts, classification, manner of presentation, or disclosure (Gupta, 2005)

Source: (Young, 2013, p. 21)

Table 3: Errors versus Irregularities

IRREGULARITIES: **Intentional** misstatements or omissions of amounts or disclosures in financial statements, such as: a) deception e.g. manipulation, falsification, or alteration of accounting records or supporting documents from which financial statements are prepared b) misrepresentation or intentional omission from, the financial statements of events, transactions, or other significant information c) intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure (Kwok, 2005)

Source: (Young, 2013, p. 21)

4 Earnings Management

The topic of earnings management and especially the quality of earnings hasn't stopped being a topic for research for many years. Users of accounting information use the financial statements of the current accounting period for forecasting future performance, future cash flows and future financial position. If the financial statements are of a poor quality, they are not a reliable base for forecasting, for decision making and they will mislead the users. If the company intentionally underestimates warranty expense and defers revenue it will report a higher net income (net earnings) but the following year or years the net income figures will be lowered, that means the net income will reverse. Earnings, that are the consequence of using selected accounting methods in the particular fiscal year, always reverse in the future. **So earnings are of good quality if they do not reverse.** Manipulation is often referred to as earnings management. Earnings management can be described as the desire of company management to meet their targets and forecasts.

Table 4: Earning Quality

Quality Earnings (QE) ➡	**Scenario** ➡ The analysts' work	**Adjustments required and implemented:** ➡	**Results expected:**
Low quality earnings (LQE) due to the low quality of accounting	LQE are not detected by the analysts	Required action not implemented	Low quality forecasts Low quality valuations
	LQE are detected by the analysts	Forecast can be adjusted to anticipate the reversals	Improved quality forecasts & valuations
High quality earnings (HQE)	Yes/No	No action needed	High quality forecasts High quality valuations

Source: processed by authors

It is very common that external financial analysts and agencies issue profit estimates for publicly traded companies, and these should meet their estimates is they do not want to see their stock lose in its value to competition in the market. Those companies which fall behind their profit targets sometimes seek to manage their earnings, for example in a form of **profit smoothing**. Financial markets tend to reward companies with stable and predictable profit levels, which have increasing trend on year-to-year basis, or quarter-to-quarter basis. On the other hand, companies which profits tent to rise and fall each period would have worse rating and corporate image. Hence such companies might prefer to report steady period-to-period profits instead of reporting big fluctuations in their profit levels, and their managers would use certain techniques to smooth profits. Common way is to issue expense, revenue or profit based incentive plan. Depending on particular incentive strategy for company sales population, their sales might be affected if they are measured on expenses, revenues or profits. By selecting correct method a company can save its profits for worse periods and vice versa. According to many authors, to mention at least few of them e.g. Michael Jones, (2011), Penman (2009), Saxunova (2008 and 2014), Balaciu et al.(2012), (Ruckova, 2011) and many others the company can potentially report increased income, for example, by the following actions:

a) Premature sales recognition
b) Increase in interest receivable
c) Inclusion of non-operating profits
d) Treatment of loans as sales
e) Swaps

Table 5: Earnings management examples - revenues

Accounting	**Conservative**	**Liberal**	**Aggressive**	**Fraud**
Revenue recognition manufacturing	After sale, delivery & acceptance	After sale is made	Bill and hold	Fraudulent sale
Revenue recognition services	Services prepaid and already performed	Services prepaid & partially performed	Services agreed to, not performed yet	Fraudulent scheme
Impact on NI & Total Assets	↓ ↓	↓ ↓	↑ ↑	↑ ↑

Adapted from the source: (Giroux, 2014)

Table 6: Earnings management examples - expenses

Accounting	**Conservative**	**Liberal**	**Aggressive**	**Fraud**
Inventory	LOCOM followed	Slow to write-down slow moving inventory	Obsolete inventory still on the books	Sham rebates on purchased inventory, non-existent inventory
Accounts Receivable	Conservative credit terms and higher bad debt allowance	Liberal credit terms and bad debt allowance	Lenient credit policies to expand sales & reduce bad debt by ignoring probable uncollectibles	Fake invoices on non-existing sales (bogus revenues), Sales that do not allow revenue recognition
Advertising marketing	Expensed as incurred	Expensed based on some formula, e.g. GP percentage	Marketing costs capitalized	Capitalized & manipulated to meet profit targets, other costs treated as marketing & capitalized
Impact on NI &Total Assets	↓ ↓	↓ ↓	↑ ↑	↑ ↑

