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Workaround Opportunities in Concealing Revenue and Expense Misstatements

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I. Introduction

A financial statement fraud (FSF) is an intentional act of dishonesty. Mulford and Comiskey (2002, p. 15) define FSF as "any and all steps used to play the financial numbers game, including the aggressive choice and application of accounting principles, and fraudulent financial reporting". FSFs involve intent, deception, and considerable gamesmanship to manipulate financial statements, which continue to baffle experts (Borthick, 2012; Albrecht et al., 2015; Chen et al., 2017; Gao and Srivastava, 2011; Lokanan, 2014). Besides resulting in huge litigation costs and reputational damage to the alleged offenders, FSFs cause stakeholders to lose confidence in the quality and integrity of the financial reporting process.

The perpetrators of FSFs primarily take advantage of the internal opportunity provided by flexibility within the accounting rules and regulations. Different schemes may be adopted by managers for the concealment of revenue and expense misstatements, either through altering accounting entries or by colluding with third parties such as vendors and customers. Previous studies have identified that the accounting standards related to revenue recognition, capitalisation, amortisation policies, non-trading profit, provisions, and depreciation accounting to name a few are exploited by the perpetrators for misstatements (Jones, 2011; Mulford and Comiskey, 2002; Smith and Hannah, 1991). A well-planned FSF, often involves the following schemes: (a) falsification, alteration, or manipulation of material financial records, supporting documents, or business transactions; (b) material intentional misstatements, omissions, or misrepresentation, and wrongful execution of accounting standards, principles, policies, and methods used to measure, recognize, and report economic events and business transactions, and (c) the use of aggressive accounting techniques (Rezaee, 2005, p. 279). Konos et al. (2011) add that FSF is often concealed with the help of related third parties. Smart perpetrators are fully conversant with common audit procedures and can design a scheme to evade detection in an audit (Albrecht et al., 2019, p. 427). Previous studies on FSF indicate that management used a variety of 'accounting opportunities' to inflate profit by overstating income, understating expenses, or both (e.g., Carnegie and O'Connell, 2011, p. 156). However, the specific *modus operandi* of concealment is yet to be uncovered.

This study aims to answer the research question: How does management use revenue and expense concealment strategies (workarounds) to commit FSF? Framed by the opportunity perspective, this study unravels the context within which revenue and expense misstatements and concealment strategies are carried out to enable a greater understanding of the differences and commonalities of FSFs (Stone and Miller, 2013; Albrecht et al., 2015). This study focuses only on revenue- and expense-related strategies for misstatement to identify linkages between these misstatement strategies for different types of concealment. Revenue recognition is an area commonly questioned by Securities and Exchange Commission (SEC) staff in their review of public filings (Alford et al., 2011).

Workaround opportunities are the ability and propensity of people holding privileged hierarchical positions to leverage relationships with others, both internal and external to the organisation, to hide misconduct, deceit, and deviance (see Hilliard and Neidermeyer, 2018; Portes and Sensenbrenner, 1993; Baker and Faulkner, 2004; Needleman and Needleman, 1979). The type of fraud committed, and thus the concealment, is typically contingent upon the opportunity available from the perpetrator's position in the company (Benson et al., 2009; Felson, 2002) and the ability of the perpetrators. Opportunity theory states that people willingly exploit any opportunity—legal or illegal—to achieve their goals or solve problems (Clarke, 2012; Holtfreter, 2005). Even without a clear motive for such deviant behaviour, opportunity can still cause an individual to commit fraud or be drawn into criminal behaviour (Benson et al., 2009; Clarke, 2012; Schuchter and Levi,

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2015). Top management refusing or resisting deteriorating financial performance may be incentivised to find workaround opportunities (Bagaygo et al., 2013; Martin et al., 2013). It can, therefore, be extrapolated that the senior positions held by management, often paralleled with more power and control, can provide an opportunity to override controls and other malfeasants or strategies (ACFE, 2020; Australian Institute of Criminology and PricewaterhouseCoopers, 2003; Hymes, 2013; Röder, 2017). In fact, power is likely to increase the perception of opportunity and the viability of that opportunity even for fraudulent intent without threat of serious consequence (Albrecht, et al., 2015). They may suppose that they can control and manipulate the environment to reduce the likelihood of detection, including how they conceal misstatement strategies. Though limited by its descriptive nature, the paper enhances further understanding of how workarounds match with different FSF opportunities and management strategic decisions.

Using a sample of 30 cases of FSF headlined in the media between 1998 and 2020, the study identifies internal or external methods used by the perpetrators to expose the *modus operandi* of concealment strategies. This descriptive study contributes to the FSF literature in several ways. First, this study focuses on the opportunity element of perpetrating FSF. Clark (2012) reports that even people with no pre-existing disposition to commit fraud can be drawn into criminal behaviour when criminal opportunities present themselves in the course of their work. By focusing on revenue and expense misstatements, the emphasis is on the specific, rather than general opportunity (Donelson et al., 2017, p. 48). The specific opportunities are related to internal control weaknesses and failings of the corporate governance system. Second, by linking the revenue and expense misstatements to concealment strategies, this study aims to provide a pathway towards a better understanding of the complex nature of FSF. To enhance better understanding, this paper links the misstatement to the concealment strategies employed by real cases, acknowledging the interdependence of the strategies, opportunities, and work around behaviour (Röder, 2017). Last, the study offers the context of how the revenue and expense misstatements are likely to be committed and concealed by management in different industries. According to Albrecht et al. (2015), even when fraud is made public, most of the details on how the FSF was perpetrated do not surface. This attempt to convert some hindsight into foresight has become an increasing focus of the regulators and standard setters (Kenyon and Tilton, 2011, p. 236). As emphasised by Jones (2011, p. 507), "Where there is accounting, there will, it seems, always be accounting malpractice. We can only hope to understand and perhaps mitigate the problem."

The rest of the paper is structured as follows. The next section provides a review of the literature and the research framework, followed by the research method, research findings, discussion, and conclusion.

