

## 5.7: Case Study - Accounting Fraud



Fig. 5.7: Vicari, Mario O. "The Fraud Triangle and Your Business." Kreischer Miller

One of the major issues examined in the field of accounting is the concept of fraud. **Fraud** can be defined in many ways, but here we define it as the act of intentionally deceiving a person or organization or misrepresenting a relationship in order to secure some type of benefit, either financial or non-financial.

### Fraud Triangle

Workplace fraud is typically detected by anonymous tips or by accident, so many companies use the fraud triangle to help in the analysis of workplace fraud. Donald Cressey, an American criminologist and sociologist, developed the **fraud triangle** to help explain why law-abiding citizens sometimes commit serious workplace-related crimes. The **fraud triangle** consists of three elements: **pressure, opportunity, and rationalization**. When an employee commits fraud, the elements of the fraud triangle provide assistance in understanding the employee's methods and rationale. Each of the elements needs to be present for workplace fraud to occur.

Typically, all three elements of the triangle must be in place for an employee to commit fraud, but companies usually focus on the opportunity aspect of mitigating fraud because, they can develop internal controls to manage the risk. The rationalization and pressure to commit fraud are harder to understand and identify. Many organizations may recognize that an employee may be under pressure, but many times the signs of pressure are missed.

### Opportunity

Perceived opportunity is when a potential fraudster thinks that the internal controls are weak or sees a way to override them. This is the area in which an accountant has the greatest ability to mitigate fraud, as the accountant can review and test internal controls to locate weaknesses. After identifying a weak, circumvented, or nonexistent internal control, management, along with the accountant, can implement stronger internal controls.

### Rationalization

Rationalization is a way for the potential fraudster to internalize the concept that the fraudulent actions are acceptable. A typical fraudster finds ways to personally justify his or her illegal and unethical behavior. Using rationalization as a tool to locate or combat fraud is difficult, because the outward signs may be difficult to recognize.

### Pressure

Pressure (or incentive or motivation) is another element necessary for a person to commit fraud. The different types of pressure are typically found in

- vices, such as gambling or drug use
- financial pressures, such as greed or living beyond their means
- work pressure, such as being unhappy with a job
- other pressures, such as the desire to appear successful.

Pressure may be more recognizable than rationalization, for instance, when coworkers seem to be living beyond their means or complain that they want to get even with their employer because of low pay or other perceived slights.

## Famous Examples of Accounting Fraud

### Enron Scandal

A series of events that resulted in the bankruptcy of the U.S. energy, commodities, and services company **Enron Corporation** in 2001 and the dissolution of **Arthur Andersen LLP**, which had been one of the largest auditing and accounting companies in the world. Enron kept huge debts from the balance sheet, which resulted in shareholders losing \$74 billion, thousands of employees and investors losing their retirement accounts, and many employees losing their jobs.

### Toshiba Accounting Scandal

On July 21, 2015, Toshiba CEO Hisao Tanaka announced his resignation in the face of an accounting scandal tied to \$1.2 billion in overstated operating profits. An independent investigative panel revealed that improper accounting was found to have taken place over seven years, embroiling two former CEOs in the scandal alongside Tanaka. The scandal was directly linked to unscrupulous accounting practices, such as booking future profits early, pushing back losses, and pushing back charges. Toshiba's corporate culture, one where strict obedience to superiors was required, enabled fraudulent accounting practices.

### Waste Management

To meet analysts and investor expectations, the company journalized several fraudulent accounting transactions to eliminate and defer expenses. By decreasing the expenses on the income statement, the company was able to report a higher profit. To do this, the company used several fraudulent accounting techniques: avoided depreciation expenses on garbage trucks, failed to record landfill and other expenses, and other accounting manipulations. The company revised their annual financial reports for 1992 through 1996, plus the first three quarters of 1997. The revision caught the attention of the U.S. Securities and Exchange Commission which launched an investigation filed fraud charges.

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