Journal of Forensic & Investigative Accounting
Vol. 4, Issue 2, 2012

ROLE OF CORPORATE GOVERNANCE PARTICIPANTS IN PREVENTING AND PARTICIPANTS IN PREVENTING AND DETECTING FINANCIAL STATEMENT FRAUD

Zabihollah Rezaee
Ben L. Kedia*

INTRODUCTION

Financial statement fraud (FSF) was a contributing factor to the recent financial crisis and threatens the efficiency, liquidity, and safety of both debt and capital markets (Black, 2010).[1]Furthermore, it has significantly increased uncertainty and volatility in financial markets, shaking investor confidence worldwide. FSF also reduces the creditability of financial information that investors use in investment decisions. The effects of FSF are clear. For, example Sorkin (2010) reports that the Financial Fraud Enforcement Task Force of the Department of Justice has brought cases against 343 criminal and 189 civil defendants for their fraudulent activities which have harmed more than 120,0000 victims for more than $8 billion in recent years in the United States. Thus, effective corporate governance is necessary to prevent this phenomenon[2].

Corporate governance is defined broadly from the agency theory perspective as a process of aligning management interests with those of shareholders or from the regulatory perspective as a process of ensuring compliance with all applicable laws, rules and regulations (Rezaee, 2007). Corporate governance is no longer simply a compliance process, but rather a business strategic imperative that is crucial to business sustainability and corporate social responsibility goals. The

*The authors are, respectively, Thompson-Hill Chair of Excellence and Professor of International Business at the Fogelman College of Business and Economics at University of Memphis.

demand for ever-improving corporate governance and accountability for business organizations has been a global trend in recent years. But the role of corporate governance participants in preventing and detecting FSF has not been adequately examined in the literature. The 2010 Committee of Sponsoring Organizations (COSO) report pinpoints the importance of corporate governance research and its relation to the prevention of FSF (COSO, 2010). The primary purpose of this study is to examine how effective corporate governance can prevent and detect incidents of FSF. Insights were derived from a survey of executive MBA (EMBA) students to obtain their perspective on the antifraud policies, procedures and practices of all participants involved in corporate governance including the board of directors, management, internal auditors and external auditors. The key finding of this paper is that effective corporate governance can prevent and detect FSF through the competent actions of corporate gatekeepers. Results have implications for: (1) regulators and policymakers in combating fraud that threatens the integrity, efficiency and safety of our capital markets; (2) corporations and practitioners in designing effective antifraud policies and practices to reduce incidents of FSF; and (3) academics in furthering our understanding of roles and responsibilities of corporate governance participants (gatekeepers) in preventing and detecting FSF.

FINANCIAL STATEMENT FRAUD

From Enron and WorldCom in 2001 to Madoff and Satyam in 2009, FSF has been a dominate news item in the past decade. There has been ample evidence that FSF has undermined the integrity of financial reports and has contributed to substantial economic losses. Furthermore, fraud has eroded investor confidence in the usefulness and reliability of financial statements. The existence and persistence of FSF in recent years continues to contribute to financial uncertainty and market volatility, thus preventing global investors from receiving

meaningful financial information to make savvy investment decisions. For example, Rezaee and Riley (2009) report that since the passage of the Sarbanes-Oxley Act of July 2002 (SOX), which was primarily intended to combat FSF and scandals, the Department of Justice has obtained nearly 1,300 fraud convictions. Internationally, PricewaterhouseCoopers' 2007 Global Economic Crime Survey reports that of the 5,428 companies in 40 countries that took part in the survey, about 12% had suffered from accounting fraud between 2005 and 2007 (PricewaterhouseCoopers, 2007). Furthermore, the 2010 COSO report concludes that: (1) FSF has persisted in the past two decades with 347 incidents between 1998-2007 as compared to 294 cases from 1987-1997; (2) the magnitude (mean per cases) of FSF during 1998-2007 was about $400 million as compared to a mean of $25 million per case between 1998-1997; (3) FSF cases were committed with some level of involvement of senior executives (CEO, CFO) in 89 percent of studied cases in 1998-2007 as compared to 83 percent of cases in 1987-1997; (4) almost 20 percent of alleged fraudulent executives were indicted and of those more than 60 percent were convicted; (5) the most common FSF schemes continue to be improper revenue recognition and overstatement of assets; (6) over one fourth of firms changed auditors either during the fraud period or in the fiscal year preceding the fraud period; and (7) firms involved in fraud experienced negative consequences such as a decline in stock prices, bankruptcy or delisting from major stock exchanges (COSO, 2010).

