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1 INTRODUCTION

In 1997, according to a survey carried out in the US, 76 percent of the graduate business student, 41 percent of the controllers and 47 percent of the top executives were willing to commit financial fraud. These figures were even considered to be conservative. The most worrisome information gathered from this study was the 71 percent of business students who were willing to commit fraud and the fact that these students were entering the business profession and “when put under time pressure to make the budget or bring in the numbers”, they might be willing to commit fraud to achieve the necessary results. (Zeune, 1997)

For auditors, the field is challenging. There has been an ongoing discussion about auditors' independence and their excessive desire to take on more consultancy work instead of auditing. They have been accused of becoming cosy insiders who happily look the other way if the numbers do not add up, knowing that any criticism would jeopardise their some times long business relationship with the client that includes lucrative consultancy and other more profitable services. Auditors have been accused of failing to come to terms with new technology and developments, avoiding awkward items in sample test and to be inclined to hide uncomfortable truths. They have also been blamed of taking short cuts to meet the budget and because of their fear of performing the job at loss, not carrying out any extra work, possibly resulting failure to detect fraud and drawing wrong audit opinion. Or is there a misinterpretation by the audit profession of the phrase “true and fair” as meaning something somehow less demanding than “true and correct” or “right and adequate”?

So on whose shoulders has it been left to detect fraud? In UK judge Lopes LJ re Kingston Cotton Mill Co. Ltd (1896) legal case ruled that an auditor is “a watchdog not a bloodhound”. 2002 Sarbanes-Oxley Act has been considered to be an answer for our preys. The legislation applies to the CEO, the CFO, Board of Directors, the Audit Committee and all other management personnel that have influenced over the accuracy and adequacy of external financial reports. Sections 201 and 203 in the Act have a significant impact on the audit profession. Section 203 mandates audit partner rotation, and section 201 prohibits services by external auditors for audit clients such as bookkeeping, legal services and expert services internal audit outsourcing services.

However, there has been an ongoing debate about auditor's responsibility in relation to fraud. Furthermore, what are the auditors actually paid to do and what some sections of society believe they should do? This has been referred as an audit expectation gap, expression first used by Cohen Committee in 1974 in the US. Few possible public expectations on reading an audit report are that the company will not fail, financial statements are right, the company is and will be run in accordance with the law and that the company is free off fraud. Throughout the history of the modern corporate audit function, the auditors can be observed continuously denying rather than accepting their responsibilities. Interestingly, study carried out by Humphrey, Moizer & Turley (1992) disclosed another form of expectation gap, a perception gap. In their study, auditors and five different groups of audit report users where interviewed and the study revealed that auditors believed themselves to be more successful than accountants, finance directors, investment analysts and journalists believed them to be at diagnosing problems, acquiring information, detecting and preventing errors and irregularities, complying with professional rules and even forming correct judgements. So what is the true value of the audit report if the users do not even believe the judgement to be completely correct?

1.1 Statement of Aim and Objectives

The aim of this dissertation is to lay a soil where the auditors and managers will be working in the future, when the graduate students enter the business profession and some of them become managers and executives of the company with access and opportunity to commit fraud. Are the results as worrisome as they were in the study carried out in the US? Are the Finnish students entering the business profession similarly appliquéd to commit fraud as the students in the US? How do they value the seriousness of different forms of fraud and the punishment? Is there a difference between genders and for example between accountancy and entrepreneur students in terms of being more appliquéd to commit fraud or valuing the seriousness?

The other area of the dissertation concentrates on audit expectation gap. Once again, the main focus is on graduate business students. Is there an expectation and perceptions gap between business students and audit profession? How well do they consider audit profession performs series of tasks commonly connected to auditors' work? Do they consider these tasks to be

auditors' responsibility, and would they limit these tasks? If the auditor is not the bloodhound, who do they expect to be that? This dissertation also tries to compare the results to statistics from financial fraud legal cases in Finland. Is there a parallel propensity?

