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Beyond the Numbers: Assessing the Risk of Management Motives for Fraud in External Audits

Abstract

Purpose: Exploring how the risk of management motives for fraud can be assessed in external audits.

Methods: Semi-structured interviews were conducted with twenty-six experienced external auditors to explore their perspectives on the methods they employ to assess the risk of management motives for fraud.

Results: The study identifies six methods external auditors can use to assess management motives for fraud. It emphasises that assessing management motives requires auditors to go beyond understanding these motives and necessitates a sceptical and analytical mindset. Auditors need to identify the accounts most vulnerable to management manipulations, observe management attitudes, and assess the credibility of management assertions. The auditors in this study highlight specific accounts frequently manipulated by management. Still, manual year-end journal entries are the most vulnerable to management manipulations as they are subject to fewer controls. They recommend increasing the sample size to 100% and assigning more experienced staff, particularly those with qualifications in fraud examination or anti-fraud training, to audit these vulnerable accounts thoroughly. They also provided examples of how auditors can identify management motives for fraud, observe management attitudes, and assess the credibility of management assertions.

Originality: Assessing the risk of management motives for fraud in external audits has received limited attention in the literature. This study is the first to address this knowledge gap.

Practical Implications: Audit standards (e.g., ISA 240, SAS99) lack explicit guidance on assessing management motives for fraud, but auditors are required to consider it in fraud risk assessment. This study proposes guidance recommendations to improve auditors' ability to assess this risk, which could be integrated into professional audit standards and training materials to improve auditors' professional scepticism, ability to challenge management, and skills in fraud risk assessment.

Keywords: Fraud risk assessment; Management motives; Fraudulent financial reporting; Financial statement fraud; External auditors; Professional scepticism.

1. Introduction

This paper examines the assessment of management motives for fraud in external audits. The research was motivated by several factors: the existing literature gap in this field, the absence of guidance in audit standards (such as ISA 240 and SAS 99) regarding the evaluation of management motivation risk, and the growing demand from audit regulators to enhance auditors' fraud risk assessment skills following the high-profile fraud cases of companies like Patisserie Valeri, Carillion, and Wirecard (FRC, 2019; ICAEW, 2020).

The Institute of Chartered Accountants in England and Wales (ICAEW) has highlighted the importance of considering management's motives for fraudulent financial reporting, calling for enhanced efforts from external auditors to counter fraud (ICAEW, 2020). Nigel Sleigh-Johnson, Head of ICAEW's Audit and Assurance Faculty, emphasised that "*Improving the effectiveness of audit in relation to fraudulent financial reporting will do much to restore trust in the profession*" (ICAEW, 2020, p. 1). Furthermore, inspections conducted by the Financial Reporting Council (FRC) in the UK revealed that challenging management is an area of concern that requires the attention of audit firms (FRC, 2019). Similarly, the Public Company Accounting Oversight Board (PCAOB) inspections in the United States consistently identify response to risks of material misstatement as a significant area of focus and highlight it as a recurring audit deficiency, underscoring the need for improved performance by external auditors in fraud risk assessment and challenging management (Popova, 2018).

For several reasons, improving performance in fraud risk assessment, particularly in assessing management motives for fraud, is crucial for external auditors. Financial reporting fraud is more likely to be committed by management with the authority to override controls (Brennan & Mcgrath, 2007). The motivation or pressure from management often initiates such fraud (Davies, 2000; Kassem, 2018), and it is typically not detected by analysing financial statements alone. Instead, it is revealed when contextual information about management's actions and motivations is considered (Albrecht et al., 2006). Recent studies highlight the influence of management motives on external auditors' evaluations of material misstatements (Commerford et al., 2022), and detecting fraudulent financial reporting becomes unlikely if auditors fail to recognise management motives as a significant fraud factor (Kassem, 2023). Some studies argue that external audits should be seen as

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3 evaluations of management motivations to provide value to stakeholders (Higson, 2003).
4 Considering these perspectives, effectively assessing management motives for fraud is vital for the
5 future of external audits.
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10 While previous studies have explored the motivations behind management's fraudulent behaviour
11 (see literature review section), a significant research gap exists regarding how external auditors
12 can assess the risk associated with management motives for fraud. Furthermore, despite the
13 requirement for auditors to include this assessment in their fraud risk evaluation during external
14 audits, existing audit standards (ISA 240, ISA 315, SAS 99) do not provide explicit guidance on
15 this matter. The current study aims to fill this knowledge gap and meet the growing demand for
16 enhancing external auditors' skills in fraud risk assessment. To achieve this, the study conducted
17 interviews with twenty-six experienced external auditors, exploring the assessment of management
18 motives for fraud within a standard external audit.
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27 The study identifies six methods external auditors can use to assess management motives for fraud.
28 It emphasises that assessing management motives requires auditors to go beyond understanding
29 these motives and necessitates a sceptical and analytical mindset. Auditors need to identify the
30 accounts most vulnerable to management manipulations, observe management attitudes, and assess
31 the credibility of management assertions. The auditors in this study highlight specific accounts
32 frequently manipulated by management. Still, manual year-end journal entries are the most
33 vulnerable to management manipulations as they are subject to fewer controls. They recommend
34 increasing the sample size to 100% and assigning more experienced staff, particularly those with
35 qualifications in fraud examination or anti-fraud training, to audit these vulnerable accounts
36 thoroughly. They also provided examples of how auditors can identify management motives for
37 fraud, observe management attitudes, and assess the credibility of management assertions. The
38 findings and implications are later discussed.
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3 This study contributes to audit literature, policy, and practice by providing guidance on assessing
4 the risk of management motives for fraud and addressing the current gap in professional audit
5 standards. Incorporating this guidance in audit standards ensures consistency and standardised
6 procedures, reducing audit quality variations and enhancing results' comparability. From a
7 practical standpoint, the study's guidance helps auditors identify specific risks related to
8 management motives for fraud. It offers a framework with indicators and red flags, enabling
9 proactive detection of potential fraudulent activities. It assists in developing comprehensive audit
10 plans and resource allocation, focusing efforts on vulnerable areas. The guidance also supports
11 training and professional development, keeping auditors updated on emerging trends and
12 regulatory requirements. From an academic perspective, the study expands the literature on fraud
13 risk assessment in external audits, providing new empirical evidence and paving the way for future
14 research and debate on this crucial topic.
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25 The paper is structured as follows: Section 2 provides a comprehensive literature review of relevant
26 academic and professional sources. Section 3 outlines the methods employed for data collection
27 and analysis. Section 4 presents the findings, followed by a thorough discussion of the results and
28 their implications in Section 5.
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2. Literature Review – Insights from the Academic and Professional Literature

In this section, the study reviews prior academic research and professional literature to gain valuable insights into assessing management motives for fraud in external audits. The findings of this extensive review are presented and discussed in detail.

2.1 Professional Literature Insights and Gaps

A comprehensive review of the professional literature was conducted to identify clear professional guidance on assessing the risk of management motives for fraud in external audit practice. This review encompassed professional auditing standards and publications from reputable bodies, including the Financial Reporting Council (FRC), the Institute of Chartered Accountants in England and Wales (ICAEW), The Institute of Chartered Accountants of Scotland (ICAS), and the Association of Chartered Certified Accountants (ACCA). Additionally, online platforms such as Google and professional magazines were utilised to search for relevant articles and reports.

Professional Audit Standards

This section primarily focuses on the International Standard on Auditing (ISA) 240, titled "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements." ISA 240 outlines the auditor's responsibilities concerning fraud and guides addressing fraud risk throughout the audit process—consequently, this review centres on the specific requirements and provisions outlined in ISA 240.

ISA 240 identified two fraud types relevant to auditors' responsibility: (a) fraudulent financial reporting and (b) asset misappropriation. It requires auditors to provide reasonable assurance that the financial statements are free from material misstatements, whether due to error or fraud. To provide this reasonable assurance, ISA 240 requires auditors to:

- Perform a fraud risk assessment as part of their overall risk assessment process. This involves identifying and assessing the risks of material misstatement due to fraud, including considering the potential for management override of controls. Auditors should consider both the entity-level and transaction-level risks and evaluate the controls in place to mitigate these risks.

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- Exercise professional scepticism throughout the audit process, recognising the possibility of management intentionally manipulating financial statements to deceive users. It states that auditors should be alert to the potential for fraud, considering the incentives or pressures management may have to commit fraudulent acts.
- Obtain an understanding of the control environment, evaluate the design and implementation of relevant controls, and test their operating effectiveness. This helps auditors identify any weaknesses or opportunities for management to override controls and manipulate financial statements.
- Discuss the susceptibility of the entity's financial statements to material misstatement due to fraud with the engagement team. In doing so, audit team experience or other knowledge of the competencies and attitudes of employees should be considered in areas where there are risks of material misstatement.
- Respond to the assessed fraud risk. ISA 240 provides examples of possible audit procedures to address the assessed risks of material misstatement due to fraud in Appendix 2.

However, while the standard emphasises the significance of comprehending and evaluating the risks of material misstatement caused by fraud, including considering the potential for management override of controls and the auditors' need to examine the incentives or pressures that management may have to engage in fraudulent activities, it does not explicitly address the assessment of management motives for fraud. It merely offers examples of fraud risk factors associated with incentives (refer to Appendix 1 in ISA 240) and circumstances that indicate the potential for fraud in general (refer to Appendix 3). Additionally, it provides examples of potential audit procedures to address the evaluated risks of material misstatement caused by fraud in general. However, it does not furnish specific guidance on addressing management motives for fraud (refer to Appendix 2).

