

# ***Reduce Fraud: From Fraud Motivation to Fraud Avoidance***

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**Abstract:** The development of information technology and digital transformation in recent years, not only brings the innovation of fraud detection and the progress of fraud avoidance but also brings new fraud motivation and more serious fraud impact. This paper mainly studies the motivation, impact, detection, and avoidance of fraud, through the discussion of these aspects to assist to reduce the occurrence of fraud. The research method of this paper is to summarize and analyze the literature related to the fraud in recent 10 years. This paper finds that starting from the motivation of fraud, impact, detection, and avoidance are closely related to the motivation, especially the study shows that there is a strong connection between fraud motivation and fraud avoidance, in other words, the most effective way to avoid fraud is to cut off the source of the motivation.

**Keywords:** fraud motivation, fraud impact, fraud detection, fraud avoidance

## **1. Introduction**

In the context of information development and digital transformation, research on fraud motivation, fraud impact, fraud detection, and fraud avoidance have almost been involved in a single aspect, but the research referring to these complete aspects is very limited. Starting from the motivation of fraud, this paper successively discusses the impact of fraud, the detection of fraud, and finally the avoidance of fraud. Through the analysis of the complete aspects, the connection and mutual influence of various links can be more intuitively found, which helps reduce the occurrence of fraud more effectively. This paper mainly discusses four aspects: first, from the macro environment, the actual situation of the company and management's expectations to analyze the motivation of fraud; Second, analyze the impact of fraud from individual, social and public levels; Third, through the traditional methods, widely used methods, and innovative methods to analyze fraud detection; Fourth, from the internal and external levels respectively to analyze the avoidance of fraud. This paper relies on systematically collecting and analyzing the current research which mainly adopts professional journals, empirical research reports, and explanations from the official department from 2014 to 2022 for research and analysis. This paper will be helpful for scholars who want to discover the link between fraud motivation and fraud avoidance and provide them with a comprehensive consideration of factors to analyze fraud. At the same time, this paper is also conducive to enterprises and the public to understand fraud and cultivate their awareness of fraud prevention and self-protection.

## **2. Motivation for Fraud**

When it comes to the motivation for fraud, it can be analyzed from three perspectives. The first is the changes in the macro environment, and the others are the firm's actual situation and management's expectations of the firm.

### **2.1. Motivation from the Macro Environment**

In recent years, digital transformation has always been a hot topic and development trend. Unfortunately, digital transformation has brought more opportunities for fraud with its development. According to the research of Zhu et al., digital transformation increases digital processes, which leads to aggravated information asymmetry and creates favorable conditions for fraud [1]. In addition, due to the rapid development of digitalization, the existing fraud detection methods can no longer fully meet the needs of fraud detection, and the existing regulatory policies cannot keep up with the changes of digitalization in time [1]. Therefore, new forms of fraud under the background of digitalization can be more convenient to carry out. This means that the digital transformation has given those who try to commit fraud a motivation, from asymmetries in information to failures in existing detection methods and last to poor regulatory regulations.

### **2.2. Motivation from the Firm's Actual Situations**

The actual situation met by the firm in its operation, especially some urgent needs, is often the most direct motivation for fraud. Kanapickienė and Grundienė mentioned that financial distress leads to fraud, especially when firms have trouble with huge debts, and they have a greater motivation to commit financial fraud [2]. Mohamed and Handley-Schachler suggested that attracting investors by enhancing investors' willingness through financial performance, increasing the share prices, and dressing up financial statements to meet listing standards are the main motivations for fraud [3]. All the frauds mentioned above are carried out to alleviate difficulties or achieve certain purposes, however, the frauds brought by the actual situation of the company may also be caused by the lack of its culture and accountability system. Mohamed and Handley-Schachler discussed that the lack of corporate culture, especially those promoting integrity and business ethics, and the lack of corporate accountability system provide a hotbed for the occurrence of fraud [4]. Without the influence of the integrity and business ethics culture and the constraint of the accountability system, the firm including its employees will not keep integrity and ethics in mind, nor will they fear accountability, so it will bring stronger motivation to fraud.

### **2.3. Motivation from Management's Expectations**

The agency theory describes the conflict of interests between shareholders and the company's management. As shareholders, they want management to prioritize shareholders' interests over the company's short-term performance, which is typically driven by management's own interests. Davidson found that firms with equity incentives and senior management with a high percentage of equity incentives are more likely to engage in fraud [5]. Therefore, when the management's interests are closely related to the firm's performance, it creates motivation for them to commit fraud.

## **3. The Impact of Fraud**

Once the motivation to commit fraud is translated into real fraud actions, there will be of all kinds impacts from different perspectives. From the range and degree of influence, the impact of fraud can be divided into three levels: the impact of fraud on individuals, the impact of fraud on firms, and the impact of fraud on the public.

### **3.1. The Impact of Fraud on an Individual Level**

The impact of fraud on the individual level is mainly reflected in the negative effects brings to the employees in the financial department. Mohamed and Handley-Schachler argued that fraud can damage the reputation of employees in the financial department [3]. As a result, once financial fraud happens in a firm, the abilities, professional spirits, and moral character of the financial personnel, such as accountants, will be questioned, and the original persuasiveness and credibility of the financial reports they provide will be weakened.