1.2 Research Methods

This study is empirical and quantitative in nature and this approach was selected because it allows more contextual, focused and detailed information to be obtained from a larger quantity of subjects than for example interviews would have provided. Primary data was collected with questionnaires that were held in January 2008 for graduating business students (min. 120 credits) or studies have begun earlier than year 2004 in University of Jyväskylä and University of Tampere. A hyperlink to this questionnaire was sent to these selected students via e-mail. Classes were selected so that all major business subjects were covered. To be more precise, the main target groups were students from accountancy, finance and economics, entrepreneurship, leadership, information systems, marketing and taxation. The data from the questionnaires were processed with Digium Enterprise and results analysed and discussed. Secondary data that included text and journals were obtained from libraries in Napier University in Scotland, University of Jyväskylä, Tampere University Libraries in Finland and Tallinn University Library. Internet and electronic databases such as ABI/Inform were also actively used to get access to electronic journals and other up to date information and surveys. Data resulting from the primary and secondary sources were analysed with regards to similarities and differences in material. Also personal intuitive interpretations were used.

The approach walks in lines of positivistic accounting methodology. There is a survey to collect data from firmly targeted group. Then the data is processed and analysed. It is considered to be the methodology of economics, finance, and science in general, and based on that, theories are not discarded merely because some inconsistent observation. The main focus is to meet the demand of students and practitioners for theories that would predict and explain accounting choice. (Watts and Zimmerman, 1990) According to Ryan, Scapens & Theobald (1992, 78) "Positive accounting research, and in particular the research based on agency theory, has stimulate numerous studies into the role of financial accounting in contractual relationship between managers and shareholders". Hermeneutical method is used where the

aim is to understand and interpret human behaviour. This method differs from normal science methods and the results do not qualify for traditional scientific research. Studies based on hermeneutical method cannot usually be repeated or falsified.

A survey program Digium Enterprise was used when forming the questionnaire. The questionnaire form and e-mail sent to students can be found in Appendix A and B. There were four parts in the questionnaire. In the first part, there was a string of questions about students' background; their sexes, level of accounting and auditing studies and main field of studies. In the second part, graduate students were asked series of questions about typical fraudsters, what kind person in their opinion is most likely to commit fraud. In the third part, 14 different imaginary examples of occupational fraud cases were explained and each of them were followed by two questions; Is this a fraud and if it is, how serious? And; were they willing to commit similar frauds? The fourth part concentrates on their views on auditors' work and responsibilities. Is there a perceptions gap between students and auditors? This part used modified framework from studies carried out by Humphrey *et al.* (1992) and Viitanen (1995). In these surveys different parts of society who used audit reports, were asked to value the work of audit profession and what they considered to be auditors' main responsibilities.

1.3 Structure and Limitations of the Study

The biggest limitation when evaluating the results from this dissertation is there were 187 respondents from two universities. Neither does it cover all graduating business students nor geographically all Finnish Universities and Business Schools. However, this is a good starting point for more expanded research in terms of the quantity of subjects. Even though response percentage of 19.7 can be considered to give relevance and reliability for this specific dissertation, it is still time and cost limited section from the whole proportion. These limitations mentioned above might have had an impact on the results.

In terms of structure, chapter 2 lays a framework for the study. It introduces the profound theories behind auditing. It discusses different views on auditors' responsibilities and independence in Finland and internationally, mainly focusing those responsibilities relating to detection of fraud. Why are there conflicting views? Chapter 3 introduces occupational fraud

and previous studies on business students' attitudes towards financial fraud. Also surveys that have been done to draw a profile for a fraudster and the environment where it was carried out are discussed. It also gives information about the financial fraud legal cases we have had in Finland in recent years and legal cases against auditors. Chapter 4 introduces audit expectation gap, who are involved, where does it lead and what attempts have been made to narrow it down. Also previous audit surveys are discussed. Chapter 5 studies graduate business student views on fraud and their willingness to commit fraud, how they value the seriousness of different forms of fraud and auditors' responsibilities. It investigates if there are any differences on views and value between genders and line of studies. Results and conclusions regarding graduate business students views on fraud and auditors responsibility are discussed in chapter 6.