High profile FSF cases have raised serious concerns about (1) the role of boards of directors and audit committees in preventing and detecting FSF; (2) the integrity, competency, and ethical values of top management teams in firms indicted for fraud; (3) the ineffectiveness of audit functions in detecting and reporting FSF; and (4) the substantial declines in the market

capitalization of the alleged fraud companies. Rezaee and Riley (2009) argue that FSF is harmful in many ways. It:

1. Undermines the reliability, quality, transparency, and integrity of the financial reporting process.
2. Jeopardizes the integrity and objectivity of the auditing profession, especially auditors and auditing firms.
3. Diminishes the confidence of the capital markets, as well as market participants, in the reliability of financial information.
4. Makes the capital market less efficient and adversely affects the nation's economic growth and prosperity by reducing the credibility of financial information used by investors.
5. Results in huge litigation costs as corporations, their auditors, and individuals complicit in the fraud can be sued for alleged financial statement fraud by investors.
6. Destroys the careers of individuals involved in financial statement fraud.
7. Causes bankruptcy or substantial economic losses for the company engaged in financial statement fraud. For example WorldCom, with $107 billion in assets and $41 billion in debt, finally filed for Chapter 11 bankruptcy protection on July 21, 2002. WorldCom's bankruptcy is the largest U.S. bankruptcy ever, almost twice the size of Enron.
8. Encourages regulatory intervention such as the passage of SOX in 2002. Regulatory agencies (e.g., the SEC) considerably influence the financial reporting process and related audit functions.
9. Destroys the normal operations and performance of alleged companies. The FSFs of Enron, WorldCom, Global Crossing, Adelphia and Satyam have caused these high profile

companies to file bankruptcy and their top executives to be fined and, in some cases, indicted for violation of Securities Acts.

10. Raises serious doubt about the efficacy of financial statement audits. The financial community is demanding that high-quality audits and auditors improve their audit effectiveness and efficacy to produce the needed assurance.

CORPORATE GOVERNANCE

Corporate governance has garnered considerable attention in the wake of the recent global financial crisis and is now emerging as a central issue for regulators and public companies. Large public companies have undergone a series of regulatory reforms stemming from legislation enacted by the US Congress (e.g., Sarbanes-Oxley Act of 2002, SOX), new regulations from the Securities and Exchange Commission (SEC), listing standards of national stock exchanges, and the best practices of investor activism. Corporate governance is a process affected by legislation, legal, regulatory, contractual and market-based mechanisms, as well as best practices to create substantiate shareholder value while protecting the interests of other shareholders (Rezaee, 2007). This implies that there is a disperse ownership structure and that the role of corporate governance is to protect shareholders and other stakeholders' interests by limiting opportunistic behavior of managers who control their interests. In a capital structure where there is concentrated ownership and a small group of shareholders can exercise ownership control, corporate governance should ensure the alignment of interests of controlling shareholders with those of minority or individual shareholders. Coffee (2005) suggests that different capital ownership structures (e.g., dispersed versus concentrated) may lead to different types of FSF. More specifically, in the U.S. a dispersed ownership system is more prone to short-term earnings management and quarterly FSF. Conversely, European's and Asian's concentrated ownership

system is more susceptible to the extraction of private benefits from controlling shareholders at the expense of minority shareholders or the likelihood that the controlling shareholders over reach minority shareholders.

Thus, effective corporate governance promotes accountability, improves the reliability and quality of financial information, strengthens the integrity and efficiency of the capital market, and improves investor confidence. Poor corporate governance adversely affects the company's potential, performance, financial reports and accountability and can pave the way for business failure, inefficiency in capital markets and loss of investor confidence. Corporate governance in the twenty-first century goes beyond focusing on shareholder value creation as corporations play a vital role in the global economy and capital markets. Public companies are required to comply with the corporate governance requirements of state and federal laws as well as the listing standards of national stock exchanges. However, mere compliance will not guarantee effective corporate governance, and companies should integrate the best practices suggested by investor activists and professional organizations into their corporate governance structure. Corporate governance is ultimately about leadership and accountability for: (1) the efficiency and effectiveness of operations to compete in global markets; and (2) disclosure of accurate, complete, and transparent financial and non-financial key performance indicators regarding corporate performance in areas of economic, ethical, environmental and social activities. One of the key responsibilities of corporate governance participants is to ensure the quality, integrity, reliability and transparency of financial statements and to provide a reasonable assurance that they are free from any misstatements caused by errors or fraud.