Professional Articles and Reports

The professional literature strongly emphasises the importance of enhancing external auditors' efforts and abilities to detect significant instances of fraud. However, there is a notable absence of specific professional guidance on how auditors can evaluate the risk associated with management motives for fraud.

Audit reform in the UK has prioritised deterring and detecting fraud, as highlighted by the ICAEW (2022). To address concerns following several high-profile fraud scandals in the UK, including Patisserie Valerie (O'Connell, 2021), Redcentric (Croft, 2022), Carillion (BBC, 2022), and Ted Baker (Simpson, 2019), the UK Government appointed Sir Donald Brydon to propose recommendations for enhancing external audit quality. In his 2019 report, Sir Brydon suggests incorporating an explicit statement in the auditor's report regarding their examination of the director's statement on fraud prevention and detection and its appropriateness. Additionally, auditors should disclose the measures taken to evaluate control effectiveness and identify fraudulent activities. Notably, Sir Brydon recommends including forensic accounting and fraud awareness training in the formal syllabus and ongoing professional development for financial statement auditors (Adrain, 2019a).

The Brydon review has been welcomed by ICAS, which advocates for enhancing external auditors' capabilities in detecting fraud, reassessing auditors' liability, and ensuring directors are held accountable for fraudulent activities. ICAS further suggests that companies and auditors should provide separate reports on the effectiveness of internal controls to enhance fraud detection, drawing inspiration from the Sarbanes Oxley Act (SOX) in the United States. Meanwhile, ICAEW calls for an enhanced version of the statutory audit, focusing on preventing disorderly failures, adopting innovative approaches to fraud prevention, improving audit reporting, and advocating for proportionality to address the existing performance gap (Outram, 2019).

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3 When it comes to fraud, auditors must carefully consider the integrity and ethics of management,
4 the effectiveness of internal controls, and the plausibility of explanations provided for any
5 irregularities. Jan Babiak, Audit Committee Chair for the Bank of Montreal and Walgreens Boots
6 Alliance, and Senior Independent Director at private Australian engineering company GHD Group,
7 emphasises that auditors should primarily focus on management, as it ultimately holds the
8 responsibility for addressing fraud within the organisation (ICAEW, 2023).
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12 Likewise, the ICAEW recommends that audit firms take more proactive measures to address the
13 deficit in fraud detection. This includes reinforcing professional scepticism, integrating fraud-
14 related learnings throughout the firm, broadening the scope of risk assessment by utilising external
15 data and information and promoting robust challenges to management (ICAEW, 2022).
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24 However, the FRC inspection reports on the quality of audits for FTSE 350 companies in 2019
25 revealed shortcomings in auditors' ability to adequately challenge management on judgmental
26 matters across all seven audited firms. The FRC noted a lack of professional scepticism in auditing
27 potential prior-year adjustments and related disclosures in the annual report and accounts.
28 Additionally, insufficient scrutiny was reported regarding critical estimates and assumptions in
29 asset valuations, impairment testing, intangible assets, revenue, provisions, liabilities, and auditing
30 long-term contracts. The FRC identified areas that require improvement, including the audit of
31 going concern, testing controls, valuation of financial instruments, and adjustments (Adrain,
32 2019b). Consequently, the FRC emphasised the need for auditors to enhance their efforts in
33 challenging management to prevent audit failures and safeguard their reputations (FRC, 2019).
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43 To effectively challenge management, Jock Lennox, Audit Committee Chair of Barratt
44 Developments plc and Chair of the Audit Committee Chairs' Independent Forum (ACCIF),
45 suggests that auditors should develop an independently determined understanding of the
46 organisation's objectives, risks, and risk management practices. This understanding should guide
47 the evidence auditors seek to ensure that the organisation's operations and performance are
48 accurately reflected. Lennox emphasises the importance of approaching audits with an independent
49 and curious mindset, which naturally leads to a degree of challenge. Auditors aim to comprehend
50 the situation and utilise their experience and knowledge to evaluate whether they agree with
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3 management's interpretation. The auditors must establish their viewpoint, ensuring that the
4 challenges they raise are substantive and well-founded rather than merely for the sake of challenge
5 (ICAEW, 2023).
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10 In a recent fraud prevention and detection report, EY highlights the significance of data analytics
11 in identifying fraudulent activities. They stress the importance of providing professional training
12 to auditors in this area. EY also recommends reviewing auditing standards to establish a more
13 robust framework for detecting fraud. Such a review should address aspects like materiality, level
14 of scepticism, utilisation of forensic specialists, assessment of internal controls, consideration of
15 cultural factors and incentives, engagement with audit committees, and public reporting (Delarue,
16 2020).
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24 In conclusion, the professional literature effectively outlines the responsibility of external auditors
25 in addressing fraud and emphasises the need to enhance their fraud detection skills. However, there
26 is a notable scarcity of guidance on effectively challenging management and a lack of professional
27 guidance on evaluating the risk associated with management motives for fraud.
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32 **2.2 Academic Literature Insights and Gaps**

33 A comprehensive systematic literature review was undertaken to examine the existing academic
34 research on assessing management motives for fraud in external audits. The review encompassed
35 over two decades of peer-reviewed articles published between 2000 and 2023. Multiple search
36 engines and databases, including JSTOR, Wiley Online Library, SCOPUS, EBSCOhost Business
37 Source Premier, ProQuest, Elsevier ScienceDirect, Emerald Insight, Springer Standard Collection,
38 Sage Journals Management, Allen Press American Accounting Association, IEEE Open Access
39 Journals, and Conferences, as well as Taylor & Francis Open Access, were systematically searched
40 to identify relevant papers.
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To ensure the quality and relevance of the selected publications, the following screening criteria were rigorously applied:

- i. Only full-text academic peer-reviewed articles were included in the analysis, ensuring the studies underwent a thorough peer review process.
- ii. Articles focusing on the empirical or theoretical aspects of management motives for fraud assessment in auditing or management motives for fraud were considered for inclusion.
- iii. This review specifically considered peer-reviewed academic articles written in English, ensuring consistency in language and accessibility.
- iv. Following the approach adopted by Moll & Yigitbasioglu (2019), the review was not limited to a predetermined journal list. However, attention was given to papers published in leading accounting journals cited in the Association of Business Schools Academic Journal Guide 2021, ensuring the inclusion of reputable and influential studies.

The search process involved utilising the following keywords to ensure a comprehensive coverage of relevant literature: "Fraud" combined with "management motives," "fraud" combined with "management motivation," "management motives for fraud," "management motives," "management motivation," "managerial fraud," "material misstatement" combined with "management," "material misstatements" combined with "auditor," "financial fraud" combined with "management," "fraud risk assessment," "fraud risk assessment" combined with "audits" or "auditors," "accounting fraud" combined with "management." Additionally, the terms "incentive(s)" and "pressure" were included as exact keywords, as they carry the same meaning as "motives" or "motivations."

A comprehensive search was conducted to identify relevant studies by examining paper titles, keywords, abstracts, and primary texts for the specified terms. Whenever a relevant paper was found, its reference list was thoroughly reviewed to ensure that other essential contributions were not overlooked. Subsequently, the contents of the identified sources were carefully read to determine their focus, scope, and methodology, where applicable. During this process, specific articles were excluded from further analysis if they focused solely on fraud without discussing management motives, concentrated on internal auditors rather than external auditors, or examined management motives for earnings management instead of fraud. These exclusions ensured the

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3 selection of studies directly related to assessing management motives for fraud in external audits.
4 Following the data collection and selection process, a final sample of 19 papers was analysed.
5 Table 1 concisely summarises these studies, including their focus, key findings, methodology, and
6 geographical coverage.
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15 The systematic literature review (SLR) uncovers significant gaps in assessing management
16 motives for fraud in external auditing. These gaps are presented in Table 1 and further elaborated
17 upon in this section.
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22 Firstly, it is noteworthy that no study has specifically explored how external auditors can
23 effectively evaluate management motives for fraud. Instead, previous studies have focused on two
24 main themes: (i) the characteristics of failing or fraudulent companies and (ii) the underlying
25 motivations behind fraudulent financial reporting. The key findings related to these themes are
26 discussed below. Secondly, there is a limited understanding of how management motives for fraud
27 impact an organisation's financial accounts. Only three studies have addressed this topic (Donoher
28 et al., 2007; Lail et al., 2014; Heese, 2018).
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36 Thirdly, most studies rely on secondary data analysis, primarily utilising financial data from the
37 SEC, Compustat, or Nexis Lexus sources, limiting empirical evidence's availability. As depicted
38 in Table 1, fifteen out of nineteen studies were based on secondary data analysis. Only a few studies
39 (n=4) employed surveys, and one study utilised semi-structured interviews. Lastly, it is worth
40 noting that most studies have been conducted in the United States (US), indicating a geographical
41 bias in the existing literature.
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48 These gaps in the literature highlight the need for further research to address the assessment of
49 management motives for fraud in external auditing, particularly in terms of developing effective
50 evaluation methods for auditors and exploring the impact of management motives on financial
51 accounts in diverse organisational contexts beyond the US.
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The characteristics of failing or fraud companies

Several previous studies have examined the characteristics of firms susceptible to failure or engaged in fraudulent activities. Although these findings do not directly address how auditors can assess management motives for fraud, they contribute to identifying fraudulent financial reporting in external auditing. Krambia-Kapardis (2002) highlights that companies prone to irregularities often lack an effective internal control system and a code of conduct. Specific audit areas, such as cash and provisions, are more likely to exhibit signs of fraud. Rosner (2003) reports that the behaviour of failing firms, which may not appear distressed based on accrual data but display substantial decreases in cash flows, aligns with instances of material earnings overstatements in years of ongoing concern followed by overstatement reversals in subsequent years. Johnson et al. (2008) note that fraudulent firms tend to be high-growth companies with a higher proportion of insiders on their audit committees, implying a reduced likelihood of fraud detection and lower expected costs associated with committing fraud. Firth et al. (2011) observe that firms with high debt levels and plans to issue equity are more inclined to manipulate their earnings, leading to subsequent restatements of financial reports.