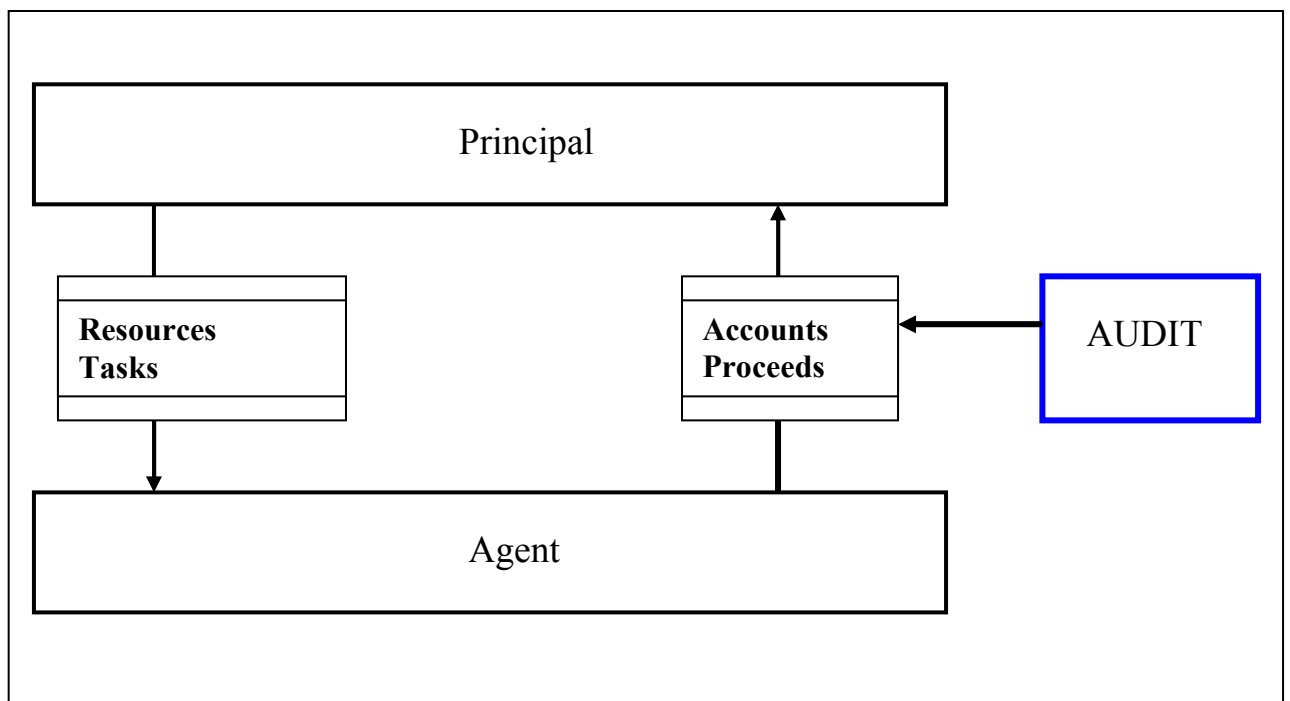
2 AUDITOR'S RESPONSIBILITIES AND LIABILITY

Explanatory theories of auditing

Separation of ownership from control within a company creates a demand for auditing. On these bases there are three explanatory theories to be introduced to understand audit function; those are agency theory, information hypothesis and insurance hypothesis.

Stewardship is the practice where resources owned by one person or group are managed by another person. Agency theory is based on this relationship between investors (principals) and managers (agents). This relationship is demonstrated in figure 1 below.