Adapted from the source : (Giroux, 2014)
Legend: The size of the arrow means the size of the impact of accounting practice on the NI & TAs

5 Innovation in Fraudulent actions

Accounting fraud or misstatement of financial statements is intentional action of an individual or a group to gain illegal financial advantage or to present financial information in misleading way. This may involve: 1. Falsification or alternation of accounting records or other documents;
2. Misappropriation of assets or theft;
3. Suppression or omission of the effect of transaction from records or documents;
4. Recording of transactions without substance;
5. Intentional misapplication of accounting policies; or
6. Wilful misrepresentations of transactions or of the organization's state of affairs.

Asset misappropriation is the most common type of fraud occurring in companies, even thought typical amount misappropriated in such cases is smaller than amount lost in other kinds of fraud schemes. Asset misappropriation, or in other words, theft of company assets, can involve employees at all levels – workers, first line managers to top executives, or even third parties. If these actions are deliberately kept in secret and not showed in company financial statements then theft is intentionally covered. Basic ways to misappropriate company assets are stealing disposable assets (like cash or inventory) or falsifying reimbursements for goods and services that this company have never been delivered for the use, yet it to pay for them (fraudulent disbursements). Regarding misstatements arising from asset misappropriation Davia et al. (1992) and Ramos (2006) identify several risk factors, such as a) incentives/pressures, b) opportunities and c) inadequate internal control over assets.

Incentives / Pressures

1. Personal financial obligations may create pressure on management or employees with access to cash or other assets susceptible to theft to misappropriate those assets
2. Adverse relationships between the entity and employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets. For example, adverse relationships may be created by following:
   i) Known or anticipated future employee layoffs
   ii) Recent or anticipated changes to employee compensation or benefit plans
   iii) Promotions, compensation, or other rewards inconsistent with expectations

Opportunities

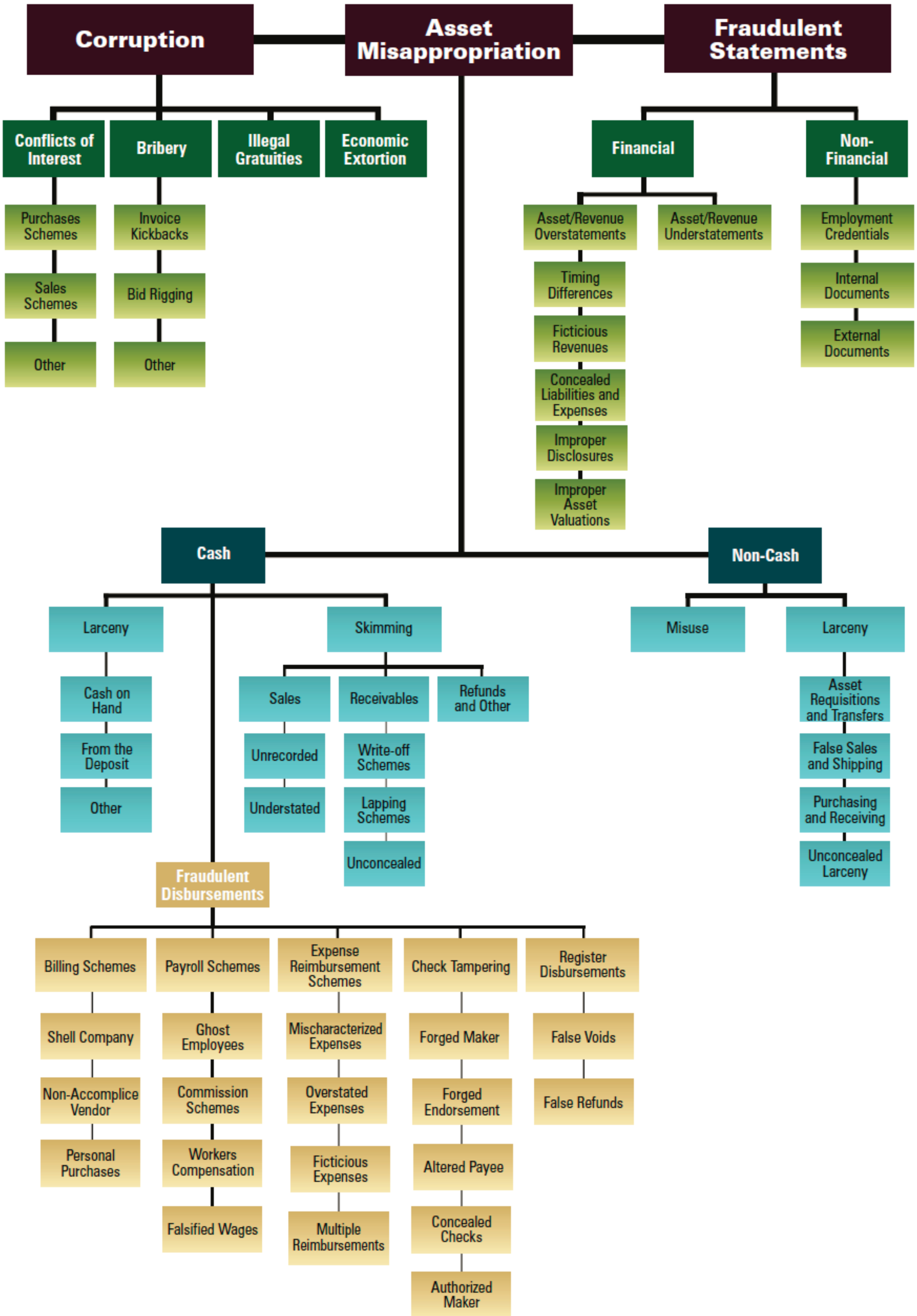
1. Certain characteristics or circumstances may increase the susceptibility of assets to misappropriation. For example, opportunities to misappropriate assets increase when there are the following:
   i) Large amounts of cash on hand or processed
   ii) Inventory items that are small in size, or high value, or in high demand
   iii) Easily convertible assets, such are bearer bonds, diamonds or computer chips