Perols and Lougee (2010) examine the characteristics of fraud firms and find that these firms are more likely to have engaged in earnings management in previous years. Furthermore, earnings management in prior periods is associated with a higher likelihood that firms meeting or surpassing analyst forecasts or inflating revenue are involved in fraudulent activities. Fraud firms also tend to meet or exceed analyst forecasts and inflate revenue, even without evidence of prior earnings management. Dechow et al. (2011) investigate the types of misstatements observed in fraud firms and conclude that the most common misstatements are the overstatement of revenues, expenses, and capitalisation of costs. During these misstatements, the quality of accruals is generally low, and both financial and nonfinancial performance measures show signs of deterioration. Additionally, financing and related off-balance-sheet activities are much more prevalent during these periods. Managers of misstating firms appear susceptible to their company's stock price.

What motivates fraudulent financial reporting

Academic research provides evidence that motives for fraudulent financial reporting can be financial and non-financial, although the weight of evidence leans towards financial motivations. Specifically, financial distress, financial pressures, and executive compensation have been identified as significant factors. Hasnan et al. (2013) report a positive and significant association between financial distress and fraudulent financial reporting. Hollow (2014) finds financial pressures motivate bank employees and managers to commit fraud. Ndofor et al. (2015) discovered that an increase in Chief Executive Officers' (CEO) stock options raises the likelihood of fraud, particularly in highly complex industries. Furthermore, information asymmetries resulting from industry and firm-level complexities increase the probability of financial fraud.

Zuberi and Mzenzi (2019) uncover that financial strain and greed motivate employees and managers to engage in fraudulent behaviour in Tanzania. Kassem (2018) identifies the desire for remuneration or bonuses and the need to secure financing as Egypt's most common management motivations. Sallal et al. (2021) conclude that in Iraq and Iran, the most significant motivating factors for committing fraudulent financial reporting are tax incentives due to perceived high tax rates, a heavy tax burden, and a lack of or poor government services in return.

Johnson et al. (2008) elucidate that executives who commit corporate fraud face greater financial incentives to do so, with unrestricted stockholdings being the largest source of managerial incentives at fraud firms. Additionally, fraud incidents are often motivated by a desire to avoid declines in stock prices. Cullinan et al. (2008) show that companies whose independent directors do not receive stock options are less likely to misstate revenues. Dechow et al. (2011) observe that misstatements in fraud firms appear to be made to conceal a slowdown in financial performance and maintain high stock market valuations.

A few studies have examined non-financial motives for fraudulent financial reporting, revealing additional factors that can drive such behaviour. Ball (2009) concludes that individuals who have tied their self-esteem to the success of a business perceive the public announcement of failure as a direct threat, leading them to take protective actions that may involve financial reporting fraud. Hasnan et al. (2013) find that family ownership is negatively and significantly associated with fraudulent financial reporting in Malaysian publicly listed companies. Shi et al. (2017) further note

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3 that when top managers face stricter external control mechanisms, such as activist shareholders,
4 the threat of a takeover, or zealous securities analysts, they are more inclined to engage in financial
5 misconduct. Zuberi and Mzenzi (2019) identify several factors that incentivise employees and
6 managers to participate in fraudulent behaviours in Tanzania, including social incentives and
7 pressure, operational challenges, internal pressures, and a hostile work environment. Seidel et al.
8 (2020) conclude that companies employ income-increasing, unexpected non-GAAP exclusions to
9 meet or slightly surpass analysts' expectations, an alternative technique subject to less scrutiny
10 from auditors.
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19 ***How management motives to commit fraud impact an organisation's financial accounts.***

20 Limited academic evidence exists on the impact of management's motives on an organisation's
21 financial accounts. However, a few studies shed light on this topic. For example, Lail et al. (2014)
22 highlight that managers may exploit vague cost allocation requirements to shift expenses between
23 different organisation segments. This manipulation can artificially enhance the reported
24 performance of underperforming core segments. When proprietary motives are at play, this
25 expense shifting allows core profits to be concealed.
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32 Heese (2018) examines the behaviour of hospital managers and finds that they tend to prefer
33 overbilling as a manipulation technique when they face constraints in managing accruals (such as
34 cutting discretionary expenditures). Conversely, when managing accruals is constrained, managers
35 may resort to overbilling as an alternative manipulation tool. This suggests that overbilling is a
36 significant method of manipulation in hospitals. Donoher et al. (2007) conclude that managerial
37 equity ownership and contingent compensation are positively associated with restatements related
38 to improper disclosures. This implies that managers with higher equity ownership and contingent
39 compensation may have a higher propensity to engage in fraudulent activities involving improper
40 disclosures.
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3 In conclusion, the academic and professional literature acknowledges the crucial responsibility of
4 external auditors in detecting fraud and emphasises the need for improved efforts in this regard.
5 However, it falls short of guiding auditors in assessing the risk associated with management
6 motives for fraud. This is a significant gap, as financial reporting fraud is more likely to be
7 perpetrated by management with the knowledge and authority to override controls (Brennan &
8 McGrath, 2007). Furthermore, research indicates that fraudulent activities typically originate from
9 management pressure or motive (Davies, 2000; Kassem, 2018). Recent audit research further
10 highlights that management's motives directly impact external auditors' evaluations of material
11 misstatements (Commerford et al., 2022). Auditors must recognise that management motives are
12 crucial in fraudulent financial reporting. Without considering these motives as a primary element
13 in their assessments, auditors are unlikely to succeed in effectively detecting such fraudulent
14 activities (Kassem, 2023). Therefore, considering management motives in the audit process is of
15 utmost importance.
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27 The present study aims to fill this knowledge gap by addressing the following research question:
28 How can external auditors assess the risk associated with management motives for fraud during
29 external audits?
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34 **3. Methodology**

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36 Semi-structured interviews were conducted with twenty-six external auditors with expertise in
37 fraud risk assessment to investigate how management motives for fraud can be assessed in external
38 audits. The interviews took place between May and November 2018. Convenience sampling and
39 snowballing techniques were employed to identify suitable participants for this study. The
40 snowballing approach is particularly effective in auditing research that spans multiple firms, as
41 Malsch and Salterio (2016) have highlighted, due to the limited number of experts in specific areas
42 who are acquainted with their counterparts in other organisations. Initially, five connections on the
43 professional networking platform LinkedIn were established, which aided in identifying an
44 additional thirty potential participants for this study. Of these thirty-five prospects, twenty-six
45 agreed to participate in an online interview via Microsoft Teams.
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3 To address bias in the sample selection process, the study implemented a systematic, criteria-based
4 selection to target auditors with varying experience levels and qualifications from different Big 4
5 audit firms and diverse demographic characteristics. A breakdown of the final sample composition
6 is provided to ensure the transparency of the sampling procedures (see Table 2).
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11 Regarding the sample size, there are no set rules regarding sample size in qualitative inquiry, as it
12 depends on various factors such as the researchers' objectives and the need for credibility. This
13 concept is called saturation, which occurs when a sufficient range of ideas has been explored and
14 no new information is being obtained. In purposive sampling, saturation is reached when adding
15 more participants does not yield novel insights contributing to theme development (Teddlie and
16 Tashakkori, 2009). Prior auditing studies have typically achieved saturation with sample sizes
17 between 15 and 30 interviews (Malsch & Salterio, 2016). The current study reached saturation
18 with a sample of twenty-six auditors. Therefore, it falls within the range observed in similar
19 research. To determine when saturation had been reached, the interviews were carefully monitored
20 for the emergence of recurring themes and the absence of new, unique insights. Specifically, the
21 point at which no additional or substantially different perspectives on assessing management
22 motives for fraud were uncovered through the interviews. An iterative analysis approach was
23 employed, reviewing interview transcripts after each data collection round. By the 20th interview,
24 the key themes and conceptual insights had stabilised, and subsequent interviews were not yielding
25 novel information that significantly altered or expanded the findings. At this stage, it was
26 determined that a comprehensive understanding of how external auditors assess management fraud
27 motives was achieved and that conducting more interviews would not provide sufficient
28 incremental value to justify the additional time and resources. To further validate the saturation
29 point, six additional interviews were conducted to confirm that no significant new themes or
30 perspectives emerged. With this additional confirmation, the final sample of twenty-six auditors
31 was confirmed to be sufficient to provide a credible and in-depth exploration of the research topic
32 without excessive repetition or redundancy in the data collected.
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To adequately explore the perspectives of external auditors on complex and technical subjects, it was crucial to select participants with substantial experience in auditing, particularly in the field of fraud risk assessment. All auditors included in this study possessed more than five years of experience in auditing, as well as a minimum of three years of experience, specifically in fraud risk assessment. Furthermore, all participants held professional qualifications in auditing. Some participants also held additional professional certifications in fraud examination, such as the Certified Fraud Examiner (CFE) designation. The interview sample comprised six audit partners, eleven audit managers, and nine senior auditors, as detailed in Table 2. The participants' extensive experience and educational background were vital to ensure their ability to respond to the technical research questions. It is important to note that respondents lacking adequate knowledge or experience may provide uninformed responses, deliberately guessing the answers, which can compromise the reliability of the data (Saunders et al., 2009).