FIGURE 1 Agency Theory



Adopted from Jensen & Meckling (1976)

There is a behavioural assumption that all parties involved in this relationship are rational and will attempt to maximise their benefits. Also individuals act to maximise their own welfare or utility. However, it is expected that the agent's interest will diverge from the principal's interest. Jensen et al. (1976) identified two problems with agency contracts. First one is the

adverse selection, which arises in situations where manager chooses investment projects, which the principal would not and rejects those the principal would not. This may be because of different attitudes towards risk. The other problem is moral hazard. In this case the manager spends more or work less than the principal would.

In order for the principal to evaluate agent's performance, management needs to provide regular reports, and based on those principal takes certain action. To be sure that these reports can be trusted, an auditor is brought in to the equation to monitor. In the agency theory, the agent is the source of demand for audit, the information hypothesis stresses the increase in the reliability of information as an input to decision making. An audit is a means of improving the quality of financial information and the data for internal decision-making. An auditor can detect errors and therefore motivate agents to exercise more care in preparing records and anticipation of an audit. (Gosserat, 2000)

Wallace (1980) introduced another explanation of the demand for auditing, called the insurance hypothesis. It has been considered to be important factor especially in the litigation crisis. The basic idea of it is the ability to shift financial responsibility for reported data to auditors. This lowers the expected loss from litigation to managers and creditors involved. Wallace (1980, 21) identifies four reasons why managers and professionals look to auditors for insurance:

1. Because an audit function is well expected by society, managers can validate that they exercised reasonable care by using auditing services.
2. Auditors have in-house legal expertise, and may provide more efficient insurance coverage as co-defendant than an insurance company could provide as a third party.
3. There is a common interest between auditors and management to ensure the proper consideration of the effects of litigation on the reputation of the parties versus insurance companies' cost-benefit choice.
4. The court view auditors as a means of socialising risk. Because auditors are held responsible for business failures, they, in turn shift this cost to clients through higher fees and then to society through higher prices and lower ROI. Risks otherwise faced by investors are now carried by society.

Whenever there is a notable corporate failure it is often convenient for the legislators/politicians to point the finger on the auditors. This incentive of politicians to require audits is another dimension of the insurance audit. “Increasing liability exposure of auditors to provide greater remedies to individual investors who lose money in the market, and focusing attention on audit failure which places auditors in the defendant’s chair” (Wallace, 1980, 21)

2.2. Auditors’ Independence, Responsibility and Liability

The word “auditing” comes from the Latin word *audire*, which means “to hear” and in the late middle Ages in Britain, both accounts of revenue and expenditure for estates and manors were “heard” by an auditor, whose task it was to examine such accounts. Auditing, as we know it today can be traced back from the early 1800s Industrial Revolution in the UK and to the development of joint-stock corporations. This led to the growth of class of managers, who handled large sums of capital on behalf of shareholders. (Cosserat, 2000, Riistamaa 1994)

The enduring principles of auditing and desirable qualities of an auditor are independence, integrity, competence, rigour, accountability, judgement, communication and providing value, depending on the country in question. At EU level, there is no common agreement on auditor’s work, authority, position or responsibilities. The auditor is employed by the shareholders to report independently about directors. This laid the basis for auditor’s involvement in the agency theory. Shareholders employ auditors; however, appointment may in practice rest with directors. Auditors are also reliant on directors for information and they control consultancy work. Also one of the biggest issues is the fact that the directors are there, shareholders are not. This close relationship between auditors and managers creates an information paradox and is serious threat to auditors’ independence.

There are problems when it becomes maintaining the independence in the public eye. There has been an ongoing discussion about auditors’ independence and their excessive desire to take on more consultancy work instead of auditing. Their involvement in accounting systems could result in them being required to pass judgement on their own work. Auditors have been accused of becoming cosy insiders who happily look the other way if the numbers do not add

up or fail to question dubious accounting practices, knowing that any criticism would jeopardise their some times long business relationship with the client that includes lucrative consultancy and other more profitable services (Drutman & Gray, 2002). Is total independence something we can expect from auditors? Money is involved, it is someone's profession, livelihood, and losing a client might just make the difference between profit and loss. What about honesty and competence? Are these something we can measure? Accounting and auditing standards, legislation and systems are changing all the time. And there is diversity in different sectors. How are the auditors able to keep up?