Inadequate internal control over assets

Inadequate internal control over assets may increase the susceptibility of misappropriation of those assets. For example, the misappropriation of assets may occur because of the following shortcomings:
a) Inadequate segregation of duties or independent checks,
b) Inadequate management oversight of employees responsible for assets, for example inadequate supervision or monitoring of remote locations,
c) Inadequate job applicant screening of employees with access to assets,
d) Inadequate recordkeeping with respect to assets,
e) Inadequate system for authorization and approval of transactions (for example in purchasing),
f) Physical safeguards over cash, investments, inventory or fixed assets,
g) Lack of timely and appropriate documentation of transactions,
h) Lack of mandatory vacations for employees performing key control functions.

Even though cash is primarily the target for employees' theft, other assets such as supplies, inventory or other kinds of equipment might be part of assets misappropriation, as well, varying from stealing boxes of paper or small office supplies, to unauthorized usage of expensive equipment or machinery.
Taking non-cash assets into account, employees can commit several kinds of misconduct: unauthorized use of equipment (e.g. company car or truck, computer), inventory shrinkage, fake sale or purchase on behalf of company.

Figure 1: Fraud Categorisation



Source : (Report to the Nation on Occupational Fraud & Abuse, 2008 p. 7)

Report to the Nation on Occupational Fraud & Abuse presents general classification of asset misappropriation in nine categories (2008, p.12). Frauds that are aimed at company incoming receipts are included in first two categories: skimming, and cash larceny. Following five categories then describe aiming at outgoing cash disbursements: billing schemes, checks tampering, expense reimbursements, payroll schemes and cash register disbursements. Cash on hand misappropriations involve the theft of cash or currency maintained onsite by the victim organization. The last category, non-cash misappropriations, involves the theft or misuse of physical assets such as inventory or equipment, or the misappropriation of proprietary information.