II. Literature Review and Research Framework

FSF undoubtedly causes massive financial loss (Association of Certified Fraud Examiners, 2020; Tom, 2019; Albrecht et al., 2019; Agostini and Favero, 2017). A stream of research focuses on the combination of pressure, opportunity, rationalisation, capability and other factors to explain a fraudster's involvement with the fraud (e.g., Free, 2015; Beasley et al., 2000; Sutherland, 1983; Cressey, 1953). Given it is the aim of corporate managers to meet analyst and shareholder expectations, there is pressure to present results in the most favourable light. This pressure is the most commonly cited driver for FSF, but there is less known about how management capitalises on opportunities to commit and conceal FSF. As established by previous studies, the fraud triangle alone is not an adequate tool since all the 'predator' seeks is an opportunity; they require no pressure and need no rationalisation (Donelson, et al., 2017; Wall et al., 2016; Soltani, 2014; Dorminey et al., 2010).

The propensity to be drawn into fraudulent activities is much higher if FSF is perceived to be easy to commit, has minimal risk of detection, offers an attractive reward, is encouraged by the immediate environment, and is easy to justify (Benson et al., 2009; Albrecht et al., 2015). In this respect, management has multiple opportunities to commit and conceal their dishonest acts simply through the course of their occupation. There are potentially hundreds of different items in the accounts which could be manipulated to make them extremely difficult for an auditor to detect, referred to as 'tricks' to fool shareholders (Schilit et al., 2018, p. 4). In addition, concerted efforts from various parties further aggravated successful execution and concealment (Soltani, 2014; Rockness and Rockness, 2005; Clarke et al., 2003; Beasley et al., 2000). By being complicit with others, the crime is more organised and equipped with more complex concealment schemes (Hamilton and Sanders, 1995).

Concealment strategies can involve the manipulation of internal records, documents, and procedures, such as creating fictitious documents or customers or colluding with external parties. Specifying a misstatement strategy can be problematic (Bonner et al., 1998). For example, Mulford and Comiskey (2002) point out that it is often difficult to distinguish between premature and fictitious revenue recognition because: (1) Goods may be ordered but not shipped at the time of recognition;

(2) Goods may be shipped in advance of an expected order; or (3) Goods were shipped for which no orders are expected, or non-existent shipments were created. Their use depends on the aims or problems that management attempts to resolve by portraying a different picture in the financial statements. In Appendix I, authoritative studies by the Centre for Audit Quality (CAQ) (2021) and the Committee of Sponsoring Organizations of the Treadway Commission (COSO) (2010) highlight revenue and expense-related schemes are the top two techniques used to perpetrate FSF, and are thus the focus of this study. [See Appendix I, pg. 447]

III. Research Method

The study uses a qualitative method which is uncommon in forensic accounting studies (e.g., DiGabriele and Huber, 2014; Stone and Miller, 2013). Discourse analysis is used in this study based on the media discourses of fraud cases. This approach is one of the ways to use narratives to understand the fraud context (e.g., Watson, 1995). Undoubtedly, discourse spreads in society through many channels including stories, documentaries, and newspaper articles. The media mentions of corporate scandals grow exponentially from 1946 onwards and exceed 34,000 in 2002 and 2006 (Hail et al., 2018, p. 621, CNNMoney, 2002; CNNMoney, 2001, CNNMoney, 2000; CNNMoney, 1998), a trend which was particularly noticeable between the 1990s and early 2000s. This study uses discourses on FSFs in the media as they become a topic of discussion among regulators such as the SEC and business press online, as this channel offers greater access to wider audiences (Hail et al., 2018; Sikka, 2010; Sikka and Willmott, 1997).

Following previous FSF research (see e.g., Dechow et al., 2011), the information used in this study is primarily from the Securities and Exchange Commission (SEC) Accounting and Auditing Enforcement Releases (AAERs). The primary references include SEC AAERs, SEC press releases, two independent investigation reports on Toshiba and Olympus, and one report on Tesco by the UK Financial Conduct Authority (FCA). The SEC issues AAERs when a company commits a violation, including intentional falsification of financial statements, over-statement of assets and income, and inadequate disclosure. AAERs provide critical information of the context in which the misstatement and concealment strategies were perpetrated. In addition, reports of regulatory bodies are useful in understanding the context to gain a better understanding of the inside story (Soltani, 2014). These narratives are lost if they are aggregated using a quantitative method. The secondary references used in this study include scholarly books, empirical studies, and publicly available information in the media, especially the financial press. Schilit et al. (2018, p. 289) assert that financial press reinforces technical rules that have been violated, the significance of the violations, and who within the organisation is believed to be responsible.

Sample

To compile a sample for this study, FSF cases which made headlines in the media between1990 and 2020 were identified using the following keywords on Google search engine: ‘fraud’, ‘financial statement fraud’, ‘accounting scandals’, and ‘financial scandals.’ The study sample is derived using the following selection criteria:

	No. of cases	No. of cases
Case headlines identified from 1990 to 2020		83
Minus:		
Ponzi scheme	2	
Bank fraud	5	
Bribery, corruption, and money laundering	6	
Theft and embezzlement	9	
Complex or mix of misstatements, not mainly related to accounting (e.g., insider trading, illegal payments, tax fraud)	31	53
Sample of cases		30

After implementing the selection criteria, the sample consists of 23 cases from the U.S., three from Japan and one each from Italy, the Netherlands, the UK, and India. Despite the Sarbanes-Oxley Act of 2002 (SOX) that mandated certain practices in financial record keeping and robust internal controls over financial reporting process (Section 404), and penalties for wrongdoings (Section 802), the sample consists of 22 U.S. cases of FSF. Previous studies such as Brennan and McGrath (2007), Rezaee (2005), and Soltani (2014), examined between six to 14 FSF cases, while some researchers studied a single case to determine fraud risk factors (Lokanan, 2014) and how individuals are recruited to commit such fraud (Albrecht et al., 2019). In total, the revenue and expense manipulations ranged from U.S.$46 million to U.S.$30 billion. Once identified, each case was subjected to the SEC website for validation to ensure that the case involved: (1) one or more financial reporting practices and (2) alleged or actual accounting fraud (Hail et al., 2018). According to DeChow et al. (2011, p. 25), using the SEC's AAERs as a source of contextual information avoids bias induced in samples based on the researcher's individual classification schemes and can be easily replicated by other researchers. [See Appendix II, pg. 448]

The alleged accounting manipulations and fraud are the events, and the narratives are the stories grounded in these events. Stories provide a narrative structure that explains the events through the development of a plot (Golden-Biddle and Locke 2007, p. 5). In this study, plot is the strategy employed in misstating and concealing accounting manipulation in the financial statements. The case narratives were scrutinised and matched with the misstatement strategies outlined in Tables I and II. Albrecht et al. (2019) suggest that identification of specific schemes should always be considered in context. Instances that did not fit within the pre-determined misstatement strategies were considered within their original contexts as unusual techniques. Patton (1990) termed this category as 'weighting alternatives' to avoid the data being categorized in a single-minded fashion and presented from a single viewpoint. These procedures were followed by both researchers in this study and inconsistencies were examined and deliberated to reach a consensus.