Troberg and Viitanen (1999) emphasised that the real problem may not necessarily rest audit professions reluctance to accept the reporting duties expected of them by the public, but in their perceived disclosure to the risk of litigation if they do so. They were suggesting that "if auditors were given legal protection against actions by their clients for breach of confidentiality or defamation of character, where they report matters of concern uncovered during an audit to the appropriate authorities in a good faith, they would be more willing to accept such duty".

Auditors have been accused of failing to come to terms with new technology and developments, and to be inclined to hide uncomfortable truths. They have also been blamed of taking short cuts to meet the budget and because of their fear of performing the job at loss, not carrying out any extra work, possibly resulting failure to detect fraud and drawing wrong audit opinion. Willet and Page (1996) carried out a survey of time budget pressure and irregular auditing practices among newly qualified UK chartered accountants. They found in their study that audit staff used irregular methods to speed up audit testing. The primary cause was the time budget pressure and that they were unpaid for overtime. Auditors' made their own assumptions that the work designated to them was unlikely to uncover material errors and was perceived as boring and unimportant. Or that others did the work. Some types of irregular audits were introduced. Not in any particular order issues such misreporting sample sizes and results of sample test, use of irrelevant evidence to fill audit files, not testing all the items ticked, avoiding obviously awkward items, accepting doubtful evidence or not doing the work at all, were discussed (Willet and Page 1996, Millichamp 2002). However, it has also been claimed that the cost of performing extensive audit procedures that would be needed to detect all material fraud and the delay in completing the audit, would be disproportional to the benefits received by users.

It is the audits independence that derives its authority and acceptance. According to Millichamp (2002, 18) “If the auditor is known to be independent, honest, and competent, then his opinion will be relied on”. But what are independence, honesty and competence in this context? Is it a state of mine, something that is perceived? Also word objectivity is commonly associated with the word independence; auditors’ ability and willingness to comment objectively. Usually it is public expectation that auditors act independently of any interest, including self-interest. When it comes to auditors’ self-interest and quality of audited accounts, few incentives to prevent “anything goes” policy were introduced by Millichamp (2002, 22). The primary incentive is naturally accounting and auditing standards to ensure at least some level of guidance, framework and uniformity within the profession. Also extending auditor’s liability has been discussed. But it seems that the most effective incentive is the fear of public disgrace. There is always the other side in the coin. In case the auditor would be worried on something, let us say, whether the company is in going concern or not, they need to be very careful when coming publicly forward with their concerns. One of the reasons the company continues to do business and has a change to do it also in the future might be that is that the rest of the world does not know that its position as an operating company is uncertain. If they would, the lenders might immediately call in their loans or the suppliers would deliver goods on advance payments only. And this would certainly result company being a going concern.

2.3 Auditors’ responsibility to detect fraud - International aspects

Auditing has internationalised because of the emergence of Multinational Enterprises (MNEs) and because of the demand for international auditing for international capital markets. International accounting firms, usually very large international Certified Public Accounting (CPA) firms, have tried to continue to serve their multinational clients as they have grown and extended their activities to foreign countries. Some firms have done this by establishing offices in the countries where their major clients are based or merged with foreign audit firms. As far as their organisational form is concerned, most large international firms operate as an international network of member firms, often sharing common methodologies, operating and technical standards, training and technology. However, each national member firm is a separate and independent legal entity. The discussion on audit fees and responsibilities of

auditors worldwide are conducted in the context of using the services of one audit firm throughout the world. (Nobes & Parker, 2004)

Metcalf Committee (1978) already at the time saw that many of the problems facing the accounting profession could be traced directly to the enormous growth and concentration which had taken place. The accounting firms which audited most major companies had developed into large MNEs themselves with hundreds of partners and thousands of personnel. The Metcalf Committee believed that the primary problem was that of independence, which is the auditor's single most valuable attribute. Maintaining the independence and individual professionalism that is pivotal to audit would be very difficult for auditors working in such large firms and problems had already resulted. (Metcalf Committee, 1978)