Skimming involves any situation in which company cash is stolen before it is recorded in its books and records – for example occurring when an employee accepts cash payment from customer or another third party, but does not record the sale or the transaction in the books. **Cash larceny** occurs, on the other hand, when cash receipts were recorded into company accounting books, but the receipts are stolen afterwards before they can be deposited. During fraudulent **billing** an employee causes issuance of a payment by submitting invoices or receipts for fictional goods and services which the company have never been delivered. **Check tampering** involves theft or alternation of a check which the company issued for someone else. Situation when an employee claims fictional **expense reimbursement** or inflated reimbursement is another kind of fraudulent disbursement of cash**. Payroll** is any scheme when an employee falsely claims compensation and causes the company to issue such a payment. **Cash register disbursements** occurs when an employee makes false entries on a cash register in order to conceal the fraudulent removal of cash. **Cash on hand misappropriation** involves theft of cash kept in company premises, and **non-cash misappropriation** involves misuse or theft of non-cash assets of the organization. According to study conducted by Association of Certified Fraud Examiners, approximately 85% of all asset misappropriation involves the theft or misuse of cash. The chart above depicts Fraud and Abuse Classification System (adopted from the annual report by Association of Certified Fraud Examiners), and highlights the asset misappropriation position. (see figure 1).

6 Usefulness of Financial Statements

Certain accounting and financial statements conditions may be the warning signals that should not be ignored by an internal or external auditor or potential investor or creditor or the company's managers in analyzing the financial information communicated through the financial statements. Professional skepticism of theirs will be a threshold in judging performance of the investigated company, its financial position and cash flows. The following symptoms should be carefully examined because they may indicate earnings manipulation.

a) Accounting principles or estimates are suddenly changed
b) Major part of the company is surprised by the results reported
c) A decrease in profitability after a period of good profitable years
d) Sales are constant or falling
e) Sales grow in a slower pace than earnings
f) Net profit is bad, very low
g) Almost no growth, zero or even decline for profit margins
h) Analysts' earnings expectations are met with big difficulties by the company
i) Tax reporting and financial reporting show discrepancies in expenses
j) Adjustments are made in the last quarter of the year in accounting books

For earnings manipulation it is necessary focus on the sales figures – it is necessary to monitor sales growth, especially unusually high growth rates, then expenses related to normalised operating assets (NOA) and affecting return on NOA (normalised assets mean five year average assets usually used by operations in the company). Unusual and important changes resulting in different return on NOA are in focus: a) gross margin ratio, advertising -to - sales ratio, G&A-to-sales ratio, R&D-to-sales ratio and b) ratios affecting asset turnover (receivable, inventory and payable turnover and inventories to sales ratio, account receivable to sales ratio, bad debt- to sales ratio, other asset to sales ratio, operating liabilities to ales ratio). These figures must be monitored and compared with industry average values and revealed discrepancies must be explained. The process of ordering is also very important and regular checking are necessity, an accumulated order backlog indicates demand for the product which company has not satisfied yet (book –to bill ratio is necessary to be monitored), sudden changes in sales prices (per unit) should be checked, the investment or operational plans must be examined, labour force changes.

A real problem for the company is when the internal auditor will finds out: a) slower sales increase as planned, b) order backlog dropped, c) sales returns are evidently growing, the return of goods is piling due to the customers' dissatisfaction with the product; d) the big problem is increase in account receivable to sales ratio leading to cash problems, e) similarly increase in inventory turnover reveals the problem of slow sales, or it may be a sign the production is increased because there is a forecast for the higher sale in the future, therefore the reason must be detected in order to correctly interpret the results.

External user may have a problem to correctly interpret or sometimes he/she is unable to determine certain ratios, because the company report only operating expenses in an aggregated amount and notes do not provide more information how big advertising expenses, research and development expenses (R&D), selling, general and administrative expenses (S,G&A) are etc., and therefore it is not possible to monitor and calculate development and trend in these ratios (these expenses to sales ratios). But internal auditor cannot have these problems as this information is available in accounting department, and may be demanded upon request.