(Insert Table 2 here)

On average, each interview had a duration of approximately 40 minutes. All interviews were conducted using Microsoft Teams and a digital recorder, and the audio recordings were subsequently transcribed professionally. The transcription process was carried out by a reputable and secure company recommended by the University. Before commencing each interview, the research objective, rationale for selecting each participant, data usage and protection protocols, assurance of confidentiality and anonymity, and the participant's right to withdraw their data were explicitly communicated. To establish rapport and encourage participants to provide comprehensive insights on the research topic, introductory questions about participants' demographics were posed. These initial inquiries aimed to foster a sense of engagement and facilitate sharing of relevant details related to the research issue.

Thorough consideration of ethical aspects, such as anonymity, confidentiality, participant well-being, and data protection, has been an integral part of this research endeavour. To ensure the validity of the interview questions, three experienced academics specialising in auditing and qualitative research, as well as the University's ethics committee, reviewed them. Ethical approvals were obtained before engaging any human participants in the study. Additionally, the interview

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3 questions underwent a pilot test with four external auditors with over five years of audit experience.
4 This pilot testing phase aimed to ensure the questions' optimal wording, structure, and clarity.
5 Before conducting the interviews, explicit permission to record the sessions was sought from each
6 participant, and consent was obtained from all individuals. To maintain transparency and
7 credibility, a comprehensive package consisting of the participant's information sheet, consent
8 form, and interview schedule was provided to each participant before the interview (see appendix).
9 To safeguard the anonymity of the interviewees, Table 2 presents summarised demographic
10 information, including participant codes, rank, years of audit experience, years of experience in
11 fraud risk assessment, and educational background. The paper references participant quotes using
12 the respective participant code identified in Table 2 (e.g., P1, P2, etc.).
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22 Content analysis was used to analyse the qualitative data following these steps. First, all interviews
23 were transcribed verbatim to prepare for data analysis. This process started by carefully reading
24 through the transcripts and comparing the recordings with the notes to ensure that important details
25 were not missing. Second, each transcript was then reviewed in detail. The data were explored to
26 identify and develop a coding system by carefully exploring and reading through the data to obtain
27 a general sense and noting key points and ideas. Every passage of each transcript was coded to
28 allow the answering of the research questions. The data were coded inductively, meaning that the
29 codes emerged from the data rather than a predetermined coding scheme, into the following four
30 categories/themes: (i) Understand and identify potential management motives and vulnerable
31 accounts; (ii) Observe management attitude; (iii) Assess the credibility of management assertions;
32 (iv) other methods for assessing management motives for fraud. Third, common and similar
33 answers were grouped using NVivo, which also helped track the number of times specific audit
34 procedures/methods were mentioned or suggested. A frequency count was conducted based on the
35 number of participants who recommended the methods (see Table 3). Lastly, the findings were
36 interpreted based on the qualitative results. As a sole researcher, I coded all the interviews to ensure
37 a consistent approach. Additionally, I asked an independent researcher who is an expert in
38 qualitative research to review the coding process to ensure consistency and reliability. Cohen's
39 kappa was 0.85, a high score indicating coding consistency and reliability.
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4. Results

The analysis of the findings has revealed six distinct methods for assessing the risk of management motives for fraud, as recommended by the auditors participating in this study. However, it is worth noting that some methods were mentioned more frequently than others. Notably, all participants emphasised the importance of understanding and identifying potential management motives and conducting comprehensive audits of vulnerable accounts. This was followed by the recommendation of observing management attitudes, which fifteen participants mentioned. Additionally, ten participants suggested assessing the credibility of management assertions.

A smaller number of participants mentioned other methods. Table 3 summarises all six methods, indicating the frequency of recommendations by the participants.

Moreover, Figure 1 visually represents the distribution of these recommendations. The findings have been organised into four overarching themes outlined in the methods section. The first three themes focus on the most commonly suggested methods, while the final theme, titled "Other Themes," encompasses methods mentioned by only a few participants.

(Insert Figure 1 and Table 3 here)

Theme # 1: Understanding and identifying potential management motives and vulnerable accounts

All participants unanimously highlighted two crucial steps for assessing the risk of management motives for fraud. Firstly, they emphasised the significance of understanding and identifying potential management motives, as this awareness can enable auditors to identify the accounts that are most susceptible to manipulation by management. Secondly, participants stressed the importance of conducting thorough audits on these vulnerable accounts. They provided various examples to illustrate how auditors' understanding or knowledge of specific management motives can serve as a valuable alert to detect potential manipulations. These are a few examples mentioned by the participants:

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3 *If management wants bonuses linked to financial performance, then there might be*
4 *a high likelihood that the revenue account will be overstated. If management wants*
5 *to avoid tax, then revenue will be understated (P2)*
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10 *Liabilities can be concealed to get loans from banks or misclassified to make the*
11 *liquidity ratio look better to meet the bank's covenant agreements. Expenses could*
12 *be overstated to avoid paying taxes (P15)*
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17 *Management could commit improper disclosure to receive bonuses, and that could*
18 *be committed through hiding critical information about the company's ability to*
19 *continue in the future, non-disclosure of related party transactions, and omission of*
20 *important information or the disclosure of only favourable information (P26)*
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26 Subsequently, probe questions were employed to investigate how external auditors could identify
27 management motives in their auditing practices. The consensus among all participants was to
28 prioritise two critical approaches. Firstly, they highlighted the significance of comprehending the
29 nature of the client's business, industry, and the geographical context in which the audit client
30 operates. This understanding enables auditors to gain insights into the factors influencing
31 management motives for fraud. Secondly, participants emphasised the importance of being
32 attentive to red flags indicating management motives for fraud. These red flags serve as warning
33 signs that warrant further scrutiny during the auditing process.
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41 Additionally, a subset of participants (n=5) suggested the potential benefit of integrating a
42 comprehensive checklist of possible management motives for fraud into audit software. This
43 feature would serve as a helpful tool to remind auditors to consider and evaluate management
44 motives throughout the audit engagement.
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3 ***Critical considerations in understanding the nature of the client's business and industry:***
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7 To gain a comprehensive understanding of the client's business and industry, as well as the country
8 in which the audit client operates, the majority of auditors (n=20) recommended focusing on the
9 following key areas:
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13 ▪ The nature of business activities: Examining the specific operations and
14 activities conducted by the client's business to ascertain its unique characteristics
15 and potential risks.
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18 ▪ Economic conditions and political stability: Assessing the economic climate and
19 political stability of the country in which the audit client operates, as these factors
20 can impact the business environment and management motives.
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- 22
23 ▪ Market position and financial performance: Evaluate the client's position and
24 historical and current financial performance to gain insights into its competitive
25 standing and financial stability.
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28 ▪ Management objectives and operating style: Understanding the goals,
29 philosophy, and approach adopted by the company's management, as these
30 factors can influence their motives and decision-making processes.
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33 ▪ Delegation of power and authority: Assessing the extent to which power and
34 authority are delegated within the organisation can impact the risk of
35 management override of internal controls.
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39 ▪ Relationship with employees: Examining the dynamics and relationship between
40 management and employees can provide insights into potential motives for
41 fraudulent activities.
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44 ▪ Listing status: Determining whether the company is publicly listed can indicate
45 the presence of stakeholder pressure on management to achieve specific targets.
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48 ▪ Regulatory environment: Understanding the company's regulatory environment,
49 particularly tax laws and any new regulations that may impact its profitability or
50 market position.
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3 One participant highlighted the importance of conducting an overall assessment of the company's
4 business to identify potential pressures or incentives that could drive management to engage in
5 fraudulent activities. They provide specific examples, such as the company being publicly listed
6 and needing to demonstrate better financial performance to boost its share value. This suggests
7 that the pressure to meet investor expectations and increase shareholder value might motivate
8 management to manipulate financial results. The participant also mentions the possibility of the
9 company needing finance and, as a result, being inclined to improve its financial ratios to secure
10 funding from banks. This indicates that the need for financial resources might serve as an
11 incentive for management to engage in fraudulent practices:
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20 *To assess management motives for fraud, first, an overall assessment of the*
21 *company's business must take place to identify whether there is a pressure or*
22 *incentive that could drive management to commit fraud, such as whether the*
23 *company is publicly listed and needs to show better results to increase its share*
24 *value, or whether the company needs finance and thus might be motivated to*
25 *improve its financial ratios to get finance from banks (P14)*
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32 **Red flags for management motives for fraud:**