The Financial Reform Act of 2010 again brought corporate governance to the central stage of corporate accountability, regulatory requirements and investor demand. On July 21, 2010 President Barack Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) which is cited as the most sweeping financial reform since the Great Depression. Dodd-Frank provisions pertain to banks, hedge funds, credit rating agencies and the derivatives market. Dodd-Frank authorizes the establishment of an oversight council to monitor systemic risk of financial institutions and the creation of a consumer protection bureau within the Federal Reserve. Dodd-Frank requires the development of over 240 new rules by the Securities and Exchange Commission (SEC), the Government Accountability Office (GAO), and the Federal Reserve to implement its provisions over a five-year period (Dodd-Frank, 2010).

Many provisions of Dodd-Frank are considered to be positive and useful in protecting consumers and investors. This includes the establishment of a consumer protection bureau and a systemic risk regulator, as well as provisions requiring derivatives to be put on clearinghouses/exchanges. The new Consumer Financial Products Commission (CFPC) will make rules for most retail products offered by banks such as certificates of deposit and consumer loans. Dodd-Frank requires managers of hedge funds (but not the funds themselves) with more than $150 million in assets to register with the SEC. Corporate governance provisions of Dodd-Frank include:

1. Proxy access which directs the SEC to promulgate rules permitting the use by a shareholder of company proxy materials to nominate director candidates.
2. No majority voting for director elections which is inconsistent with the best practices of corporate governance adopted in European countries.

3. Chairman and CEO disclosures which amends Section 14B of the Securities Exchange Act of 1934 to direct the SEC to issue rules requiring public companies to disclose in their annual proxy statements the reasons why the company has chosen to combine or separate the board chair and CEO positions.
4. Broker discretionary voting which amends Section 6(b) of the Exchange Act to require that the national securities exchanges prohibit proxy voting by a broker in connection with the election of directors.
5. Risk committees at certain non-bank financial companies and bank holding companies which require that public non-bank financial companies supervised by the Federal Reserve and bank holding companies with assets of $10 billion or more to establish a risk committee.
6. Smaller public company exemption from Sarbanes-Oxley (SOX) internal control requirements which exempts public companies with less than 700 million market capitalization to comply with Section 404 of SOX regarding management certification and audit opinion on internal control over financial reporting.

The seven essential corporate governance functions are oversight, managerial, compliance, internal audit, advisory, external audit, and monitoring (Rezaee 2007). Corporate governance participants fulfill their responsibility when their role in corporate governance is viewed as a value-added function. Four of these functions, however, are crucial to the effective prevention and detection of FSF. These functions are the oversight function assumed by the board of directors, managerial function delegated to management, internal audit function conducted by internal auditors and external audit function performed by external auditors. The antifraud role of

these corporate governance participants (corporate gatekeepers) is examined through insights obtained from experts as described in the next section.

METHOD AND PROCEDURES

Questionnaire

We prepared, pretested, revised, and then sent the four-page, seven-section questionnaire to the participants. We conducted a pilot test of the questionnaire by sending it to several professors and practitioners known to the authors that are experts in the areas of corporate governance and FSF. They were asked to review, correct and suggest refinements of the original draft of the questionnaire to ensure relevance, correct content and appropriate wording. The six main sections of the survey asked respondents for their perceptions of the future demand for and interest in corporate governance, the role of corporate governance, as well as the antifraud role of the board of directors, management, internal auditors and external auditors. The last section sought comments on corporate governance and financial statement fraud. To improve the response rate, we included with each questionnaire a cover letter stating the survey objectives, defining corporate governance and financial statement fraud, assuring confidentiality of the responses, agreeing to share the summary of findings, and giving the approximate time needed to complete the questionnaire. The original draft of the questionnaire was pretested by asking several colleagues to review it for content, format, transition, completeness and accuracy. Corrections are made in the final draft submitted to participants. The Appendix shows a copy of the surveyed questionnaire.