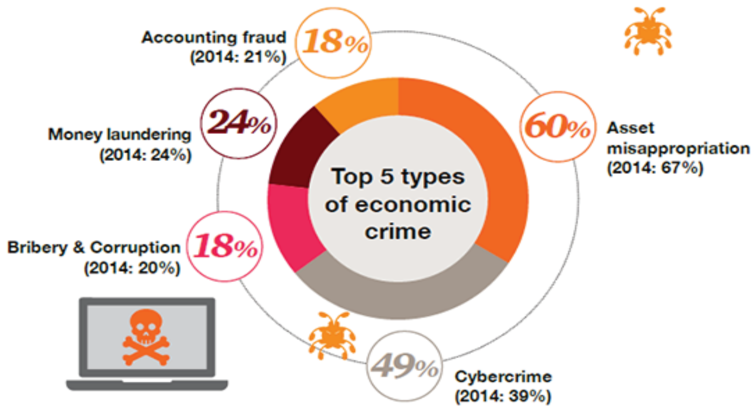
Possible red flags in performance shortcomings:

a) increase in advertising –to –sales ratio: low effectiveness of marketing activities for sales increase
b) research and development expenses (R&D) should be monitored to assess product innovation
c) increase in S,G&A expenses -to-sales ratio: should be monitored if variable or fixed cost increased, because if the sales increases fixed cost should decline.
d) low depreciation or amortization expenses mean that there will be future asset write-downs owing to disposing assets, or incurring losses from the asset sale or restructuring expenses Too high depreciation expenses usually leads to later gains from asset disposals.
e) provisions require the estimates, therefore accruals and also deferrals must be also monitored if they reflect true and fair picture of the related transactions.(Penman, 2009)

7 Results and discussion

According to the PWC's Economic Crime Survey 2016, majority of economic crime is created by asset misappropriation. In 2014 such crimes created 67% of all economic crimes which took place in that year, compared to 60% in 2016 which means we notice slight decrease in this trend. Asset misappropriation is followed by Cybercrime which is the second largest category of economic crimes. Only two years ago in 2014 39% of economic crimes were classified as cybercrimes. According to the 2016 report, nowadays in 2016 almost half of all crimes (49%) belongs to this group – this is significant increase which we can dedicate to development of IT instruments and entire instrastructure, and its easier availability to corporate employees and general public. Steady share of 24% in 2014 vs. 2016 among economic crimes is formed by Money Laundering. Slight decline in crime trend can be seen in two last categories – Accounting Fraud and Bribery & Corruption. In 2014 level of accounting fraud was 21% which decreased by 3% to 18% in 2016. Bribery and corruption category has seen decrease from 20% in 2014 to 18% in 2016. Economic crime is a global problem and according to the report, its share among all crime categories was 37% in 2014 and 36% in 2016. In general 36 out of 100 reported crimes are economic crimes. This slight decrease from 2014 to 2016 can be considered as steady, non-progressing value.

Figure 2: Economic crime in global world in 2016 compared to 2014



Source: (PwC, 2016).

To divide this value into geographies, we have to look at the table below which depicts rate of economic crime in various geographies.

Table 7: Economic Crime survey 2016

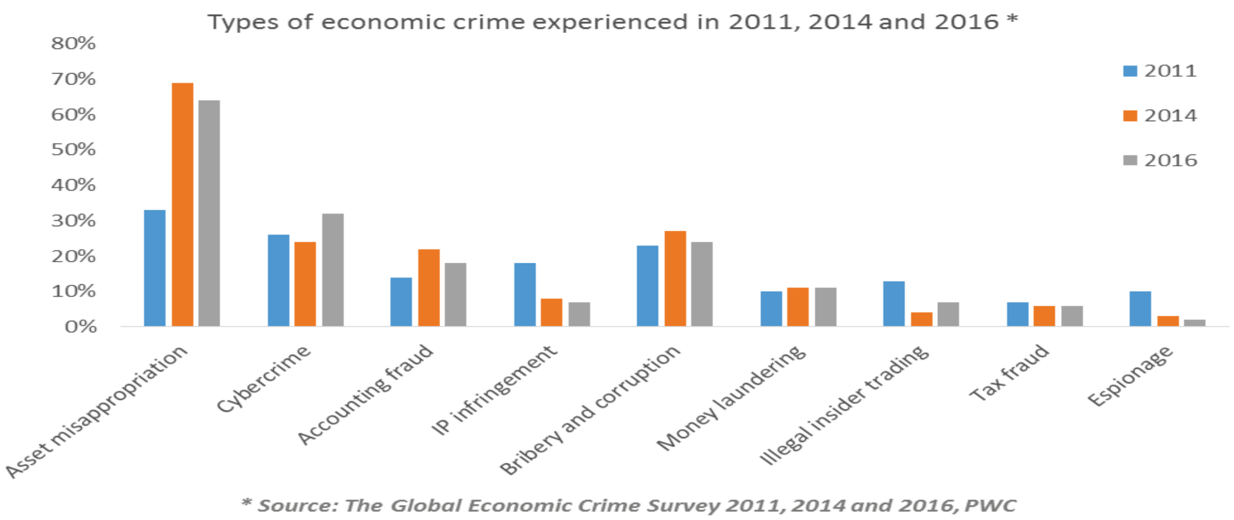
Region	Reported economic crime in 2016	Reported economic crime in 2014
Africa	57 percent	50percent
Western Europe	40 percent	35 percent
North America	37 percent	41 percent
Eastern Europe	33 percent	39 percent
Asia Pacific	30 percent	32 percent
Latin America	28 percent	35 percent
Middle East	25 percent	21 percent
Global	36 percent	37 percent