Data Analysis

There are five main classifications of creative accounting strategies: increase income; decrease expenses; increase assets; decrease liabilities; and increase operating cash flow associated with aggressive accounting. This study focuses only on revenue-related schemes and expense-related schemes.

Assuming management takes an opportunistic view, the context of each revenue and expense misstatement strategy was scrutinised to determine the main concealment strategy. This phase required examination of how the misstatement strategies were perpetrated, whether they were committed mainly using internal methods through the alteration of accounting entries or usage of internal documents/procedures, or external methods of collusion with third parties. The misstatement strategies and concealment methods are elaborated on in the next section.

IV. Findings

In total, 57 different concealment strategies were used by companies to misstate revenues and 29 different concealment strategies to misstate expenses. Table I shows that 23 of sample companies (77 percent) were involved in revenue misstatements while 16 companies (57 percent) misstated their expenses. Some of the alleged revenue misstatements were committed more than once (case 2, 5, 7, 8, 11, 16, 18, 20, 22, and 27), using different concealment strategies on each occasion. There was an incredible diversity in the accounting-related schemes used to boost sales and earnings and to understate expenses. Almost one-third of the cases suffered two years of fraud prior to detection. The length of fraud varied from one year to 11 years. A summary of the revenue and expense misstatement techniques and associated concealment strategies using internal and external methods (opportunities) is shown in Tables I and II. [See Table I, pg. 449]

Consistent with prior studies, the most frequently employed revenue-related misstatement strategy was fictitious revenues, followed by premature recording of revenue. The latter strategy involves the recording of sales of goods and services that did not occur, and therefore is a clear fraudulent act. Premature recording of revenue is one of the most common and pervasive schemes as it involves the interpretation of when a sale is a sale which determines at what stage of the transaction or contract companies may record the revenue. The sampled companies used the timing of operating decisions to artificially boost performance numbers. According to the SEC (2000b), revenue manipulation exemplifies how critical it is to strictly adhere to the letter and the spirit of the accounting rules for revenue recognition.

Table II shows that expenses are reported lower than the actual amount of the expense (case 1, 2, 3, 7, 12, 14, 21, and 26) or are not reported at all (case 2, 3, 12, 17, 19, 27, and 28). Unusual techniques and delays in reporting expenses were found (case 16, 23, 27, and 30). In reporting a lower amount of expenses, capitalisation methods were used more often than others. In delaying the recording of expenses, companies resorted to collusion with the third parties (case 2, 12, 25, 26 and 28). Unusual techniques varied from an off-book recording system (case 16), spreading contract losses across reporting periods and reporting false tax amounts, and using an unsubstantiated 'carry over' to close the gap between the targeted and actual expenses amounts (case 27). In one unusual case, the perpetrators even inflated expenses to support the overstatement of revenues (case 30). [See Table II, pg. 452]

Most companies were reliant on internal (36 occurrences) rather than external methods (21 occurrences) to conceal revenue misstatements. It is noteworthy that non-U.S. companies used more external than internal methods for creative accounting (Suda, 2011). The concealment strategies used by non-U.S. companies also involved colluding with subsidiaries. For instance, Tesco (case 26) overstated profits and this was linked to how it booked payments from suppliers (The Guardian, 2017). Kanebo's executives (case 17) removed 15 unprofitable subsidiaries and affiliates from their consolidated accounting report (Konishi, 2010). It was also alleged that the auditors worked with executives to falsify Kanebo's financial statements (The Japan Times, 2005a, 2005b, 2005c). An insider whistle-blower exposed tobashi operations in which three European banks assisted in complex accounting FSF (case 23) (GlobalCapital, 2012). The executives made a false representation to the auditors (case 12) by inducing its vendors to confirm false receivable balances and purchase allowances. The auditors were misled into believing that the fictitious promotional allowances were in fact valid. [See Figure I, pg. 455]

Table III displays a heatmap of internal concealment methods for each of the revenue and expense misstatement strategies. To provide further understanding of the context in which the (alleged) fraud occurred, the most common concealment methods for revenue and expense misstatements are described in the following section. Unusual techniques to conceal revenue and expense misstatements are illustrated separately due to their unique nature in the next section. [See Table III, pg. 454]

Revenue Misstatement and Concealment Strategy Context

Fictitious Revenue

The SEC complaint narratives provide the contexts and plots on how accounts receivables were used to record fictitious revenues in Peregrine Systems Inc. (case 11) and Vitesse Semiconductor Corporation (case 20). With regards to Peregrine, the SEC (2002, para. 3) stated that, … "When Peregrine booked the non-binding contracts, and the customers predictably did not pay, the receivables ballooned on Peregrine's balance sheet. To make it appear that Peregrine was collecting its receivables more quickly than it was, a senior officer entered financing arrangements with banks to exchange receivables for cash. Peregrine improperly accounted for these financing arrangements as sales of the receivables and removed them from the company's balance sheet. There were several problems with this. First, because Peregrine had given the banks recourse, and frequently paid or repurchased unpaid receivables from them, Peregrine should have accounted for the financing arrangements as loans and left the receivables on its balance sheet. Second, some of the 'sold' receivables were not valid because the customers were not obligated to pay Peregrine. Third, several of the 'sold' invoices were fake. One of the fake invoices purported to reflect a $19.58 million sale. Senior employees also concealed the revenue fraud and resulting collection problem by improperly writing off receivables …."

In its complaint report, SEC mentioned that, … Peregrine failed to maintain adequate books and records to support its financial statements. For example, Peregrine did not maintain detailed accounts receivable sub ledgers that reconciled to the company's general ledger. Nor did Peregrine maintain a detailed sales journal that reconciled to the general ledger. Peregrine used a 'back of the envelope' system to track and record license revenue. Instead of appropriately using Peregrine's computerized accounting system, company personnel used a spreadsheet, known as the "Revenue Report", to record license revenue. At the end of each quarter, Peregrine personnel recorded a manual entry to force the general ledger to match the Revenue Report but did not reconcile the variance—sometimes greater than $10 million—between the general ledger and the Revenue Report … (SEC, 2003g, para. 30).