International auditing standards have arisen because it is the interest of MNEs and especially to international auditing firms to have no differences in auditing requirements between countries. It is also in the interest of those who interpret the financial reports of multinational groups. Under the present system international audit standards (ISAs) are issued by the International Auditing and Assurance Standards Board (IAASB), a private sector body composed of professional accountants. On the other hand, the IAASB may be working in the self-interest of international accounting firms, which is not necessarily the general interest and it has no means of ensuring compliance with its standards. (Nobes & Parker, 2004)

The standards form of the audit report is very similar in many countries; however, the most common difference is statement on auditors' view on the accounts and if they for example give a "true and fair view" (IFRS), are "fairly presented" (US GAAP) or "regular" and "sincere" (France). In Germany, like in Finland, financial reporting for legal purposes and tax reporting are closely connected. As a consequence, the audit in Germany has historically been focused more on legal acceptability and acceptability for tax purposes than on true and fair presentation for the benefit of external shareholders. In France, there are similar requirements for the auditors depending on the size and nature of the company as there were in Finland. Rather than appointing auditors annually, in France, auditors are appointed for a six years term. For companies presenting consolidated financial statements, there must be at least two auditors, drawn from different firms. When it comes to auditor's responsibilities in aspect to third parties, in France, auditors must disclose to the public authorities any criminal acts by an audit client of which they become aware of. In Japan only big companies are required to have

auditors that have professional qualifications. Overall, in Eastern European countries, accounting and moreover the auditing profession is not particularly strong, large or unified. Some of the Eastern European countries have just recently joined EU, and they are facing some difficulties in meeting the requirements and implementing both auditing and accounting standards, due to the shortage of experienced accountancy and audit professionals (Nobes & Parker, 2004)

The development of auditing profession in the UK was already mentioned earlier in this chapter. While “hearing” the accounts and checking the records were the most important functions of an audit, there were also two major audit cases in the late 1800s that helped establish the profound principles of auditing. These legal cases (Kingston Cotton Mill Co. (1896) and London and General Bank (1895) make clear that auditing is a professional activity and requires auditors to exercise reasonable care and skill as well as the “watchdog” rule, furthermore, what is proper conduct in any set of circumstances is a subjective question. Kingston Cotton Mill Co. case formed the basis for subsequent decisions as to the determination of auditor’s negligence to detect fraud.

“If there is anything calculated to excite suspicion he should probe it to the bottom but in the absence of anything of that kind he is only bound to be reasonably cautious”

“A watchdog not a bloodhound”

Judge Lopes LJ in re Kingston
Cotton Mill Co. Ltd (1896)

In detection of fraud, experience led auditors to anticipate common frauds and to design audit procedures so as to have a reasonable chance of detecting them. On the other hand they could always rely on the Kingston Cotton Mill case in denying any legal responsibility for the detection of fraud where their suspicions were not aroused. (Cosserat, 2000)

The auditor’s responsibility for detection of fraud has always been a contentious issue. According to Porter (1991) until about the 1930s, the prevention as well as detection of fraud and error have been regarded as primary audit objectives. However, between the 1930s and

1960s the importance of fraud detection as an audit objective has been grinding down. Focus in audit professions' literature has focused more on auditors' limitations to detect fraud rather than finding new solutions to carry out this duty. The auditor's role in discovering and disclosing illegal acts by company officials have also been under a dispute. The amounts involved have frequently been immaterial but, due to their somehow sensitive nature, these acts assume importance out of proportion to their monetary significance. (Porter, 1991)

The International Auditing Practices Committee of the International Federation of Accountants (IFA) recognised the need for additional directions on fraud detection when it issued International Standard on Auditing (ISA) 240, "The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements. The assessment of fraud and the response to that assessment is at the centre of the audit. Fraud needs to be considered by all members of the audit team at all stages of the audit. Furthermore, the audit must be approached with scepticism, recognising the possibility of material error due to fraud even when the auditor has past experience of the client and no reason to question the integrity and honesty of management and those charged with authority. As with ISA 315, there is a requirement for extensive discussions, with management and with the audit team. The audit file must show that a proper consideration of risks has occurred and that the appropriate procedures have been carried out.