Source: (PwC, 2016)

The 2016 Global Economic Crime Survey 2016 conducted by PWC further outlines 14 different types of economic crime experienced. The leaders in this category are asset misappropriation, cybercrime and bribery & corruption. Two out of these three categories saw decrease in 2014 rates vs. 2016 rates. Asset misappropriation category, often considered as the easiest kind of fraud to be detected, forms 64% of all economic crimes (69% in 2014). Decrease could be the result of tightening of organisation internal controls. This could, as well, mean the shift from easier to detect crimes to more advanced IT related crimes. This theory is supported by the fact that only economic crime category showing a significant increase is the cybercrime category, which has now become no. 2 among all economic crime categories. Its rate in 2014 was 24%, compared to current amount of 32% we have seen 8% increase during period of two years. Another economic crime categories have been marked with a decrease from 2014 to 2016: Bribery & corruption (27% in 2014 vs. 24% in 2016), Procurement fraud (29% in 2014 vs. 23% in 2016), Accounting fraud (22% in 2014 vs. 18% in 2016) and HR fraud (15% in 2014 vs. 12% in 2016) all have experienced declining trend. Money laundering category has been unchanged through the analyzed period – 11% in 2014 and 2016 respectively. Less experienced economic crime categories include IP infringement (8% in 2014 vs. 7% in 2016), insider trading (4% in 2014 vs. 7% in 2016), tax fraud (steady 6% in 2014, and 2016 respectively), mortgage fraud (7% in 2014 vs. 6% in 2016), competition/ anti-trust law infringement (5% in 2014 vs. 4% in 2016), espionage (3% in 2014 vs. 2% in 2016) and other uncategorized crimes (14% in 2014 vs. 11% in 2016).

Graph 1 below depicts trend of selected economic crime categories in 2016, 2014 and in 2011 (in such an order they are in the brackets) with the asset misappropriation declining (64%, 69%, 72%) as a crime leader followed by growing cyber crime (32%, 24%, 23%) and corruption and bribery (24%, 27%, 24%) crime closing the first three most frequently occurring crimes globally, pursued by **procurement fraud (not included in** which has appeared, growing fast, in 2011 not measured at all, (29%, 23%, -) which is an action of not allowed lobbying and bribing authorities in order to get a state order, followed by accounting fraud (18%, 22%, 6%), human resource fraud (12%, 15%,-) and money laundering (11%, 11%, -).

Graf 1: Economic Crime Survey in 2011,2014,2016



8 Conclusion

Doubtlessly financial information from the financial statements and annual reports is very important and valuable for the investment and credit decisions, for assessing the company's performance and performance of its managers. Incentives to manage income to meet earnings targets or to present earnings looking less risky can put aside good business practices. A company's accounting policy (e.g. revenue recognition policy) may enable flexibility of accruing or deferring recognition of revenues, expenses, gains or losses. Managements and accountants can "benefit from" this flexibility, but deliberate action involving the timing of revenue recognition (and also of expenses) can complicate the comparisons between the firms and tempts the management to engage in income smoothing (i.e. attempts to avoid reporting peaks and troughs in revenue and /or income which the manager or accountant thinks might give an alarming signal to financial markets). It is obvious this erodes the quality of earnings and the quality of financial reporting. But accountants or managers are aware that existing warning signals and indicators serve as a supporting instrument to assist in revealing practices that may be detrimental to the organisations.

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