Sample

We conducted a survey of executive MBA (EMBA) students who have already taken a "corporate governance" course. EMBA students were selected primarily because of their work experience in business, financial reporting knowledge, and familiarity with corporate governance issues. A total of 164 current and former EMBA students were identified by the office of Graduate Programs at the authors' university and their email addresses were verified. Selected EMBA students either graduated EMBA students in the past three years or planned to graduate in the fall of 2010. We used Survey Monkey to question participants. The survey link was generated by an automated survey system in the email of selected EMBA's which assured their responses would be completely anonymous[3]. To improve the response rate, we included with each questionnaire a cover letter stating the survey objectives, assuring confidentiality of the responses, agreeing to share the summary of findings, and giving the approximate time needed to complete the questionnaire.

Table 1 shows that 72 usable responses were completed, providing a response rate of 43.9 percent.

RESULTS AND DISCUSSIONS

Results are presented in the following six categories: (1) the relevance of corporate governance; (2) perceptions toward corporate governance and FSF; (3) the antifraud role of the board of directors; (4) the antifraud role of management; (5) the antifraud role of internal auditors; and (6) the antifraud role of external auditors.

Relevance of Corporate Governance

Respondents were asked to answer a question pertaining to the future demand for corporate governance. Table 2 indicates that the high majority of respondents (about 82 percent) reported that future demand for and interest in corporate governance will increase whereas 11 percent

thought it will remain the same and another four percent said it would decrease. These findings are consistent with and support the recent move to promote corporate governance by policymakers, regulators, businesses and educators worldwide.

Perceptions toward Corporate Governance and FSF

We asked several questions regarding participants' perceptions toward corporate governance and financial statement fraud and the importance of corporate governance in preventing and detecting FSF. We ranked responses on a five-point Likert scale, with five indicating strongly agrees and one representing strongly disagree. Table 3 reveals that participants strongly agree that: (1) financial scandals and crisis galvanize more interest in and demand for effective corporate governance (mean response = 4.39); (2) corporate governance participants should ensure the quality, integrity, reliability and transparency of financial statements (4.37); (3) business schools should prepare students to be ethical and competent future leaders (4.31): (4) business schools should teach ethics and corporate governance and antifraud education (4.19). Respondents partially agreed with other aspects of corporate governance and FSF as presented in Table 3 which included that effective corporate governance promotes accountability and improves the reliability and quality of financial information and reduces financial statement fraud. These results support the initiatives that have been taken by many business schools worldwide to offer corporate governance, ethics and forensic accounting courses which help students become ethical and competent future business leaders.

Antifraud Role of the Board of Directors

The board of directors as representative of shareholders has a fiduciary duty to protect investor interests and ensure that their investment and voting decisions are not affected by misleading financial information. The effectiveness of the oversight function depends on

directors' independence, due process, authority, resources, composition, qualifications, and accountability. We asked several questions regarding the perceived antifraud role of the board of directors in general and the audit committee in particular. Table 4 ranks the importance of the listed seven antifraud roles of the board of directors by using a Likert scale of one to five, with five being the most important and one being the least important. Respondents reported in the order of importance that the board of directors, particularly its audit committee should:

1. Set a proper "tone at the top" promoting ethical and competent behavior throughout the organization (mean response = 4.56)
2. Actively evaluate management performance and compensation and its relation to risk assessment. (4.37).
3. Consider feedback received from the independent auditors (4.33).
4. Supervise proper design and effective implementation of antifraud policies and procedures (4.32).
5. Effectively oversee the financial reporting process (4.21).
6. Effectively oversee internal control and risk assessment (4.11).
7. Consider the risk for the management override of controls and collusion (4.02).

Antifraud Role of Management

The top management team consisting of the chief executive officer (CEO) and chief financial officer (CFO) are responsible for running the company and managing its resources and operations as well as certifying the accuracy and completeness of financial reports. The effectiveness of the managerial function depends on the alignment of management's interests with those of shareholders and ensuring high-quality, reliable, transparent and accurate financial statements free of material misstatements caused by errors and fraud. We asked several questions

regarding the perceived antifraud role of management. Table 5 ranks the importance of the listed six antifraud roles of management by using a Likert scale of one to five, with five being the most important and one being the least important. Participants believe that antifraud policies, procedures and practices of management should address management responsibilities to:

1. Adopt a proactive approach when dealing with fraud deterrence, prevention and detection (mean response = 4.55)
2. Effectively design, implement and monitor financial processes and controls.
3. Produce reliable financial statements free of material misstatements caused by errors and fraud (4.50).
4. Design and implement effective antifraud policies and procedures (4.34).
5. Assess and report on the effectiveness of internal control over financial reporting (4.25).
6. Including a "management certification" statement in the annual reports (required for public companies) that addresses both financial reporting and internal controls (4.09).

