

# Disclosure and control of fraud in financial statements in the context of business management on the example of the polish economy

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## Abstract

All business entities that conduct economic activities in the capital market are in contact with the revenues and costs that these activities generate. This has to do with the business operations performed. This is a sphere that cannot be ignored in the preparation of financial statements, the "reading" of the report or the audit conducted by the auditor in the context of business management. It is also an area particularly vulnerable to the risk of manipulation. These manipulations are related to the tweaking or smoothing of the financial result. Accordingly, the auditor is tasked with examining income and expenses, assessing their accuracy and reasonableness, verifying the correctness of presentation and, on the basis of source documents and tests performed supported by working papers, issuing the final product of the audit - which is an opinion with a report - based on professional skepticism and judgment. These factors are necessary to assess the risks associated with the audit of the various elements affecting the financial result, as well as to be cautious about the data presented. This article aims to conduct a fraud analysis and show the essence and role of the auditor in the audit of the financial statements, as well as how to deal with the auditor when material irregularities are detected.

**Keywords:** *Fraud; Financial Statements; Business Management; Polish Economy.*

## 1. Introduction

The task of the auditor is to obtain assurance that the audit conducted by him is free from irregularities caused by error or fraud, that he is nevertheless able to create an objective document, summarizing the audit activities carried out. For the verification of individual items of income and expenses, the auditor has a number of tools that help him issue a reliable and objective opinion with the report [Nowak, Bednarek, 2021].

It is important to accurately interpret the definition of fraud. The definition of fraud can be formulated as follows: "fraud is any intentional act or failure to act so designed as to deceive others, resulting in a victim who suffers a loss and a perpetrator of fraud who gains a benefit." The term "fraud" thus means knowingly misleading someone or taking advantage of someone else's mistake for one's own benefit. Thus, it is the intentional act of one or more persons among the management, those who supervise the entity, employees or third parties, using lies to gain an unjustified or unlawful advantage. The definition of fraud from the point of view of the law is extensive, but the auditor is concerned only with those frauds that materially distort the financial statements. Thus, from the auditor's point of view, two types of intentional deformation are important [Zhukovska-Kalita, 2017; Renkas, 2013]:

- 1) Deformations involving fraudulent financial reporting;
- 2) Deformities resulting from appropriation of assets, property.

## 2. A study of the literature on the subject

The manipulation of income and expense issues that are included in financial statements is many times called creative, or creative accounting. The most common reason for using creative accounting is the desire to make a profit and to create a credible image for the company. Manipulations can be related to income or to expenses.

Revenue manipulation activities can include [Halicka, 2018]:

- Revenue recognition despite doubts about their occurrence;
- Presenting work done by subcontractors as their own;
- Fictitious sales (e.g., delivery without order);
- Rapid growth in the company's sales compared to its competitors;
- Unusual and large business operations made at the end of the fiscal year;
- Use of transfer pricing;
- Sales invoices – the performance of services or the delivery of goods occurred in the following fiscal year;

- Sales invoices with a repurchase clause;
- Accelerated invoicing and manipulation of the revenue recognition period.

On the other hand, activities relating to cost manipulation include:

- Underreporting of asset impairment or failure to record permanent impairment;
- No provisioning for costs where there is a high probability of their occurrence in the future;
- Manipulating “silent” reserves;
- Activating inappropriate costs, such as in connection with property, plant and equipment;
- The emergence of a large number of transactions with related parties;
- Negative cash flow from core operations when reporting profits;
- Cost account entries showing cost postings related to the previous fiscal year.

Most manipulations are related to so-called estimates. They are based on the appearance of a given write-down or a given provision. It is within the scope of the auditor to check the fact that has occurred and compare it with the income statement, or by analyzing the income and expenses that appeared at the turn of a given fiscal year [Zhukovska-Kalita, 2017; Renkas, 2017, 2020, 2022].

If the auditor discovers fraud or has a suspicion of such a situation during his examination activities, he should immediately contact the management of the entity where the suspected fraud occurred. If, in his judgment, such steps are insufficient, he should contact top management. If, despite taking these steps, based on his professional judgment and skepticism, he still finds the explanations he has received insufficient, he should inform the relevant authorities for whom he performs the financial statement audit service. Under Polish law, certain income and expense frauds may become economic crimes prosecuted by the state under criminal law. If such a situation occurs, it is the duty of the expert to inform the relevant law enforcement authority of such a crime.

### 3. Summary of fraud statistics on the example of the Polish economy

The chart below presents a comparison of fraud data in the three main categories of asset fraud, corruption and fraud disclosed in financial statements using Poland's economy as an example.

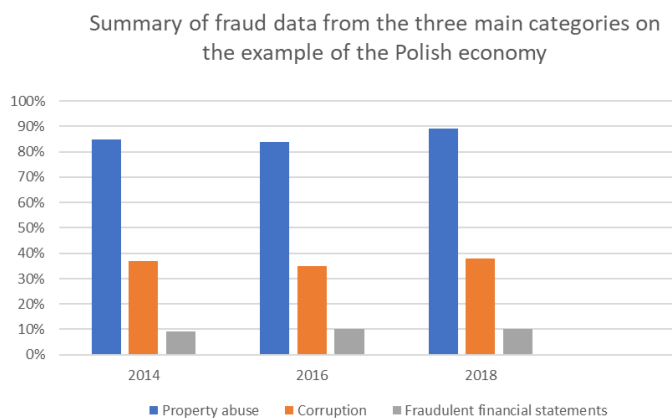


Fig. 1: Own Compilation Based on <https://stat.gov.pl>.

As can be seen from the above summary, embezzlement related to misappropriation of assets is most common in the Polish economy. These frauds are most often committed by people in the highest positions, namely the management of the entity, or managers. Corruption is another group of the most common frauds committed. Corruption is nothing more than the abuse of public positions for private gain. The last major group is fraud committed in financial statements.

### 4. Conclusions

In summary, the role of an auditor is to check the financial statements prepared by companies for clarity, reliability and compliance with the law. This is a difficult task, so auditors must be properly trained for such tasks. At the turn of the year, there has been an increased phenomenon of creative accounting, which has to do with the manipulation of a company's results. However, it should be remembered that the purpose of the auditor's work is not to detect fraud or manipulation; despite the auditor's diligence during the audit, some of the irregularities in the financial statements may go undetected, especially when they are the result of deliberate, planned and consistently executed actions.

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