### **3.2. The Impact of Fraud on the Firm Level**

The impact of fraud at the firm level is primarily manifested in the financing and extra costs which lead to the financial burden. First, Elsayed claimed that when financial frauds are exposed, a firm's share price will go down, which forces stockholders to take a loss, therefore it brings reputational problems and challenges in generating further finance to the firm [6]. Second, when fraud is discovered, the firm will incur significant litigation costs and fines which are related to the criminal action, and remediation costs that are used to mitigate the loss of stakeholders, all of these costs will bring a huge financial burden to the firm [6, 7]. If the fraud gives rise to serious consequences, the financial burden is likely to cause the firm to face financial strain and even the risk of bankruptcy.

### **3.3. The Impact of Fraud on the Public Level**

The impact of fraud on the public level focus on the interest of the whole public. Mohamed and Handley-Schachler proposed that fraud damages the public interest by manipulating the financial statement to avoid tax in an illegal way and to hide the misappropriation of public resources [3]. The firms often reduce their tax by understating the profits and by using industry-specific tax incentives to do so speculatively, however, these unreasonable actions that lead to tax reduction will harm the interests of the public as a whole.

## **4. The Detection of Fraud**

Fraud often brings serious consequences, and it is particularly important to detect fraud in a timely manner. This section will analyze fraud detection from three perspectives: the traditional method, the widely used method, and the innovative method.

### **4.1. The Traditional Method of Fraud Detection**

Traditional detection methods usually refer to those that do not require the use of technology and rely primarily on the most direct means of discovery. Mohamed and Handley-Schachler mentioned in their research that the traditional detection methods are whistle-blower reports and telephone hotlines [4]. However, the effect of the traditional detection method is very small, because it has a lag and cannot detect the occurrence of fraud in time. In the current business environment, the way of fraud has become more covert and cleverer, so such detection method is difficult to play a crucial role.

### **4.2. The Widely Used Method of Fraud Detection**

The fraud detection methods widely used in the current business environment include audit and expert evaluation [8, 9]. However, the auditor cannot guarantee the audit report for one hundred percent, and the experts tend to make subjective assumptions and over-protect the interests of themselves and their own groups, which reduces the effect of fraud detection. In addition, fraud can also be detected by

general detection tools and software, and fraud detection can be carried out by finding the motivation of fraud through abnormal values and unusual changes in financial ratio analysis [2, 4].

### **4.3. The Innovative Method of Fraud Detection**

There are two main categories of innovative fraud detection methods: Machine learning and human resource optimization. The first is the machine learning algorithm, which is a multi-field interdisciplinary, used to study computer simulation and realize human learning behavior, and constantly acquire new knowledge and skills to improve its own performance. According to the research of Chang et al., random forest and logistic regression are better than other decision trees, K-nearest neighbor, and autoencoder algorithms, and the use of feature selection and sampling methods can produce more detection effectiveness [10]. The other is human resource optimization, Wang, Yu, and Gao and Luo, Peng, and Zhang both pointed out that the possibility of fraud detection is increased by the presence of female leaders, which lowers the tendency for fraud among businesses [11, 12]. Female executives often have distinct risk-averse traits and place more emphasis on ethical constraints; hence they pay more attention to the detection and prevention of fraud [11]. Besides female leaders, Mohamed and Handley-Schachler suggested that the introduction of forensic accounting can also be used for fraud detection [4]. In terms of financial statement fraud, forensic accountants, which are specialists in accounting, auditing, and investigative techniques, can contribute to the detection of fraud.

## **5. The Avoidance of Fraud**

Fraud avoidance can be started from two perspectives: external and internal. External means mainly rely on the government level to achieve a deterrent effect and punishments, while internal means primarily rely on the firm to constantly improve itself, especially to cut off the source of fraud from the motivation.

### **5.1. The Avoidance of Fraud from External**

From the external point of view avoiding fraud primarily through the government level to deter fraud action. First of all, Button, Shepherd, and Blackburn mentioned that the government's deterrent effect has been shown by establishing the fraud justice network in England and Wales, the specialized institution has been used to investigate specific types of fraud, such as HMRC to deal with tax fraud and the department for work and pension to deal with the welfare fraud, which makes the investigation, adjudication, and prosecution of fraud more efficient and accurate [13]. In addition, Wang, Ashton, and Jaafar mentioned from the punishment aspect, set China as an example, fines are an efficient method to shock the fraud motivation since besides fines themselves, fraud action would be disclosed to the public which brings negative effects to a firm's reputation and the confidence of the stakeholders as well [14].

### **5.2. The Avoidance of Fraud from Internal**

From the internal point of view to avoid fraud mainly through the firm from its own mechanism and the underlying motivation to cut off the source of fraud. The fraud caused by the lack of corporate culture and accountability system can be avoided by establishing a sound corporate culture of integrity and high ethics and a strict and transparent accountability system [4]. The fraud caused by the compensation mechanism can be avoided by improving or canceling the bonus and equity incentive mechanism [4]. The fraud caused by agency problems can be avoided by the separation of power and responsibility, maintaining the independence of personnel and employees of the financial

department, and increasing system programming and access rights [3]. In addition, by improving the firm's internal control system, and corporate governance and strengthening the role of the audit committee of the board of directors, fraud can be effectively avoided to a certain degree [15].

## 6. Conclusion

This paper starts from the motivation of fraud to the impact of fraud, fraud detection, and fraud avoidance are studied. It found that there is a close relationship between the four-research links, especially the motivation of fraud and the avoidance of fraud. It is a very efficient way to avoid fraud from the fraud motivation. This paper also inevitably has limitations. Although this paper tries to cover all the wide research directions in recent years, it still has limited involvement in different types of fraud in different industries. Therefore, in future research, researchers can look at different types of countries which can be classified as developed countries and developing countries, and different industries to analyze and visit more enterprises or interview relevant professionals to obtain more practical experience and information.

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