In the Vitesse case, the SEC alleged that the company concealed the true age of the accounts receivables, … As further alleged, to conceal the true age of the accounts receivable from Vitesse's external auditor, Hovanec and Kaplan then directed that cash receipts received by Vitesse from the distributor and other customers be misapplied to these aged invalid receivables … (SEC, 2010).

The above contexts revealed that existing aged accounts receivables were maintained in the books of record, sold, and removed from the financial statements and their true age was concealed.

Premature Recording of Revenue

Some companies recorded revenues prematurely by adding them as new fraudulent records or transactions into the accounting system such as in Conagra Foods (case 9) and General Electric Inc. (case 10). In the Conagra case, SEC (2007a) reported, … In fiscal year 2000, former senior executives at United Agri-Products (UAP), which is one of Conagra subsidy, participated in a scheme to overstate UAP's operating results through the use of improper accounting practices including the improper recognition of revenue from deferred delivery sales and associated rebates from its suppliers, the failure to record bad debt expenses when realized and the premature recognition of revenue from advance vendor rebates … Forensic accountants retained by special counsel to the Audit Committee of ConAgra tested a sample valued at over $247 million of UAP's deferred delivery sales originally recorded from fiscal year 1998 through the second quarter of fiscal year 2001 and determined that approximately 40 percent of the transactions tested were fraudulent ….

In the case of General Electric Inc., the four accounting violations include, … In 2002 and 2003, reported end-of-year sales of locomotives that had not yet occurred to accelerate more than $370 million in revenue … In 2002, an improper change to GE's accounting for sales of commercial aircraft engines' spare parts that increased GE's 2002 net earnings by $585 million … (SEC, 2009).

As can be seen from cases 9 and 10, various strategies were employed to misstate revenue. Both cases employed internal concealment methods of recording revenue prematurely including recording deferred delivery sales, rebates from vendors, and future sales. The net effect on the yearly revenue and earnings were also substantial.

Improper Side Agreement and Round Tripping

In concealing revenue misstatements, companies also colluded with third parties and disguised them as an insurance policy such as Brightpoint (case 8) and reciprocal agreements Peregrine (Case 11) as indicated below. In the Brightpoint case, the SEC (2003b) noted, … In this case, AIG worked hand in hand with Brightpoint personnel to custom-design a purported insurance policy that allowed Brightpoint to overstate its earnings by a staggering 61 percent. This transaction was simply a 'round-trip' of cash from Brightpoint to AIG and back to Brightpoint. By disguising the money as 'insurance', AIG enabled Brightpoint to spread over several years a loss that should have been recognized immediately ….

In the Peregrine case, the SEC (2003g, Para 13) stated, ... Peregrine used other deceptive practices to inflate the company's revenue. To convince certain customers to purchase Peregrine's software, Peregrine entered into reciprocal agreements with them, including nonmonetary transactions, sometimes referred to as barters or swaps. Under certain circumstances it is appropriate to recognize revenue on nonmonetary transactions. However, Peregrine recognized revenue on transactions that did not satisfy the applicable revenue recognition rules, either because (a) Peregrine did not intend to use the product it purchased, (b) Peregrine was merely exchanging software inventory for resale, or (c) there was no vendor-specific objective evidence to support valuation. Certain senior Peregrine officers, and sales and finance personnel, understood the revenue recognition rules that applied to nonmonetary transactions, and they knew, or were reckless in not knowing, that these rules prohibited revenue recognition on many transactions for which Peregrine recorded revenue.

According to Albrecht et al. (2019, p. 394), side agreements are sales and terms of arrangements that are made in secret outside normal business channels which could be fraudulent if the amendment of the terms and conditions of existing sales contract violated the revenue recognition requirements, which are illustrated in the above excerpts.

Expenses Misstatement and Concealment Strategy Context

Reporting Lower Expenses

This misstatement strategy is most frequently employed by the sampled companies to improve their financial performance, especially by capitalising expenses to spread them into fewer accounting periods. WorldCom for example, … From the first quarter of 2001 through the first quarter of 2002, WorldCom improperly capitalized approximately $3.5 billion of operating line costs in violation of well-established accounting standards and WorldCom’s own capitalization policy. Various employees indicated that Sullivan decided the amounts WorldCom would capitalize. The capitalization entries were made in large; round-dollar amounts after the close of the quarter and only a few days before the Company announced its earnings. The capitalization entries were supplemented by an additional $377 million in improper adjustments to reduce line costs during this period by a total of $3.883 billion … SEC (2003e, p. 90).

The Securities Exchange Commission also reported that CUC also employed a similar method to improve its position by capitalising its membership related cost using opportunities chosen for the coming year. The SEC (2000a) reported that, … CUC senior management overseeing the scheme maintained an annual schedule listing revenue and operating income for each of the company's divisions for its current fiscal year and coming fiscal year and setting forth the so-called "opportunities" or means available for inflating the company's operating income during the coming year. At the beginning of each fiscal year, management decided which of these opportunities to use for that fiscal year and the amount needed from each such opportunity. Accordingly, the schedule served as management's "cheat sheet" for any given year. … CUC management utilized four principal categories of opportunities to inflate the company's income and earnings. Two of those categories involved the company's sales of membership products. First, management manipulated recognition of the company's membership sales revenues. Second, management improperly utilized two liability accounts related to membership sales, consistently maintaining inadequate balances in the accounts and on occasion reversing the accounts directly into operating income. To hide the inadequate balances, management periodically kept certain membership sales transactions off-books.

Not Reporting Expenses

Some companies blatantly did not report a certain portion or the entire amount of expenses to avoid reporting them in the financial statements. These are examples from Qwest and Waste Management.

As reported by the SEC (2005), … Szeliga reduced expenses relating to compensated absences by $71.3 million to help Qwest meet earnings targets and fraudulently failed to disclose in Commission filings Qwest's change in accounting for compensated absences.

SEC (2002a, para. 4) continues, … They improperly eliminated or deferred current period expenses to inflate earnings. For example, they avoided depreciation expenses by extending the estimated useful lives of the Company's garbage trucks while, at the same time, making unsupported increases to the trucks' salvages values. In other words, the more the trucks were used and the older they became, the more the defendants said they were worth.

