AN ANALYSIS OF FINANCIAL RISK IN A MULTI-LAYER MANAGEMENT FRAUD SCHEME

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ABSTRACT

We analyze and dissect the management fraud in a series of financial statement schemes employed to shore up a financially deficient company while enriching the executives themselves. The multi-layer scheme of management fraud involved secretly issuing convertible notes, inflating revenues, and misappropriating funds. The management committed financial frauds not only through conspiracy to commit securities fraud and wire fraud, but also by improperly influencing the conduct of audits and engaging in aggravated identity theft. We assess financial risk to provide signals of fraud by applying fraud detection models and conducting various financial analyses to identify red flags in financial statements. Additionally, we examine the ethical environment and address the ethical concerns of the parties involved.

Keywords: *Financial Risk, Fraud Detection Model, Fraud Symptom, Management Fraud Scheme,*

1. INTRODUCTION

The Association of Certified Fraud Examiners (ACFE) classifies the types of occupational fraud, in which by using the positions or taking advantage of business resources to fraudulent behaviors, into three key categories, which are assets misappropriation, collusion, and financial statement fraud (ACFE, 2022). When one organization is alleged and engaged with one fraud category, the high-level management and its board of directors are responsible for getting involved and consider it a serious matter for an investigation. However, when the fraud incident is directly triggered by their executives, i.e., financial statement fraud, it creates a major economic impact to the organization both reputation and financial, and causes loss of confidence that is entrusted by the investors and stakeholders (Albrecht et al., 2019; Crumbley et al., 2019). Oftentimes, we must learn a hefty lesson in an in-depth review of past occurrences of financial statement fraud that was staged by bad actors in key management role of the organization. These case analyses can provide a good understanding of financial events with the capacity to reoccur. We can identify the fraud symptoms and red flags of fraud, and come to analyze the drivers behind fraud and its condition that allows fraud to occur. For instance, in 2020, the scandal involving German fintech giant and electronic payments provider Wirecard shocked the global financial market. After years of criticism over alleged accounting irregularities, Wirecard was found to have engaged in a series of corrupt practices and fraudulent financial reporting (Engelen, 2020). This scandal revealed that the company had misled investors, while external auditor EY failed to verify the existence of claimed cash reserves, which ultimately led to Wirecard's collapse. Wirecard subsequently filed for insolvency after disclosing that €1.9 billion was missing (Engelen, 2020; Oelrich and Siebold, 2024).

In this study, we aim to analyze and dissect a fraudulent financial statement of a company with multiple levels of management fraud that were committed by executives' abusing powers after the company's acquisition activity in 2014. We identify many fraud symptoms with traits of red flags from their misbehaviors. Our study further analyzes financial detection models and discusses key ratio indicators as signs of financial risk. Several perspectives on its business ethical consideration to the related auditors and stakeholders are addressed.

This paper sheds light on the literature of management fraud involved with complicit motivations, opportunities, and behaviors among executives and high-level managers who intend to manipulate financials. The findings of our study also contribute to and benefit investors, demonstrating that the use of