34 The participants of this study (n=17) identified several red flags that indicate potential management
35 motives for fraud. These red flags serve as warning signs for auditors to be vigilant and further
36 investigate suspicious activities. The red flags include (i) Significant budget variances that
37 management cannot explain. (ii) Unrecorded liabilities that management cannot justify or attempt
38 to conceal. (iii) Absence of a code of conduct in the company, coupled with management's lack of
39 interest in implementing one. (iv) Existence of outstanding balances with tax authorities or
40 creditors. (v) Issues related to the company's going concern status that management is reluctant to
41 disclose. (vi) High turnover of key staff within the organisation. (vii) Presence of unqualified or
42 less qualified personnel in the finance department. (viii) Management's resistance to taking
43 corrective actions when necessary. (ix) Persistence of outstanding balances even after
44 reconciliation attempts. (x) Deterioration in the company's financial performance. (xi) The
45 company's need for finance may pressure management to manipulate financial results. (xii) Decline
46 in customer demands, potentially affecting the company's financial stability. (xiii) High operating
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3 losses that could indicate financial strain. (xiv) Management bonuses or remuneration tied to
4 financial performance may incentivise fraudulent behaviour. (xv) Excessive pressure imposed on
5 management to achieve specific targets. (xvi) Regulatory requirements that could impact the
6 company's profitability or existence.
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11 Three participants highlighted the importance of understanding the compensation structure of
12 management and executives within the company. Specifically, they emphasised the need to pay
13 attention to bonuses and incentives that are directly linked to the company's revenue or financial
14 performance:
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18 *It is imperative to understand management and executives' compensation structure,*
19 *such as bonuses and incentives that are linked to the revenue or the financial*
20 *performance of the Company (P11)*
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25 ***Considerations in auditing the most vulnerable accounts***

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27 All participants unanimously stressed the importance of allocating additional effort towards
28 auditing the accounts that are most susceptible to manipulation by management. Moreover, several
29 participants provided insightful examples of strategies to accomplish this goal.
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35 Seven participants emphasised the crucial role of assigning more experienced staff members to
36 audit the accounts that exhibit a higher vulnerability to management manipulations. These
37 experienced auditors are better equipped to detect subtle signs of fraudulent activities and exercise
38 professional judgment in evaluating the accuracy and reliability of financial information.
39 Moreover, these participants suggested that the audit staff responsible for assessing vulnerable
40 accounts should possess qualifications in fraud examination or have completed satisfactory credit
41 hours in anti-fraud training. This additional training equips auditors with specialised knowledge
42 and skills to effectively identify and address potential fraud risks associated with these accounts.
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50 Additionally, three participants recommended expanding the sample size to 100% for specific
51 accounts more likely to be targeted for manipulation by management, such as sales revenues. This
52 approach would involve examining the entirety of these accounts to ensure a comprehensive
53 assessment of potential irregularities.
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3 From the auditors' perspectives, by combining these approaches, auditors can enhance their ability
4 to detect and mitigate the risks of management manipulations in the most vulnerable accounts
5 during the audit process. They provided various examples concerning the audit of vulnerable
6 accounts.
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11 In the first example, the participant suggests specific actions to address potential revenue
12 recognition manipulation driven by management motives for fraud. They recommend conducting
13 a cut-off test at year-end to ensure proper timing of revenue recognition. Additionally, they advise
14 inspecting subsequent period sales returns to identify any potential reversals or adjustments.
15 Furthermore, the participant suggests inspecting sales transactions made to related parties, as these
16 transactions may be susceptible to manipulation for fraudulent purposes. In the case of inventory,
17 the participant recommends a physical count at year-end to verify the accuracy and existence of
18 inventory items.
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25 *If management motives for fraud indicate potential revenue recognition*
26 *manipulation, then the action would be a cut-off test at year-end. Subsequently,*
27 *sales returns would be inspected, and transactions would be made with related*
28 *parties. In the case of inventory, a physical count at year-end is recommended (P4)*
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34 In another example, the participant emphasises the importance of assessing the impact of
35 management's motivation on the financial statements. They note that the specific type of motive
36 will determine the focus areas during the audit. For example, if the company desires to obtain loans
37 from a bank, there may be a high motivation to overstate revenue. In such cases, the revenue
38 account would receive increased scrutiny, and if necessary, the participant suggests recommending
39 adjustments to the account. If management refuses to make the required adjustments, the
40 participant advises reporting the issue in the management representation letter and the audit report.
41 This ensures transparency and highlights any potential concerns to stakeholders:
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50 *Assessing the effect of management's motivation on the financial statements*
51 *depends on the type of motive (e.g. if the company wants to get loans from a bank,*
52 *there might be high motivation to overstate the revenue, so in this case, more focus*
53 *will be given to the revenue account and if necessary an adjustment in the account*
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3 *will be recommended). If management refuses to make the required adjustments,*
4 *the issue should be reported in the management representation letter and the audit*
5 *report (P20)*
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10 Another participant discussed addressing the potential manipulation of fixed assets. They suggest
11 reviewing authorisations related to the purchase and disposal of fixed assets. This involves
12 examining the approval process and verifying that proper controls are in place to prevent fraudulent
13 activities related to fixed assets:
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18 *If we suspect that fixed assets' manipulation is likely, we will review authorisations,*
19 *particularly those related to the purchase and disposal of fixed assets (P5)*
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24 When questioned about the most vulnerable accounts to management manipulations, the responses
25 from the participants (n=20) shed light on several critical areas of concern. These areas include:
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- 27 ▪ Revenue recognition and sales returns.
 - 28 ▪ Assets, with a particular focus on cash, accounts receivable, inventory, capitalised assets,
29 impairment of investments, classification of assets, and goodwill.
 - 30 ▪ Estimates made in financial statements.
 - 31 ▪ Subsequent events and year-end account balances.
 - 32 ▪ Accounts payable.
 - 33 ▪ Disclosure related to the ongoing concern issues.
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40 Among these areas, many participants (n=12) highlighted the heightened risk of manipulation in
41 manual journal entries. They pointed out that manual journal entries often have fewer controls than
42 automated processes, making them vulnerable to fraudulent activities. Accordingly, these
43 participants recommended placing greater emphasis on testing journal entries, particularly those
44 made at year-end, to identify any unusual transactions or patterns that may indicate potential
45 manipulation. The comment of one participant was:
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50 *Auditors should focus more on manual journal entries as they are subject to less*
51 *internal control than automated journal entries, which makes them riskier and more*
52 *vulnerable to manipulations (P7)*
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3 A few participants (n=3) mentioned that audit clients seeking bank loans constantly manipulate the
4 liquidity ratio. Overall, The participants' insights highlight the importance of targeting specific
5 accounts and areas prone to management manipulations during the audit process. By focusing on
6 these vulnerable areas and implementing rigorous testing procedures, auditors can increase their
7 chances of detecting any irregularities or fraudulent activities that may impact the financial
8 statements.
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15 **Theme # 2: Observing management's attitude**

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17 Another approach suggested by many participants (n=15) for evaluating management motives for
18 fraud involves observing management's attitude. These participants provided insightful examples
19 to guide other auditors in assessing management attitude. These examples include:
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- 22 ▪ Examining how management responded to inquiries about fraud from internal auditors and
23 previous external auditors. This can provide valuable insights into management's
24 willingness to address potential fraud issues and their level of transparency in dealing with
25 such inquiries.
- 26 ▪ Observing management's degree of cooperation with auditors. This involves assessing how
27 readily management provides information and access to relevant documents or processes
28 during the audit. A lack of cooperation may raise concerns about potential motives for
29 hiding or manipulating information.
- 30 ▪ Investigating whether management takes appropriate corrective actions in response to
31 issues raised by internal and external auditors. This includes assessing management's
32 willingness to address identified control weaknesses, implement recommended
33 improvements, and take prompt action to rectify any identified deficiencies.
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45 By observing management's attitude through these indicators, auditors can gain valuable insights
46 into management's commitment to ethical behaviour, transparency, and a robust control
47 environment. These observations can help auditors assess the overall risk of fraud and the integrity
48 of the financial reporting process. One participant suggested that assessing management motives
49 for fraud involves discussing previous auditors' experiences, including limitations imposed by
50 management, and evaluating management's response to internal audit reports and control
51 weaknesses. This helps auditors gauge the risk of fraud:
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3 *It is vital to assess management motives for fraud to discuss with previous auditors*
4 *management attitude and how cooperative management was in previous years,*
5 *including whether management imposed any scope limitations on previous auditors'*
6 *work. Inquiries from the internal auditor about weaknesses in the client's internal*
7 *control system and how management responded to the internal audit report and the*
8 *issues identified are also essential (P3)*
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15 **Theme # 3 assessing the credibility of management assertions**