In the first example, Qwest reported a much smaller amount of accruals and failed to disclose the change in their accounting policy regarding compensated absences. Waste Management however, extended their garbage trucks' useful life to record a lower depreciation expense, claiming rather oddly in their defense that the trucks were worth more as they aged.

Unusual Techniques

An 'unusual technique' is a technique which is not identified in the literature (see Appendix I), and as such provides findings unanticipated in this study. In most cases, inappropriate or unauthorised journal entries and adjustments are made outside the formal accounting system which are almost impossible to detect, even by data mining (Gray and Debreceny, 2015). The identification of this technique may prompt more research in the future, perhaps by exploring how pervasive they were in the perpetration of FSF. Four companies (case 7, 14, 16, and 23) are outlined to illustrate how revenues and expenses were misstated using unusual techniques.

<u>Misstating Revenue</u>

In WorldCom cases, the SEC elaborated on how deliberate WorldCom was in strategizing their actions to misstate revenue. … The principal tool by which revenue performance was measured and monitored at WorldCom was the MonRev, a comprehensive, monthly revenue report prepared and distributed by the Revenue Accounting group. The MonRev provided a revenue snapshot of the entire company for any given period. It took computer feeds from the MCI and WorldCom billing systems, and consolidated and organized them into a collection of schedules, broken down into the company's sales channels and segments. It included dozens of spreadsheets detailing revenue data from all those channels and segments. It also compared those actual results with budgeted numbers … The MonRev also contained an attachment detailing adjustments made at the corporate level—and generally not derived from operating activities of WorldCom's sales channels—known as the Corporate Unallocated schedule. Sullivan had ultimate responsibility for the items booked on the Corporate Unallocated schedule; however, the Revenue Accounting group, headed by Lomenzo, prepared the schedule and had principal responsibility for booking the entries that appeared on the schedule. The original purpose of this schedule was apparently to reflect certain items for which no individual sales channel was entitled to credit: for example, revenues from the sale of a corporate asset, or a change of accounting policy for a particular contract. As a result, no sales channel followed the entries on this schedule—indeed, no sales channel even received a copy of it. This made the Corporate Unallocated revenue schedule an ideal repository for a series of entries by which WorldCom improperly inflated its reported revenues beginning in late 1999 ….

Distribution of the MonRev was limited and access to it was closely guarded; and this was even more so with the Corporate Unallocated schedule. These reports were prepared principally by Lomenzo's Senior Director of Revenue Reporting and Accounting, Lisa Taranto, and two people reporting to her. In addition to Ebbers and Sullivan, only a handful of employees outside the Revenue Accounting group regularly received the full MonRev. Most managers at WorldCom received only those portions of the MonRev that were deemed relevant to their position; sales channels managers, for instance, received only components of the MonRev that reflected their own sales channel revenue information. It was not uncommon for Sullivan and Lomenzo to deny requests for access to the full MonRev. Sullivan routinely reviewed the distribution list for the full MonRev to make sure he approved of everyone on the list … (SEC, 2003e, p. 135–7).

In the SEC (2003a), HealthSouth was reportedly, … on a quarterly basis, HRC's senior officers would present Scrushy with an analysis of HRC's actual, but unreported, earnings for the quarter as compared to Wall Street's expected earnings for the company. If HRC's actual results fell short of expectations, Scrushy would tell HRC's management to "fix it" by recording false earnings on HRC's accounting records to make up the shortfall … HRC's senior accounting personnel then convened a meeting to "fix" the earnings shortfall. At these meetings, HRC's senior accounting personnel discussed what false accounting entries could be made and recorded to inflate reported earnings to match Wall Street analysts' expectations. These entries primarily consisted of reducing a contra revenue account, called "contractual adjustment", and/or decreasing expenses, (either of which increased earnings), and correspondingly increasing assets or decreasing liabilities ….

Misstating Expenses

Unusual techniques were also employed to misstate expenses as shown in Symbol Technologies and Olympus below. In Symbol Technologies, the SEC (2004a) stated that, … With no regard for generally accepted accounting principles (GAAP) or their financial reporting obligations, the defendants used the following fraudulent schemes to align Symbol's reported financial results with market expectations: … a "Tango sheet" process through which baseless accounting entries were made to conform the unadjusted quarterly results to management's projections … After the Commission began its investigation, Jaeggi directed subordinates to discard copies of "Tango sheets" and other incriminating documents ….

In an independent investigation report into Olympus, the Olympus Corporation Third Party Committee report (2011, p. 15, 18), stated that, … Yamada and Mori of Olympus asked Sagawa and Nakagawa to set up "Tobashi" Receiver funds that would not be recorded on Olumpus' consolidated financial statements … after the "Tobashi" was discovered by the accounting auditors in September 1999, it proceeded at a rapid pace under the direction of Yamada and Mori. Kikukawa became aware of the existence and execution of the above-described loss separation schemes before he became president, but after he became managing director in charge of parent company accounting in June 1999 ….

In summary, the unusual techniques of misstating revenues and expenses as illustrated above unmasked how deliberate management was in making sure that the intended fraudulent objectives were achieved. They invented systems which promoted fraudulent accounting practices with careful planning and strategies. As can be read from the above, a group of people in higher authority was involved. It is notable that the legitimate hierarchical authority provided each member of the group the opportunity needed to commit the FSF headed by someone who had legitimate power in the organisation.

V. Discussion and Conclusion

This study identifies accounting misstatements and associated concealment strategies using the narratives of the SEC AAERs, scholarly work, SEC press releases, and other publicly available sources for 30 companies. The study finds that the internal methods or opportunities were used to misstate revenue and expenses. This study finds that nearly two-thirds of the strategies used to conceal the misstatement of revenue were 'internal' gamesmanship. The form, alteration, and manipulation of books, documents, and records was the preferred choice, in recording fictitious revenues.

Examination of the context revealed that not only were false entries and transactions recorded, but also invoice management, automated accounting, and financial systems were manipulated to deliberately alter the financial statement results. Unusual tobashi and tango systems were reported to keep track of the revenue and expense manipulations. There was evidence that these manipulations were kept below a material level to avoid arousing auditor suspicion. In some cases, expenses were not even recorded to avoid detection of irregularities. Some companies seemed to go out of their way to avoid SEC scrutiny, thus intentionally strategizing their options to conceal any accounting misstatements (Schilit et al., 2018). Companies tend to push back losses and charges and instead show the wrong millions of dollars as expenses

(Carpenter, 2015; Norris, 2001) or even fail to report them in the correct period. Rezaee (2005) also observed that expenses could be hidden for as long as five years.