Antifraud Role of Internal auditors

Internal auditors provide both assurance and consulting services to the company in the areas of operational efficiency, risk management, internal controls, financial reporting, antifraud and governance processes. We asked several questions regarding the perceived antifraud role of internal auditors. Table 6 ranks the importance of the listed nine antifraud roles of internal auditors by using a Likert scale of one to five, with five being the most important and one being the least important. Participants thought that internal auditors in fulfilling their antifraud responsibilities should:

1. Develop and maintain sufficient knowledge to identify the indicators of fraud (mean response = 4.52).

2. Implement and monitor the established antifraud policies and procedures (4.48).
3. Adopt proactive approach in detecting corruption, misappropriation of assets, and financial statement fraud (4.32).
4. Examine and assess the design and effectiveness of the system of internal control (4.30).
5. Assess the fraud risk in the organization (4.26).
6. Plan audits in accordance with industry standards and where applicable (4.24).
7. Consider external reporting on corporate governance, risk assessment and internal controls (4.04).
8. Obtain audit committee (or the board of directors) approval on internal audit activities (3.74).
9. Use a risk-based audit methodology (3.63).

Antifraud Role of External Auditors

Current auditing standards (SAS Nos 88 & 99, 2002) require that independent auditors provide *reasonable assurance* that the financial statements are free from material misstatements, whether caused by error or fraud, to render an unqualified opinion on the financial statements. We asked several questions regarding the perceived antifraud role of external auditors. Table 7 ranks the importance of the listed 12 antifraud roles of external auditors by using a Likert scale of one to five, with five being the most important and one being the least important. Participants reported that external auditors can reduce the likelihood of FSF by:

1. Using risk-based audit tests (4.48).
2. Ensuring open and frank dialogue with the board, audit committee and management regarding the organization's vulnerability to fraud (4.38).
3. Integrating fraud risk into audit strategies and procedures (4.33).

4. Providing input into management's assessment of fraud risk (4.26).
5. Assisting audit committee (board of directors) and management with the aspect of deterrence, prevention and detection processes (4.15).
6. Being skeptical about the possibility of the occurrences of FSF (4.12).
7. Assisting audit committee (board of directors) and management by assessing the organization's process for identifying and responding to the risk of fraud (4.09).
8. Assisting the audit committee and board; asses the susceptibility to management override and collusion (3.98).
9. Resolving allegations or suspicions of fraud (3.81).
10. Helping in cultivating an appropriate anti-fraud environment (3.77).
11. Paying attentions to the symptoms of FSF (3.74).
12. Using forensic and investigative audit procedures (3.70).

Users of audited financial statements generally expect external auditors to detect financial statement fraud and employees' illegal acts which affect the integrity of financial reports. External auditors, however, are more concerned with material misstatements in the audited financial statements. They express an opinion on whether financial statements truly and fairly represent, in all material respects, the company's financial position and the results of operations in conformity with generally accepted accounting principles. This opinion lends credibility to the company's financial reports and reduces the risk that information may be misleading and fraudulent.

CONCLUSION

Entities of all sizes are susceptible to both employee (theft, embezzlement) and management fraud (manipulating financial reports). Demand for and interest in corporate governance has

significantly increased in the post-SOX era, transforming from a compliance process to a business strategic imperative—yet, many express concerns over the role of corporate governance participants in preventing and detecting FSF. Effective antifraud policies and programs should be designed to prevent and detect fraud. Antifraud programs should deter, prevent, and detect all variations of fraud, from misrepresenting financial information to misappropriating assets and employee fraud. Effective antifraud programs should also address the antifraud role of corporate governance participants. This paper provides insights on the role of corporate governance participants in antifraud policies and procedures. Our results suggest that demand for and interest in corporate governance is expected to continue to increase and all corporate gatekeepers including the board of directors, internal and external auditors play an important role in helping management in creating a corporate culture of honesty, integrity and competency in preventing detecting and correcting FSF. Corporate culture should also create an environment that sets an appropriate tone at the top, promoting ethical behavior, reinforcing antifraud conduct, and demanding "doing the right thing always."