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19 A third recommended approach for evaluating management motives for fraud, as suggested by
20 some participants (n=10), involves critically assessing management assertions. These participants
21 proposed several methods to carry out this assessment:
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26 ■ Comparing previous years' figures to management's assertions and assessments during
27 those years. This helps determine if there are any significant discrepancies between the
28 reported figures and what was observed in previous years. Such differences can provide
29 insights into potential manipulation or misrepresentation of financial information.
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34 ■ Reviewing bank covenant agreements to identify any inconsistencies between the records
35 and management's responses regarding bank loans. Discrepancies in this area may indicate
36 attempts to mislead stakeholders or lenders about the company's financial position or
37 compliance with loan agreements.
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42 ■ Examining minutes of board meetings, company legal documents, and contracts to identify
43 any inconsistencies between management's assertions and the information in these
44 documents. Inconsistencies may raise concerns about the accuracy and reliability of
45 management's statements and representations.
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3 Overall, the participants' suggestions highlight the importance of thoroughly examining
4 management assertions and comparing them to objective evidence and external documents. One
5 participant elucidated the importance of thorough auditing procedures, such as comparing
6 management's disclosures to objective evidence, to identify potential misrepresentations or
7 omissions. He shared a case where comparing management's disclosure regarding contingent
8 liabilities to the information contained in contracts provided by the legal department revealed
9 unrecorded litigation costs in one of the audited companies:
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17 *Comparing management disclosure about contingent liabilities to information in*
18 *contracts provided by the legal department showed unrecorded litigation costs in one of*
19 *the companies we audited. This made us believe that the finance manager lied about*
20 *litigation costs (P16).*
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26 **Theme # 4 Other methods for assessing management motives for fraud**

27 Five participants recommended conducting inquiries with management and those charged with
28 governance to assess fraud risks. These inquiries should include discussions about the following:
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- 31 ■ Management's response to identified fraud risks or issues brought to their attention.
 - 32 ■ Management's involvement in past fraud cases.
 - 33 ■ Relationships with related parties, such as checking for any outstanding dues from related
34 parties.
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39 Four participants suggested brainstorming with the audit engagement team to identify
40 management's incentives to commit fraud. This involves considering factors that might create
41 pressures or motivations for fraudulent behaviour.
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46 Additionally, two participants highlighted the importance of considering information from
47 whistleblowers and tips from employees and customers. These sources can provide insights into
48 management's attitude, integrity, and operating style.
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3 These recommendations underline the significance of actively seeking information and conducting
4 thorough assessments to evaluate management's potential involvement in fraud. By conducting
5 inquiries, brainstorming sessions, and considering external sources of information, auditors can
6 enhance their understanding of management's motives and integrity, contributing to a more
7 effective and comprehensive audit process. One participant shared a case where tip-offs from two
8 employees helped uncover revenue overstatement, highlighting the significant impact that
9 whistleblowers and tip-offs can have in uncovering fraudulent activities:
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17 *Tip-offs from two employees have helped in detecting a case of revenue overstatement.*
18 *Two anonymous employees submitted a report about a suspected fraud in the company*
19 *involving revenues committed by the finance manager. After auditing the revenue cycle,*
20 *the audit team concluded that revenues had been overstated. We inquired the finance*
21 *manager about this, but he intimidated us and refused to cooperate. The matter was*
22 *raised to the board of directors, who then investigated it and found evidence that the*
23 *finance manager had colluded with two financial accountants to inflate revenues to*
24 *secure his bonus for the year (P26).*
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30 **5. Discussion, Implications, and Conclusion**

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32 This study is the first to examine the assessment of management motives for fraud in external
33 audits. Doing so contributes to the existing literature on fraud risk assessment in external audits
34 with new empirical evidence on evaluating management motives for fraud.
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39 The findings reveal six methods external auditors can use to assess management motives for fraud.
40 They emphasise that assessing management motives requires auditors to go beyond understanding
41 these motives and necessitates a sceptical and analytical mindset. Auditors need to identify the
42 accounts most vulnerable to management manipulations, observe management attitudes, and assess
43 the credibility of management assertions. The auditors in this study highlight specific accounts
44 frequently manipulated by management. Still, manual year-end journal entries are the most
45 vulnerable to management manipulations as they are subject to fewer controls. They recommend
46 increasing the sample size to 100% and assigning more experienced staff, particularly those with
47 qualifications in fraud examination or anti-fraud training, to audit these vulnerable accounts
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3 thoroughly. They also provided examples of how auditors can identify management motives for
4 fraud, observe management attitudes, and assess the credibility of management assertions.
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8 These findings have significant implications for audit research, policy, and practice. From a policy
9 and practice standpoint, despite the requirement of professional scepticism in audit standards (such
10 as ISA 200: Overall Objectives of the Independent Auditor and the Conduct of an Audit in
11 Accordance with International Standards on Auditing), external auditors continue to face criticism
12 for not adequately demonstrating the necessary level of scepticism to effectively challenge
13 management (Barac et al., 2016; FRC, 2019). This study aligns with ISA 200 and reinforces the
14 importance of professional scepticism, as it highlights the critical assessment of management
15 assertions as a highly recommended approach for assessing management motives for fraud.
16 Moreover, the study offers practical examples that enhance auditors' skills in evaluating the
17 credibility of management assertions.
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27 Specifically, the auditors in this study suggest several methods to assess the credibility of
28 management assertions: (i) comparing previous years' assertions and assessments with the actual
29 figures and examining differences from the current year's figures, (ii) reviewing bank covenant
30 agreements to identify any inconsistencies between records and management's responses regarding
31 bank loans, and (iii) examining board meeting minutes, company legal documents, and contracts
32 to detect any disparities between management's assertions and these documents. These methods
33 can be integrated into professional audit training programs or potentially incorporated as guidance
34 in existing audit standards to enhance auditors' professional scepticism and ability to challenge
35 management effectively.
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45 Overall, the findings indicate that assessing management fraud motives demands heightened
46 professional scepticism and analytical rigour from auditors. They must go beyond understanding
47 these motives - systematically observing, investigating, and scrutinising management attitudes,
48 accounts, and assertions. This challenges the audit profession to cultivate these critical cognitive
49 skills further and institutionalise them.
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3 The study provides empirical evidence that certain accounts, such as manual year-end journal
4 entries, are particularly vulnerable to management manipulation. This highlights the need for more
5 strategic, risk-based audit planning and resource allocation, with increased sample sizes and
6 experienced staff assigned to audit these high-risk areas.
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11 Additionally, it highlights the significance of comprehending the client's business industry and the
12 geographical context of the audits as a means to identify management motives for fraud. This
13 finding holds crucial importance for two reasons. Firstly, regulatory inspections conducted by the
14 FRC in the UK consistently criticise auditors for insufficiently understanding the client's business
15 and industry when assessing fraud risk (FRC, 2019). Secondly, an analysis of the Lincoln fraud
16 case revealed that the auditors' major shortcoming was their inadequate understanding of the
17 client's business and the economic forces shaping the industry (Erickson et al., 2000). Failure to
18 learn from history leads to repeating mistakes. Hence, this finding serves as a vital alert to auditors
19 regarding the necessity of understanding the client's business and industry to detect future frauds
20 successfully. The study also presents several examples in Table 3 to aid auditors in grasping the
21 nature of the client's business, which can considerably enhance their skills in this area.
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32 Similarly, the study emphasises the importance of recognising specific red flags that can assist
33 auditors in detecting management motives for fraud. These red flags are conveniently summarised
34 in Table 3, serving as valuable indicators for auditors to consider when evaluating the risk of
35 management motives for fraud. Notably, one red flag that deserves attention is the company's
36 reluctance to disclose concerns about its going concern status. This finding aligns with the FRC's
37 recommendation for external auditors to enhance their efforts in the going concern audit, as current
38 practices remain insufficient (FRC, 2019). The failure of auditors in the Carillion case further
39 exemplifies the significance of this issue. Inadequate identification and resolution of financial risks
40 and issues within the company, coupled with the failure to raise sufficient concerns and provide
41 appropriate warnings regarding the deteriorating financial situation and high debt levels, resulted
42 in a lack of transparency and accountability. Ultimately, this led to the collapse of Carillion,
43 causing significant financial losses for investors and creditors. The auditors' inability to fulfil their
44 duties effectively and provide accurate and reliable financial information has raised substantial
45 concerns about the effectiveness and independence of the auditing profession (BBC, 2022).
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5 Other noteworthy red flags include financial distress or pressure and executive compensation.
6 These red flags align with the findings of previous studies that have identified them as significant
7 management motives for fraud (Cullinan et al., 2008; Johnson et al., 2008; Hasnan et al., 2013;
8 Hollow, 2014; Kassem, 2018).
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13 A significant finding from this study is that many auditors recommend assigning more experienced
14 staff, particularly those with qualifications in fraud examination or who have completed a
15 satisfactory number of credit hours in anti-fraud training, to audit the most vulnerable accounts.
16 This finding holds particular importance because research suggests that auditors may rely on the
17 risk assessments of junior accountants who often lack sufficient experience to assess risk accurately
18 (Cohen et al., 2000). Therefore, this result serves as a crucial alert to audit firms, highlighting the
19 need to prioritise audit experience when assembling audit teams for fraud risk assessment. By
20 ensuring that experienced professionals with relevant qualifications are assigned to these tasks,
21 audit firms can enhance the effectiveness and accuracy of fraud risk assessments.
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31 In this study, a minority of auditors suggested brainstorming with the audit engagement team to
32 evaluate management's incentives for committing fraud and assess management motives for fraud.
33 Academic research has shown that engaging in a brainstorming session significantly increases
34 fraud risk assessments compared to assessments made before the session (Carpenter, 2007).
35 Additionally, high-quality brainstorming enhances the connection between fraud risk factors and
36 risk assessments (Brazel et al., 2010). This finding indicates that many auditors may not fully
37 recognise the importance of brainstorming in fraud risk assessment. Consequently, it is
38 recommended that audit firms emphasise the significance of brainstorming in fraud risk assessment
39 during professional audit training. Furthermore, audit engagement teams should be encouraged to
40 actively participate in brainstorming sessions when evaluating fraud risk, particularly in assessing
41 management motives for fraud. By fostering a culture that values and encourages effective
42 brainstorming, audit firms can more effectively identify and assess management motives for fraud.
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3 While it is essential to provide recommendations on improving audit practice and policy based on
4 the study's findings, it is equally important to acknowledge the challenges and limitations of these
5 recommendations and how they can be addressed to make feasible changes. The study highlights
6 the critical need for auditors to exercise a high level of professional scepticism when evaluating
7 management assertions and motives. However, developing and institutionalising this cognitive
8 skill across the audit profession can be challenging. Audit firms must invest significantly in
9 training, mentoring, and establishing a culture that values and rewards this mindset.
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17 Staffing audit engagements with fraud examination experts or those with extensive anti-fraud
18 training is recommended. However, this may be difficult, as these specialised skill sets can be
19 costly to acquire and retain within audit firms. Careful resource planning and incentive structures
20 may be required. Also, it requires a shift in audit firms' culture, specifically when academic
21 evidence points out audit firms' reluctance to appoint forensic experts (Asare et al., 2015) and
22 consider fraud risk assessments in external audits (Kassem, 2023).
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29 Targeting high-risk accounts like manual year-end journal entries with increased audit samples and
30 experienced staff requires a fundamental shift in audit planning and resource allocation. Audit
31 firms may resist such changes from an operational and cost perspective. Still, this could be an
32 excellent opportunity to consider technology in audits. Considering the possibility of scanning
33 manual journal entries using advanced technology can save auditors a lot of time.
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39 Finally, if widely adopted, the study's recommendations may highlight existing audit standards and
40 regulatory guidance deficiencies. Updating policies and standards to mandate or provide more
41 detailed guidance on these practices explicitly could face bureaucratic and political obstacles. Still,
42 considering the study's recommendations, it could be worthwhile if audit regulators wish to see a
43 meaningful change in auditors' skills in detecting material financial fraud.
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49 Overall, the critical challenge will be overcoming the inertia of traditional audit practices and
50 cultivating the necessary mindsets, skills, and organisational capabilities to implement the study's
51 recommendations. Sustained commitment from audit firms, regulators, and professional bodies
52 will be essential to drive these transformative changes in audit theory and practice.
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3 From an audit theory perspective, this study expands the conceptual toolkit available to audit
4 researchers by uncovering new methods auditors employ to evaluate management fraud motives.
5 These insights can inform the development of more nuanced, behaviourally grounded fraud risk
6 assessment and decision-making models. The study's insights into the specific methods auditors
7 use to observe management attitudes and evaluate the credibility of management assertions
8 underscore the importance of incorporating behavioural and psychological factors into audit
9 theory. This aligns with emerging streams of research on the cognitive and social aspects of auditor
10 judgment and decision-making (e.g., Abdallah et al., 2024). Moreover, the auditors' emphasis on
11 the benefits of fraud examination and anti-fraud training suggests that audit theory should more
12 explicitly account for the role of specialised forensic skills and competencies beyond just general
13 auditing expertise.
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24 Like any other study, the current study has limitations that should be acknowledged. The paper
25 focuses solely on audit research and does not incorporate insights from psychology and
26 criminology, which could provide valuable perspectives on management motives and fraud
27 detection. Future research could enrich the current findings by incorporating psychological and
28 criminological theories and frameworks to deepen the understanding of management motivations
29 for fraudulent behaviour, discussing the implications of emerging technologies like data analytics
30 and artificial intelligence on fraud detection and prevention efforts, and considering global
31 perspectives to acknowledge the diverse regulatory, cultural, and economic contexts that can shape
32 the challenges faced in assessing management motives for fraud. Expanding the scope of this
33 research to incorporate these additional elements could provide a more comprehensive
34 understanding of the complexities involved in evaluating management fraud risks and motivations,
35 strengthening the practical utility of the findings for both researchers and practitioners in auditing
36 and fraud detection.
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48 Another limitation is the lack of gender and firm diversity represented in the sample. The
49 participants were all male external auditors, exclusively from the Big 4 audit firms. Therefore,
50 Future research should make concerted efforts to expand the diversity of the sample, intentionally
51 recruiting female auditors and those employed at national, regional, and international firms beyond
52 the Big 4 market leaders. Incorporating these diverse perspectives would enhance the richness and
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3 transferability of the findings, providing a more comprehensive understanding of how external
4 auditors assess management fraud motivations in varied organisational and individual contexts.
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8 Despite these limitations, the current study is the first to explore external auditors' perspectives on
9 assessing the risk of management motives to commit fraud in external audits. Additionally, the
10 study's findings have led to the development of practical guidance for assessing management
11 motives for committing fraud in external audits, as presented in Table 3. To facilitate their
12 application in professional audit training or standards, the findings are also visually depicted in
13 Figure 1. Still, it is important to note that assessing management motives for fraud is dynamic, and
14 ongoing research is needed to expand upon the guidance provided in this study. Future research
15 should explore additional approaches to evaluating management motivations for fraud, building
16 upon the foundation laid by this study. While the current study provides several examples of how
17 auditors can assess the reliability of management claims and discern management attitudes, the
18 evolving nature of this field requires continued investigation. Subsequent studies can test the
19 suggested guidance to assess its impact and effectiveness in enhancing auditors' ability to assess
20 fraud risks, particularly in complex management scenarios. Additionally, it is crucial to investigate
21 how the guidance aligns with upholding professional scepticism in external audit practices. By
22 conducting further research and refining the guidance, auditors can continue to improve their
23 abilities to identify and address management motives for fraud, thereby enhancing the
24 effectiveness and quality of external audits.
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Journal of Accounting Literature