The sampled companies employed concealment strategies to lower expenses to increase profits. These strategies included provision accounting, increasing inventory capitalising expenses, lengthening asset lives, minimising bad debts, or minimising tax techniques with capitalisation method as the most common strategy (Smith and Hannah, 1991; Beasley et al., 1999). One of the unusual strategies is inflating expenses. Scholars asserted that management may choose just the opposite strategy to deflate current-period profits and shift them to later periods (Albrecht et al., 2019; Schilit et al., 2018).

Overall, the data analysis carried out in this study suggests an association between concealment strategies, workaround opportunities and the type of misstatement strategies. The analysis also shows that internal opportunities were more insidious than external opportunities. Management consciously and meticulously concealed their misstatement strategies. The study findings imply that auditors must maintain a sceptical attitude about the possibility of FSF and workaround concealment strategies. The findings and the illustrated contexts reveal that the strategies employed defy legitimate accounting practices. False accounting practices were used to make sure that companies were diligent in management of their receivables, payables, liabilities, and overall good performance. These findings amplify the proposition of this paper that management tends to take advantage of internal opportunities to portray better financial performance. The workaround opportunities strategize the concealment methods, in particular where unusual techniques are employed by management to create false accounts for deviant purposes and supporting documents were made known only to a selected group of insiders. Since the invented practices were maintained outside the accounting system, management augmented their power and control to mobilise collusion with third parties for fraudulent purposes. The underlying reason is often for mutual benefit, which requires collusion at a deeper level within the company and the environment in which it operates (Röder, 2017; Soltani, 2014). The findings highlight how the inherent power of organisational hierarchical positions can enable fraud and crime.

This study also links FSF misstatements to the associated concealment strategies using a sample of international FSFs to provide a broad overview of their most common associations. The findings extend the compilations of fraud techniques described in previous research. Awareness of the complexity of the FSF contexts and management concealment strategies are important for educational and training purposes, thus examples from specific cases are incorporated into this study. When a company made headlines for committing FSF, the context and most of the details remained in the regulators' website. The regulators and standard setters have increasingly acknowledged the importance of converting hindsight into foresight to enhance awareness and exposure to prevent and detect FSF early. However, these educational contributions do not precede the requirements for auditors to maintain professional scepticism, to step away from box ticking, and to be vigilant when assessing management's opportunity privilege. Even if the misstatements not material, the implications must be evaluated as fraud always starts small and, in most cases, is extended over time. As is unravelled in this study, omission and unusual techniques gamed outside the accounting system are worth the consideration of regulators and standard setters. If it is not in existence, does not mean it is not there. Trust but verify.

This study is not without its limitations. It is descriptive in nature and brings to the fore hindsight from a limited sample of 30 cases, but the small sample size constrains generalisability. In addition, there might be bias in interpretation and limited focus on the internal (external) opportunities underpinning revenue and expense misstatements. These misstatements might be related to other concealments which are not covered in this study. Furthermore, some internal control weaknesses were not observable, thus all concealment strategies may not have been observed. Analysing the context of misstatement and concealment strategies prevents a macro-level scrutiny of the existing pre- (e.g., corporate governance, regulations, industry) and post-effects (e.g., bankruptcy).

The limitations open opportunities for future studies to validate findings of management's preferred concealment method for revenue and expense misstatements using internal opportunities. More research illustrating the commonalities and differences in misstatement and concealment strategies would be beneficial to auditors, regulators, and accounting students for teaching and learning purposes. Auditors must educate themselves with the most recent collusive and unusual revenue fraud schemes and how they were concealed to successfully recognise the risk factors that may lead to FSF. A larger sample may allow examination of the effect on FSF of the industry, corporate governance, and regulations. Since a wide-level collusion is required to perpetrate a high level FSF, an examination of the role of organizational culture may be useful. Further, scholars might want to explore whether organizations meeting their objectives are more likely to forgive deviant acts that have failed to produce positive results than those organisations struggling to survive (Mainemelis, 2010, p.

575). An international and comprehensive database of the context of misstatement and concealment strategies may be useful for the training and regulative function of the accounting and auditing profession.

Appendix I: Common Misstatement Strategies

	Misstatement strategy	Authors	This study
A	Revenue-related		No. of misstatement strategies
	1. Recording fictitious revenue	Schilit et al. (2018); Bhasin (2016); Lokanan (2014); Gao and Srivastava (2011); COSO (2010); Mulford and Comiskey (2002); Bonner et al. (1998)	9
	2. Premature recording of revenue	CAQ (2021); Schilit et al. (2018); Bhasin (2016); Gao and Srivastava (2011); Jones (2011), COSO (2010); Mulford and Comiskey (2002); Spathis (2002); Beasley et al. (2000); Bonner et al. (1998)	6
	3. Round-tripping, recording loans as sales, swapping products with one another	COSO (2010); Jones (2011)	5
	4. Unusual strategy		5
	1. Using 'contractual adjustment' procedure (1)		
	2. Practising 'Close the Gap' (1)		
	3. Misclassifying allowance from vendor (1)		
	4. Omission of cost and losses (2)		
	5. Bill-and-hold transactions/ Consignment sales	COSO (2010)	2
	6. One-off technique (non-trading profits)	Schilit et al. (2018); Bhasin (2016); Smith and Hannah (1991)	2
	7. Sales agreements manipulation	Bhasin (2016); Brennan and McGrath (2007)	1
	8. Side agreements relating to sales (conditional sales)	Lokanan (2014); COSO (2010); Brennan and McGrath (2007)	1
	9. Recording investment income as revenue	Bhasin (2016)	
	10. Increase interest receivable	Jones (2011)	
	11. Include non-operating profits	Jones (2011)	
	12. Treat loan as sales	Jones (2011)	
	Subtotal		31
B	Expenses-related		
	13. Reporting lower amount of expenses, e.g., Improper use of depreciation/ amortisation/capitalisation, write-off	Bhasin (2016); Lokanan (2014); Jones (2011); Gao and Srivastava (2011); COSO (2010); Brennan and McGrath (2007); Mulford and Comiskey (2002); Smith and Hannah (1991); Bonner et al. (1998)	16
	14. Failing to record expenses	Bhasin (2016)	10
	15. Unusual strategy to hide expenses or losses	Schilit et al. (2018)	6
	1. Inflating expenses (1)		
	2. Spreading contract losses (1)		
	3. False tax number (1)		
	4. Using carryover to close the gap (1)		
	5. Off-book record (2)		
	16. Delaying the recording of expenses	Schilit et al. (2018); Bhasin (2016); Lokanan (2014); Spathis (2002);	4
	17. Allocating cost/expenses to fixed assets	Bhasin (2016); Lokanan (2014)	
	18. Use provision accounting	Jones (2011); Smith and Hannah (1991)	
	19. Reduce tax	Jones (2011); Smith and Hannah (1991)	
	20. Be generous with bad debts	Jones (2011)	
	Subtotal		36
	Total revenue- and expenses-related schemes		67