Table 1

Sample Selection and Responses

Identified	164
Responses received	83
Incomplete with missing data	(11)
Usable responses	72
Response rate	43.9%

Table 2

Emergence of Corporate Governance

Do you expect future demand and interest in corporate governance to:

Perceptions	Percentage
Increase	81.9%
Remain the same	11.1%
Decrease	4.2%
Unsure	2.8%
Total	100.0%

*

Table 3
Perceptions toward corporate governance and FSF

Please indicate the extent to which you would agree with the following statements pertaining to corporate governance and FSF:

Statements	Mean Responses	Standard Deviation
Financial scandals and crisis galvanize more interest in and demand for effective corporate governance.	4.39	1.15
Corporate governance participants should ensure the quality, integrity, reliability and transparency of financial statements	4.37	1.22
Business schools should prepare students to be ethical and competent future leaders.	4.31	1.37
Business schools should teach ethics and corporate governance and antifraud education	4.19	1.37
Effective corporate governance promotes accountability, improves the reliability and quality of financial information.	4.03	1.14
Effective corporate governance reduces financial statement fraud (FSF) incidents.	3.90	1.07
Different capital ownership structures dispersed (concentrated) may lead to different types of FSF, namely earnings management (self dealing by controlling shareholders).	3.44	1.39
The existence and persistence of FSF continues to contribute to the recent financial crisis.	3.44	1.50

Table 4

Perceived Antifraud Role of the Board of Directors

Roles	**Mean Response**	**Standard Deviation**
Set a proper “tone at the top” promoting ethical and competent behavior throughout the organization.	4.56	0.76
Actively evaluate management performance, compensation and its relation to risk assessment.	4.37	0.84
Consider feedback received from the independent auditors.	4.33	0.91
Supervise proper design and effective implementation of antifraud policies and procedures.	4.32	0.94
Effectively oversee the financial reporting process.	4.21	1.00
Effectively oversee internal controls and risk assessment	4.11	1.10
Consider the risk for the management override of controls and collusion.	4.02	1.09

Table 5

Perceived Antifraud Role of Management

Roles	Mean Response	Standard Deviation
Adopt a proactive approach when dealing with fraud deterrence, prevention and detection.	4.55	0.66
Effectively design, implement and monitor financial processes and controls.	4.52	0.91
Produce reliable financial statements free of material misstatements caused by errors and fraud.	4.50	0.97
Design and implement effective antifraud policies and procedures.	4.34	1.32
Assess and report on the effectiveness of internal control over financial reporting.	4.25	1.04
Include a "management certification" statement in the annual reports that addresses both financial reporting and internal controls.	4.09	1.08

Table 6

Perceived Antifraud Role of Internal Auditors

Roles	Mean Response	Standard Deviation
Develop and maintain sufficient knowledge to identify the indicators of fraud.	4.52	0.64
Implement and monitor the established antifraud policies and procedures.	4.48	0.99
Adopt proactive approach in detecting corruption, misappropriation of assets, and financial statement fraud.	4.42	0.99
Examine and assess the design and effectiveness of the system of internal control.	4.30	0.99
Assess the fraud risk in the organization.	4.26	0.96
Plan audits in accordance with industry standards and where applicable.	4.24	0.82
Consider external reporting on corporate governance, risk assessment and internal controls	4.04	0.90
Obtain audit committee (or the board of directors) approval on internal audit activities.	3.74	1.23
Use a risk-based audit methodology.	3.63	1.34

Table 7

Perceived Antifraud Role of External Auditors

Roles	Mean Response	Standard Deviation
Use risk-based audit tests.	4.48	0.73
Ensure open and frank dialogue with the board, audit committee and management regarding the organization's vulnerability to fraud.	4.38	1.02
Integrate fraud risk into audit strategies and procedures	4.33	0.81
Provide input into management's assessment of fraud risk.	4.26	0.84
Assist audit committee (board of directors) and management with the aspect of deterrence, prevention and detection processes.	4.15	0.95
Be skeptical about the possibility of the occurrences of FSF.	4.12	1.34
Assist audit committee (board of directors) and management by assessing the organization's process for identifying and responding to the risk of fraud.	4.09	1.20
Assist the audit committee and board; asses the susceptibility to management override and collusion.	3.98	0.99
Resolve allegations or suspicions of fraud.	3.81	1.27
Help in cultivating an appropriate anti-fraud environment	3.77	1.17
Pay attentions to the symptoms of FSF	3.74	1.29
Use forensic and investigative audit procedures.	3.70	1.41

REFERENCES

American Institute of Certified Public Accountants (AICPA). 1997. Consideration of Fraud in a Financial Statement Audit. SAS No. 82. New York. NY: AICPA.