Tables

Table 1: Previous Studies Summary

No	Author(s)/ Year	Study Focus	Key Findings	Methodology	Country
1.	Ball (2009)	Motives for financial reporting fraud.	For individuals who have built their self-esteem around the business, the possibility of a publicly announced failure represents a direct threat that necessitates protective actions that might lead to financial reporting fraud.	Secondary data analysis/Discussion paper	US
2.	Hasnan et al. (2013)	Factors associated with fraudulent financial reporting (FFR).	Financial distress is positively and significantly associated with fraudulent financial reporting, while family ownership is negatively and significantly associated with fraudulent financial reporting in Malaysian publicly listed companies.	Secondary data analysis of 53 fraud firms convicted of securities fraud and 53 no-fraud firms were listed on the Bursa Malaysia and have a complete set of data from 1996–2007.	Malaysia
3.	Hollow (2014)	Bank employees and managers' motives to commit fraud.	Financial pressures are hugely significant in motivating bank employees and managers to commit fraud.	Secondary data analysis of 64 cases of fraud from the UK financial sector	UK
4.	Ndofor et al. (2015)	The likelihood of top managers committing financial reporting fraud.	More stock options for Chief Executive Officers (CEO) increase the likelihood of fraud when industry complexity is high. Information asymmetries arising from industry- and firm-level complexities increase the likelihood of financial fraud.	Secondary data analysis of 453 matched pairs of firms that have and have not been identified as having committed financial reporting fraud.	US
5.	Shi et al. (2017)	Management's motives to commit financial fraud.	When top managers face more stringent external control mechanisms, such as activist shareholders, the threat of a takeover, or zealous securities analysts, they are more likely to engage in financial misbehaviour.	Secondary data analysis of SEC Accounting and Auditing Enforcement Releases (AAERs) between 99-2012.	US

6.	Zuberi and Mzenzi (2019)	Factors involved in the occurrences of both employee and management fraud.	Six motivation factors incentivise employees and managers to engage in fraudulent behaviours, including business financial strain, social incentives and pressure, greed, operating problems, internal pressures, and a hostile work environment.	A survey was sent to 114 participants who had witnessed, examined, or been involved in fraud resolutions, including fraud examiners, business managers and owners, victims, auditors, lawyers, and law enforcement agents.	Tanzania
7.	Kassem (2018)	Management's motives for committing fraudulent financial reporting.	Egypt's most common management motivations are the desire for remuneration or bonuses and the need to secure financing.	Mixed-method, questionnaire, and semi-structured interviews with external auditors.	Egypt
8.	Sallal et al. (2021)	The motivations for committing fraud in financial statements.	Motivations for committing fraudulent financial reporting in Iraq and Iran encompass many factors; however, the most important factor is tax incentives due to the perceived high tax rates, the heavy tax burden, and the lack of government services or poor services in return.	A questionnaire was sent to external auditors in Iran (194) and Iraq (140)	Iraq and Iran
9.	Krambia-Kapardis (2002)	The characteristics of irregularity-prone companies.	Irregularity-prone companies are characterised by a lack of an effective internal control system and the absence of a code of conduct. Certain audit areas (cash and provisions) are more likely to evidence fraud.	Survey of Australian Auditors.	Australia
10.	Rosner (2003)	The financial reporting behaviour of failing firms	Provide insight into the financial reporting behaviour of failing firms. The behaviour of failing firms that do not appear distressed based on accrual data but show significant decreases in cash flows is consistent with material earnings overstatements in ongoing-concern years followed by overstatement reversals in going-concern years.	Secondary data analysis of SEC 242 non-sanctioned and 51 SEC-sanctioned bankrupt firms matched on year, size, and industry with 293 control firms.	US
11.	Johnson et al. (2008)	Executives' motives/incentives for fraud and the	Executives who commit corporate fraud face greater financial incentives to do so. Unrestricted stockholdings are the largest source of managerial	Secondary data analysis of SEC AAER fraud events that occurred from 1992 to 2005	US