In Britain and The U.S auditors have more specific duties to detect and report fraud. According to Porter (1994) the international disparity in auditors' duties to detect fraud mirrors the differences in various countries socio-political environments. Auditors' responsibility in detection of fraud is determined in SAS 110 Fraud and Error and SAS 620 refers to Auditors' responsibility in relation to illegalities. Auditors have no general duty to detect fraud and it has been considered to be the responsibility of directors. Auditors audit financial statements, not individual statements. Audit work must be sufficient to detect material misstatements caused by fraud and error. (Millichamp, 2002). Due to auditors' contractual obligation to honour client confidentiality, they cannot report any aspects of the client's affairs to a third party. The auditors have no obligation or right to notify other parties except in cases under SAS 60 and such as money laundering or in public interest such as illegal act or intended illegal act that could result great social harm. (Cossierat, 2000)

Auditing in the US has developed along similar lines to its development in the UK, and the US is closely watched by the UK. The 1931 Ultramares legal case in US prompted the accounting and auditing profession to clarify that instead of giving guaranteed, the auditors were expressing an opinion.

“...balance sheet and the related statements of income and surplus *present fairly...*”

Ultramares (1931)

There is no compulsory audit for most US corporations, some of which therefore choose to have an “audit review” instead. However, the Congress passed the Securities Act in 1933 and the Securities Exchange Act in 1934, which contained the requirements for the audit of financial statements of companies seeking to issue securities or those wanting to register with the Commission for the public trading of securities. The ethical focuses on those Acts were to prohibit treachery, misrepresentations and other fraud in the sale of securities as well as manipulation of financial markets, fraudulent financial reporting and insider stock trading. These Acts were considered to be the first widely based attempts to emphasize ethical behaviour and the most significant parts of legislation in the history of U.S. financial reporting and CPA profession. Hence, these Acts signified a milestone in corporation accountability and provided the foundation for growth of international audit firms. (Cosserat, 2002, Rockness & Rockness, 2005) In 1977, The Congress passed the Foreign Corrupt Practice Act and its focus was on presentation of bribery. In 1987, in addition to legislation, National Commission on Fraudulent Financial Reporting (also known as the Treadway Commission) discussed the ethical behaviour by companies and made proposals, strong emphasis on internal controls among other things, to prevent fraudulent reporting. Though, Commission focused more on detection rather than prevention and it was more about employee fraud than fraud at the management level. In 1991, The Federal Deposit Insurance Corporation Improvement Act passed and it focused on the fraud in savings and loans and required verification of internal control in financial institutions.

In 1988, SAS No. 53 the Auditor’s Responsibility to Detect and Report Errors and Irregularities was published in the U.S. However, because of the international development, mainly in UK and increased criticism of the audit profession, in 1997 the AICPA published a new so called fraud-standard. SAS No. 82, Consideration of Fraud in a Financial Statement

Audit was developed and published in intention to clarify auditors' responsibility in detection of fraud. Some even considered this standard to increase profession's responsibility but little did they know what was still on its way.