_________________. 2002. Statement on Auditing Standards (SAS No. 99): Consideration of Fraud in a Financial Statement Audit (November). New York, NY: AICPA.

Black, W. K. 2010. Epidemics of "Control Fraud" lead to Recurrent, Intensifying Bubbles and Crises, working paper, University of Missouri-Kansas City, SSRN-id 1590447.

Coffee, J. C. 2005. A theory of Corporate Scandals: Why the U.S. and the Europe Differ. The Columbian Law School Working Paper Series. Available at: www.ssrn.com/abstract=694581

Committee of Sponsoring Organizations of the Treadway Commission (COSO). 1999. Fraudulent Financial Reporting: 1987-1997, An Analysis of U.S. Public Companies. AICPA, New York.

Committee of Sponsoring Organizations of the Treadway Commission (COSO). 2010. Fraudulent Financial Reporting: 1998-2007: An Analysis of U.S. Public Companies. Available at www.coso.org

Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") 2010.

PricewaterhouseCoopers. 2007. *Economic Crime: People, Culture and Controls*. Accessed on November 10, 2009. Available from http://www.pwc.com/en_GX/gx/economic-crime-survey/pdf/pwc_2007gecs.pdf

Rezaee, Z. 2007. Corporate Governance Post-Sarbanes-Oxley. John Wiley & Sons, Inc., Hoboken, New Jersey.

Rezaee, Z.and R. Riley. 2009. *Financial Statement Fraud: Prevention and Detection*. 2nd , Edition John Wiley & Sons, Inc., Hoboken, New Jersey

Sarbanes-Oxley Act (SOX). 2002. "Accounting and Corporate Governance Regulation." Available at http://www.whitehouse.gov/infocus/corporateresponsibility.

Securities and Exchange Commission (SEC). 2002. Auditor's Independence Rules. Available at http://www.sec.gov.

Sorkin, A.R. 2010. Pulling Back the Curtain on Fraud Inquiries, The New York Times (december 6, 2010).

ENDNOTES

[1] Financial statement fraud is adapted from Rezaee and Riley (2009) and defined in this study as any intentional acts by management to mislead investors through preparation of materially misstated financial statements.
[2] Corporate governance is adapted from Rezaee (2007) and defined as a process of managing an organization to create shareholder value while protecting interests of other stakeholders.
[3] To complete and submit the survey, participants were asked to click on the Web address (URL) provided. The instruction was provided that the survey URL is for their use only and if they could not click on the Web address, they could copy the underlined text and paste it into the address field of their Web browser.

Appendix

CORPORATE GOVERNANCE QUESTIONNAIRE

This questionnaire is designed to determine the role of corporate governance in preventing and detecting financial statement fraud. When answering the questions below, keep in mind that corporate governance is defined as "a process of managing, controlling, and assessing business affairs to create shareholder value while protecting interests of other stakeholders." Likewise, financial statement fraud is defined as "intentional misstatements or omissions of amounts or disclosures of financial statements to deceive financial statement users."

		Increase	Remain the same	Decrease	Unsure
1.	Do you expect future demand and interest in corporate governance to:	1	2	3	4

2. Please indicate the <u>extent to which you agree with the following statements</u> by circling the appropriate responses, where 1 = Strongly Disagree and 5 = Strongly Agree. If you have no opinion, please indicate by circling N/A.

		Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	N/A
A.	Financial scandals and crisis galvanize more interest in and demand for effective corporate governance.	1	2	3	4	5	6
B.	Effective corporate governance reduces financial statement fraud (FSF) incidents.	1	2	3	4	5	6
C.	Different capital ownership structures dispersed (concentrated) may lead to different types of FSF, namely earnings management (self dealing by controlling shareholders).	1	2	3	4	5	6
D.	Effective corporate governance promotes accountability, improves the reliability and quality of financial information.	1	2	3	4	5	6
E.	Corporate governance participants should ensure the quality, integrity, reliability and transparency of financial statements.	1	2	3	4	5	6
F.	The existence and persistence of FSF continues to contribute to the recent financial crisis.	1	2	3	4	5	6

G.	Business schools should prepare students to be ethical and competent future leaders.	1	2	3	4	5	6
H.	Business schools should teach ethics and corporate governance and antifraud education	1	2	3	4	5	6

3. Please indicate the importance of the following antifraud role of the *board of directors* including the *audit committee* by circling the appropriate responses, where 1 = Least Important and 5 = Most Important. If you have no opinion, please indicate by circling N/A.