		characteristics of fraud firms.	incentives at fraud firms. Frauds are attempts to avoid stock price declines. Fraud firms are also high-growth and have proportionately more insiders on their audit committees, implying a lower likelihood of fraud detection and, thus, lower expected costs of committing fraud.		
12.	Firth et al. (2011)	The characteristics of firms committing fraud.	Firms with high debt planning to make equity issues are more likely to manipulate their earnings and thus have to restate their financial reports in subsequent years.	Secondary data analysis of financial restatements in China in the years 2000 to 2005	China
13.	Perols & Lougee (2010)	The characteristics of firms that commit financial statement fraud.	Fraud firms are more likely to have managed earnings in prior years, and earnings management in prior years is associated with a higher likelihood that firms that meet or beat analyst forecasts or that inflate revenue are committing fraud. Fraud firms are more likely to meet or beat analyst forecasts and inflate revenue even when there is no evidence of prior earnings management.	Secondary data analysis of SEC sample of 54 fraud and 54 non-fraud firms.	US
14.	Cullinan et al. (2008)	Association between director option compensation and the likelihood of misstatement.	Companies whose independent directors do not receive stock options are less likely to misstate revenues.	Secondary data analysis of 105 US firms that misstated their revenue matched a sample of non-misstatement firms.	US
15.	Seidel et al. (2020)	Motivates for overstating a firm's income.	Firms increase the use of income-increasing, unexpected non-GAAP exclusions to meet or just beat analysts' expectations, an alternative technique subject to less auditor scrutiny.	Secondary data analysis of manufacturing firm financial data between 2008 and 2014 from the Compustat database.	N/A
16.	Lail et al. (2014)	Management's motives and methods to conceal expenses.	Managers use vague cost allocation requirements to shift expenses between the corporate/other segment and core segments. This shift increases the reported performance of underperforming core segments. By	Secondary data analysis of segment financial data from the Compustat Segment database	N/A

1			shifting expenses to core segments, core profits are	and firm-level financial data	
2			concealed when proprietary motives exist.	from 1998 to 2010.	
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5	17.	Heese	Management's motives	Hospital managers prefer overbilling to managing	Secondary data analysis of a
6		(2018)	and methods to manipulate	accruals (cutting discretionary expenditures) when	sample of general acute-care
7			the accounts.	cutting discretionary expenditures (managing	for-profit hospitals in California
8				accruals) is constrained, and vice versa—	1996–2007.
9				collectively, suggesting that overbilling is a critical	
10				alternative manipulation tool in hospitals.	
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12	18.	Donoher et	Management's motives for	Both managerial equity ownership and contingent	Secondary data analysis of
13		al. (2007)	committing improper	compensation were positively related to restatements	matched firms that either did or
14			disclosure.	concerning improper disclosures.	did not restate misleading
15					financial disclosures from 1994-
16					2003 using an electronic word
17					search in Lexis/Nexis Business
18					News for reports of financial
19					restatements.
20					
21	19.	Dechow et	The characteristics of	The overstatement of revenues, misstatement of	Secondary data analysis of
22		al. (2011)	misstating firms.	expenses, and capitalising costs are the most	2,190 SEC AAERs between
23				frequent types of misstatements. At the time of	1982 and 2005.
24				misstatements, accrual quality is low, and financial	
25				and nonfinancial performance measures are	
26				deteriorating. Financing activities and related off-	
27				balance-sheet activities are much more likely during	
28				misstatement periods. Managers of misstating firms	
29				appear to be sensitive to their firm's stock price.	
30				Misstatements appear to have been made to cover up	
31				a slowdown in financial performance and maintain	
32				high stock market valuations.	
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Table 2 – Participants' Demographics

Participant Code	Rank	Audit Experience	Experience in fraud risk assessment	Professional qualifications	Employment Location	Audit Firm Type
P1	Audit Manager	13 years	10 years	ACCA ¹ ; CFE ²	UK	International, not Big 4
P2	Audit Partner	16 years	10 years	FCA ³ ; CFE	Egypt	Big 4
P3	Audit Manager	11 years	7 years	CPA ⁴ ;	US	Big 4
P4	Audit Partner	19 years	16 years	CPA	US	Big 4
P5	Audit Partner	21 years	15 years	FCA; CFE	Egypt	Big 4
P6	Audit Manager	10 years	6 years	CPA; CFE	US	International, not Big 4
P7	Senior Auditor	8 years	5 years	CPA	US	International, not Big 4
P8	Audit Partner	20 years	15 years	CPA	US	Big 4
P9	Audit Manager	9 years	6 years	FCA; CFE	UK	Big 4
P10	Senior Auditor	7 years	5 years	ACA ⁵	UK	Big 4
P11	Audit Manager	9 years	5 years	ACCA	Egypt	Big 4
P12	Audit Manager	10 years	8 years	FCA; CFE	UK	International, not Big 4
P13	Senior Auditor	8 years	6 years	CPA	US	Firm D
P14	Senior Auditor	8 years	5 years	CPA	US	International, not Big 4
P15	Audit Manager	12 years	8 years	FCA; CPA	Egypt	Big 4
P16	Senior Auditor	6 years	4 years	CPA	US	International, not Big 4
P17	Senior Auditor	6 years	4 years	ACCA	UK	Big 4
P18	Senior Auditor	6 years	4 years	ACCA; CFE	UK	International, not Big 4
P19	Audit Manager	9 years	5 years	CPA	US	Big 4
P20	Senior Auditor	7 years	4 years	CPA	Egypt	Big 4
P21	Audit Manager	9 years	5 years	CPA	US	Big 4
P22	Audit Manager	11 years	6 years	CPA	US	International, not Big 4
P23	Audit Manager	12 years	8 years	CPA	Egypt	Big 4
P24	Senior Auditor	7 years	5 years	CPA	US	International, not Big 4
P25	Audit Partner	20 years	8 years	FCA	UK	Big 4
P26	Audit Partner	25 years	11 years	FCA	UK	International, not Big 4

¹ ACCA: Associate Chartered Certified Accountant of the Association of Chartered Certified Accountants (ACCA)

² CFE: Certified Fraud Examiners, Association of Certified Fraud Examiners (ACFE)

³ FCA: Fellow Chartered Accountant of the Institute of Chartered Accountants in England and Wales (ICAEW)

⁴ CPA: Certified Public Accountant of the American Institute of Certified Public Accountants (AICPA)

⁵ ACA: Associate Chartered Accountant of ICAEW

Table 3 – Methods for assessing management motives for fraud in external audits

Methods	Frequency Count*
1. Understand and identify potential management motives and vulnerable accounts by:	26
<ul style="list-style-type: none"> • Understanding the nature of the client's business and industry and the country where the audit client operates, especially: <ul style="list-style-type: none"> ➤ the nature of business activities; ➤ the economic condition of the country where the audit client operates and the extent of its political stability; ➤ the company's position in the market and its past and current financial performance; ➤ management's objectives, philosophy, and operating style; ➤ the delegation of power and authority to assess the risk of management override of controls; ➤ the relationship of management with employees; ➤ whether the company is a publicly listed company to determine if there is stakeholder pressure on management to achieve specific targets; ➤ understanding the company's regulatory environment, particularly tax laws, and whether any new regulations might affect the company's profitability or position in the market. • Paying attention to some red flags for management motives for fraud, including: <ul style="list-style-type: none"> ➤ significant budget variances that management cannot explain; ➤ unrecorded liabilities that management cannot justify or tried to hide; ➤ the company does not have a code of conduct, and management is not keen on having one; ➤ the availability of outstanding balances with tax authorities or creditors; ➤ issues with the company's going concerns that management is reluctant to disclose; 	

- high turnover of key staff;
- the existence of unqualified or less qualified staff in the finance department;
- management's reluctance to take corrective actions;
- the existence of outstanding balances after reconciliations;
- the deterioration in the company's financial performance;
- the company's need for finance;
- the decline in customer demands;
- high operating losses;
- management bonuses or remuneration that is linked to financial performance;
- excessive pressure imposed on management to achieve specific targets;
- regulatory requirements that might impact the company's profitability or existence

2. Observe management attitude, particularly: 15

- How they responded to fraud inquiries from internal auditors and previous external auditors,
- Their degree of cooperation with auditors,
- Whether they take corrective actions when needed.

3. Assess the credibility of management assertions: 10

- Assessing whether the assertions and assessments made by management in previous years agree with the actual figures in those years and how different they are from the current year's figures.
- Review bank covenant agreements to determine discrepancies between the records and management's responses concerning bank loans.
- Examining minutes of board meetings, company legal documents, and contracts to determine any discrepancy between management's assertions and these documents

4. Inquire management and those charged with governance about 5

- Their response to fraud risks that have been identified by management or brought to management's attention
- Management's involvement in past fraud cases

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- Their relation with related parties (e.g., Checking if there are any suspended dues from related parties)

5.	Brainstorm with the audit team, focusing on management motives for fraud.	4
6.	Investigate employees, customers, and other whistleblowers' tip-offs about management integrity, attitude, and operating style.	2

*Frequency count based on the number of auditors recommended the methods

Figure 1: Assessing management motives for fraud



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