Misstatement strategy	Authors	This study
Other than revenue- and expenses-related schemes	10	
Grand total	77	

Appendix II: Sampled Cases

Case	Company Name	Industry	Year fraud discovered
1	CUC (Cendant)	Business and consumer services	1998
2	Sunbeam Corporation	Consumer Products	1998
3	Waste Management	Waste management	1998
4	MicroStrategy (Italy)	Business Intelligence and Mobile software	2000
5	Enron	Energy	2001
6	Xerox	Information Technology	2001
7	WorldCom	Telecommunications	2002
8	Brightpoint	Wireless Telecommunications	2002
9	Conagra Food	Food Processing	2002
10	General Electric	Conglomerate	2002
11	Peregrine Systems Inc	Computer Software	2002
12	Royal Ahold (The Netherlands)	Retailing	2002
13	Bristol-Meyers Squibb	Pharmaceuticals	2003
14	HealthSouth	Healthcare Services	2003
15	Freddie Mac	Financial Services	2003
16	Symbol Technologies	Automatic Identification and Data Capture	2004
17	Kanebo (Japan)	Cosmetic and Textile	2005
18	Krispy Kreme Doughnuts	Restaurant	2005
19	Qwest Communications	Telecommunications	2005
20	Vitesse Semiconductor Corporation	Semiconductor	2006
21	Dell Computer	Computer hardware and software	2007

Case	Company Name	Industry	Year fraud discovered
22	(HP) Autonomy	Information Technology	2011
23	Olympus (Japan)	Electronics	2011
24	Satyam (India)	IT Services and Consulting	2011
25	Diamond Foods	Consumer Packaged Goods	2012
26	Tesco (UK)	Retail	2014
27	Toshiba (Japan)	Conglomerate	2015
28	Celadon Group Inc.	Transport and Logistics	2019
29	SAExploration Holdings Inc.	Oil and Gas; Exploration Services	2019
30	Luckin Coffee	Coffee and Tea Manufacturing	2020

Table I: Revenue Misstatement and Concealment Strategy Overview

Case	**Length of fraud (year)**	**Reported Revenues Misstatement**	**Concealment Strategy (Opportunity)**	
			Internal Methods	**External Methods**
1	2	Recording fictitious revenue	Altering books and records	
2	2	Recording fictitious revenue	Deleting records to conceal returns from channel partner	Offering discounts and other incentives before period ends
		One-off	Recording one-off sales as recurring revenue	
		Bill-and-hold scheme		Offering compensation to wholesaler and distributor
				Offering customers financial incentives to order goods before they are required
4	2	Premature recording of revenue	Recording yet-to-occur or incomplete sales	
			Using unsigned sales contract	
5	10	Premature recording of revenue	Recording yet-to-occur or incomplete sales	
		Recording fictitious revenue		Creating special purpose entities and colluding with bankers
6	3	One-off	Recording one-off accounting adjustments to close the gap in targeted revenue and earnings numbers	

Case	Length of fraud (year)	Reported Revenues Misstatement	Concealment Strategy (Opportunity) Internal Methods	External Methods
7	1	Recording fictitious revenue	Recording unsupported accounting entries to show targets were achieved	
		Unusual technique	Practising "Close the Gap" process	
8	3	Improper side agreement and round tripping	Recording round-tripping with customers disguised as completed sales delivery	Round-tripping with customers disguised as completed sales delivery
			Recording round-tripping with banker disguised as an insurance policy	Round-tripping with banker disguised as an insurance policy
9	2	Premature recording of revenue	Recording yet-to-occur or incomplete sales	
10	2	Premature recording of revenue	Recording yet-to-occur or incomplete sales	
11	2	Recording fictitious revenues	Concealing uncollected receivables as an expense	
			Maintaining of "Revenue Report" to force manual entries	
			Altering aged accounts receivable to make them appear as collectable	
		Manipulation of sales agreements	Books were opened after fiscal quarters e.g., 37th of December	Used secret, oral and written, agreement to arrange payments to be received
			Paid purchases on behalf of the customers and used it to reduce receivables	Paid purchases on behalf of the customers and used it to reduce receivables
			Financing receivables from bank and used own fund to record and pay the bank instead of collecting from receivables	Financing receivables from bank and used own fund to record and pay the bank instead of collecting from receivables
12	2	Unusual technique	Misclassifying allowances from vendor as revenue	
13	2	Premature recording of revenue		Guaranteeing compensation to wholesaler
14	6	Unusual technique	Using a contra revenue account, called	

Case	Length of fraud (year)	Reported Revenues Misstatement	Concealment Strategy (Opportunity) Internal Methods	External Methods
			'contractual adjustment'	
16	5	Recording fictitious revenues	Undisclosed reclassifying aged receivables to note receivables	Channel stuffing with resellers
		Bill-and-hold scheme	Concealing channel stuffing	Deliberately shipping wrong products when they are not available
			Falsely setting the process status on accounting system	
			Executing manual entries on general ledger based on goods ordered	
17	8	Premature recording of revenue		Guaranteeing compensation to wholesaler
18	3	Improper side agreement and round-tripping	Round-tripping with franchisee disguised as completed sales	Round-tripping with franchisee disguised as completed sales
			Round-tripping with former franchisee manager disguised as management fee	Round-tripping with former franchisee manager disguised as management fee
19	3	One-off	Recording one-off sales as recurring revenue	
20	11	Premature recording of revenue	Recording invalid receivables	Shipping to largest distributor at period end
		Recording fictitious revenue	Failing to record returns from distributors	
			Misapplying cash received against invalid accounts receivables	
22	2	Improper side agreement and round-tripping	Backdating and colluding with resellers to effect side agreement	Backdating and colluding with resellers to effect side agreement
			Round-tripping with resellers disguised by backdating purchase orders	Round-tripping with resellers disguised by backdating purchase orders
24	4	Recording fictitious revenue	Creating bogus invoices	
27	6	Recording fictitious revenue		Channel stuffing with manufacturing partner
		Unusual technique	Directly omitting from cost and losses	
29	1	Bill-and-hold scheme		Misappropriating company's funding