		Least important		Neutral		Most important	N/A
A.	Supervise proper design and effective implementation of antifraud policies and procedures.	1	2	3	4	5	6
B.	Set a proper “tone at the top” promoting ethical and competent behavior throughout the organization.	1	2	3	4	5	6
C.	Actively evaluate management performance, compensation and its relation to risk assessment.	1	2	3	4	5	6
D.	Effectively oversee the financial reporting process.	1	2	3	4	5	6
E.	Effectively oversee internal controls and risk assessment.	1	2	3	4	5	6
F.	Consider the risk for the management override of controls and collusion.	1	2	3	4	5	6
G.	Consider feedback received from the independent auditors.	1	2	3	4	5	6

4. Please indicate the importance of the following antifraud roles of *management* by circling the appropriate responses where 1 = Least Important and 5 = Most Important. If you have no opinion, please indicate by circling N/A.

		Least important		Neutral		Most important	N/A
A.	Produce reliable financial statements free of material misstatements caused by errors and fraud.	1	2	3	4	5	6
B.	Effectively design, implement and monitor financial processes and controls.	1	2	3	4	5	6
C.	Adopt a proactive approach when dealing with fraud deterrence, prevention and detection.	1	2	3	4	5	6

D.	Include a "management certification" statement in the annual reports that addresses both financial reporting and internal controls.	1	2	3	4	5	6
E.	Assess and report on the effectiveness of internal control over financial reporting.	1	2	3	4	5	6
F.	Design and implement effective antifraud policies and procedures.	1	2	3	4	5	6

5. Please indicate the importance of the following antifraud roles of *internal auditors* by circling the appropriate number, where = Least Important and 5 = Most Important. If you have no opinion, please indicate by circling N/A.

		Least important		Neutral		Most important	N/A
A.	Implement and monitor the established antifraud policies and procedures.	1	2	3	4	5	6
B.	Develop and maintain sufficient knowledge to identify the indicators of fraud.	1	2	3	4	5	6
C.	Assess the fraud risk in the organization.	1	2	3	4	5	6
D.	Plan audits in accordance with industry standards and where applicable.	1	2	3	4	5	6
E.	Obtain audit committee (or the board of directors) approval on internal audit activities.	1	2	3	4	5	6
F.	Examine and assess the design and effectiveness of the system of internal control.	1	2	3	4	5	6
G.	Adopt proactive approach in detecting corruption, misappropriation of assets, and financial statement fraud.	1	2	3	4	5	6
H.	Use a risk-based audit methodology.	1	2	3	4	5	6
I.	Consider external reporting on corporate governance, risk assessment and internal controls	1	2	3	4	5	6

7. Please indicate the importance of the following antifraud roles of *external auditors* by circling the appropriate number, where = Least Important and 5 = Most Important. If you have no opinion, please indicate by circling N/A.

		Least important		Neutral		Most important	N/A
A.	Assist audit committee (board of directors) and management by assessing the organization's process for identifying and responding to the risk of fraud.	1	2	3	4	5	6
B.	Ensure open and frank dialogue with the board, audit committee and management regarding the organization's vulnerability to fraud.	1	2	3	4	5	6
C.	Assist audit committee (board of directors) and management with the aspect of deterrence, prevention and detection processes.	1	2	3	4	5	6
D.	Provide input into management's assessment of fraud risk.	1	2	3	4	5	6
E.	Help in cultivating an appropriate anti-fraud environment.	1	2	3	4	5	6
F.	Assist the audit committee and board; asses the susceptibility to management override and collusion.	1	2	3	4	5	6
G.	Resolve allegations or suspicions of fraud.	1	2	3	4	5	6
H.	Integrate fraud risk into audit strategies and procedures.	1	2	3	4	5	6
I.	Use risk-based audit tests.	1	2	3	4	5	6
J.	Be skeptical about the possibility of the occurrences of FSF.	1	2	3	4	5	6
K.	Use forensic and investigative audit procedures.	1	2	3	4	5	6
L.	Pay attentions to the symptoms of FSF	1	2	3	4	5	6

8. Comments: Please feel free to comment on corporate governance and financial statement fraud:

____

____