Case	Length of fraud (year)	Reported Revenues Misstatement	Concealment Strategy (Opportunity)	
			Internal Methods	External Methods
30	1	Recording fictitious revenue	Directly altering accounting and bank records	Reporting fake operations

Table II: Expenses Misstatement and Concealment Strategy Overview

Case	Length of fraud	Reported Expenses Misstatement	Concealment Strategy (Opportunity)	
			Internal Methods	External Methods
1	2	Reporting lower amount of expenses	Using capitalisation method	
2	2	Reporting lower amount of expenses		Aggressively negotiating with suppliers
		Failed to record expenses	Using restructuring reserves	
3	5	Reporting lower amount of expenses	Using capitalisation method	
			Extending unsupported useful lives of assets	
		Failed to record expenses	Omitting expenses relating to accruals	
			Omitting write-off of impaired assets	
7	1	Reporting lower amount of expenses	Using capitalisation method	
12	2	Reporting lower amount of expenses		Making use of fake rebates from vendors
		Failed to record expenses	Omitting expenses relating to accruals	
14	6	Reporting lower amount of expenses	Using bad debt reserves	
			Using capitalisation method	
16	5	Unusual technique	Off-book record – "Tango sheet" to record baseless accounting entries	
17	8	Delaying the recording of expenses		Under-reporting current expenses
		Failed to record expenses	Omitting the recording of obsolete inventories	
			Omitting the recording of loss-making subsidiaries and project expenses	
19	3	Failed to record expenses	Omitting expenses relating to accruals	
21	3	Reporting lower amount of expenses	Predetermining adjustments to be made	
23	31	Unusual technique	Off-book record using a "tobashi" system to cover up investment losses	
25	1	Delaying the recording of expenses		Capitalising advance payments to suppliers

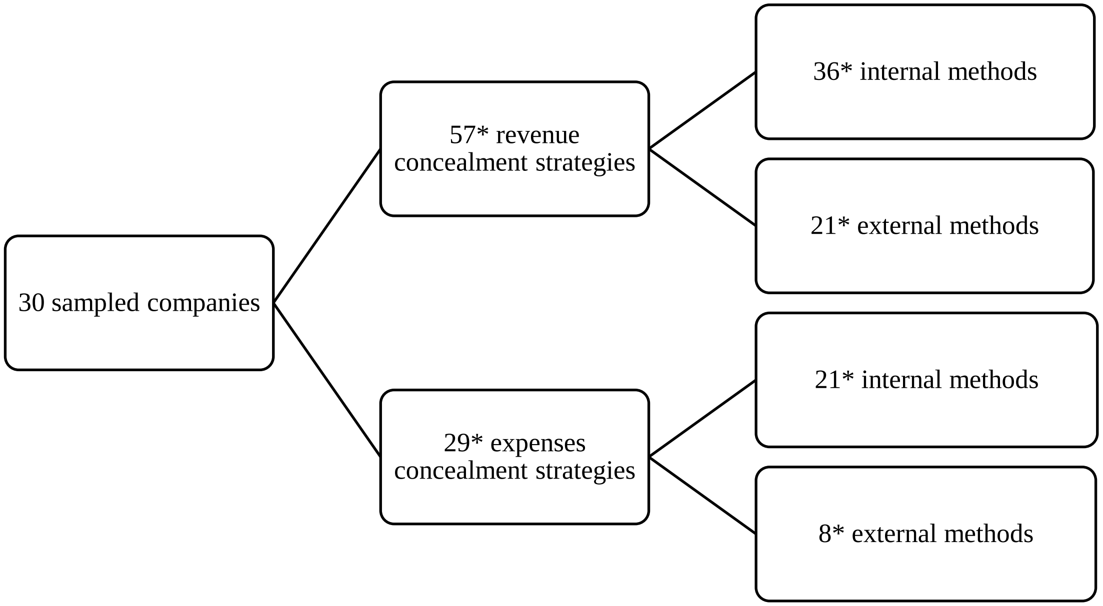
Case	**Length of fraud**	**Reported Expenses Misstatement**	**Concealment Strategy (Opportunity)**	
			Internal Methods	**External Methods**
26	2	Reporting lower amount of expenses		Repackaging payments to suppliers into "back-end profits"
		Delaying the recording of expenses		Recording suppliers' payments in the wrong period
27	6	Delaying the recording of expenses		Requesting vendors to delay invoices
		Failed to record expenses	Omitting the recording of loss-making subsidiaries and project expenses	
		Unusual technique	Spreading contract losses	
			Reporting false tax amount	
			Using a 'carryover' to close the gap directly between the targeted and actual amounts	
28	1	Failed to record expenses		Reclassification assets as investments colluding with third party
30	1	Unusual technique	Inflating expenses	

Table III: Heatmap of Misstatement and Internal Concealment Methods

	Accounting System - Books/Records/Transaction					**Other Methods**						
Revenue	Alteration	Deletion	New/ Addition	Omission	Misclassification	Manipulate sales contract / agreement	Close-the-gap Process/ Adjust Contract	Manipulate Accounts Receivables/Returns	Manual entries/ report/ system	Manipulate accounting system	Odd dates/ quarters	Channel stuffing
Fictitious												
Premature												
Unusual												
One-off												
Improper side/sales agreement and round tripping												
Bill-on-hold												

	Accounting System - Books/Records/Transaction								**Other Methods**	
Expenses	Capitalise Expenses	Manipulate Reserve	Extend Assets Useful Life	Omission of Accruals	Omission of Expenses/ Losses	Inflate Expenses	Spread/ Plan expense/ losses	False Tax number	Off-book/ Manual System	Close-the-gap procedure
Lower										
Omission										
Unusual										

Figure 1: Overall Summary of Revenue and Expenses Misstatement Techniques and Concealment Strategies



*A company may commit more than one misstatement strategy, or use more than one internal, or external, or both methods in concealing the misstatements strategies.

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