In 2002 the most significant Act in terms of fraudulent financial reporting and ethical guidelines for both listed companies and their auditors, was passed in an aftermath of several corporate fraud crises at the end of and the at beginning of the millennium. It was called the Sarbanes-Oxley Act. (Rockness & Rockness, 2005) Congress ratified the Act in response to highly publicised business failures, allegations of corporate improprieties and financial statement restatements. Sarbanes-Oxley Act requires senior management to certify the reliability of the financial statements and imposes greater independence requirements on auditors. Sections 201 and 203 of the Act have a significant impact on the audit profession. Section 203 mandates audit partner rotation, and section 201 prohibits services by external auditors for audit clients such as bookkeeping, legal services and expert services internal audit outsourcing services. Section 404 of the act requires management to acknowledge its responsibility for establishing and maintaining adequate internal controls, including asserting their effectiveness in writing. The financial statement auditor, in turn, must report on management's assertion about the effectiveness of its internal controls as of the company's yearend. These provisions apply to entities with market capitalisation of more than \$75 million for fiscal years ending on or after 2004. And smaller companies must comply as of June 2005. It has been speculated that smaller public companies will face problems in complying with section 404. Often these entities have less extensive documentation of their control processes. Furthermore, they may not have the same levels of accounting or internal audit capabilities as larger companies, which could require substantially greater external auditor involvement in preparing control documentation, within the independence restrictions described above, and a proportionately greater increase in audit engagement hours. (McConnell & Banks, 2003)

The Sarbanes-Oxley internal control certification provisions imposed considerable responsibilities on both management and the auditor. Management had to take ownership of the process of identifying, documenting and evaluating significant controls, as well as determining which locations or business units to evaluate. They could not delegate these functions to the auditors, nor can they rely on the auditors' testing to support its assertion. The

auditor would require management to identify, document and evaluate significant internal controls. More precisely:

- Controls over initiating, recording, processing and reporting significant account balances, classes of transactions and disclosures and related assertions embodied in financial statements.
- Antifraud programs and controls.
- Controls, including general ones, on which other significant controls depend.
- Each control in a group that functions with another one to achieve a control objective.
- Controls over significant non-routine and non-systematic transactions.
- Controls over the period-end financial reporting process.

(McConnell & Banks, 2003)

Alternatively, for auditors, providing an opinion on the effectiveness of an entity's internal controls was a considerable engagement. And we have not even begun to discuss the monetary side of things. The most common argument against these new fraud standards is the cost-benefit argument. It seems to be questionable whether the benefits will outweigh the increased costs in the form of additional audit planning and examination in order to safeguard for fraud risk. And it still seems to be a dispute who are paying for these extra costs and who are the beneficiaries? The general views of the audit profession in UK and in the U.S. are that the auditors should plan their audits so that they have reasonable expectations of detecting material misstatements in the financial information which result from fraud. The main responsibility for preventing and detection of fraud, though, rests with management and can best be achieved through the maintenance of sufficient internal controls. (Troberg & Viitanen, 1999)

2.4 Auditors' responsibilities to detect fraud in Finland

According to Riistamaa (1994) the development of auditing profession in Finland has followed the economic trends. Particularly, any economic downturns have had the biggest impact on the development of the profession. For example, regression in 1980s and 1990s, a wave of bankruptcies re-launched the discussion about necessity of auditing. And in 1993 the Government handed out its first proposal for the first Audit Act. This Audit Act regulated the auditing obligatory for all companies except sole traders. In Finland, previously the size and quality of the business determines the requirements for auditors. There a long history of having three types of auditor in Finland: Non-qualified, HTM-Auditors and KHT-Auditors. KHT-auditors are authorised by the Central Chamber of Commerce and HTM-auditors, authorised by regional Chamber of Commerce (Virtanen, 2002). The main recommendations concerning professional ethics are given by the Finnish Institute of Authorised Public Accountants, and by the law. The 1995 Auditing Act (936/94) used the term good auditing practice, which refers to the auditors' code of ethics. Professional auditors are expected to practise it in accordance with certain prescribed ethical standards. The main ethical dimensions characterising auditors' work in Finland are confidence, credibility, essentialism and responsibility. (HE 295/1993) There has been a long tradition for the use of non-qualified auditors and the audit profession overall is not particularly large and strong. With small enterprises auditor could be a non-qualified person with good reputation, who has not been declared bankrupt or under guardianship. The only requirement was that the person had an adequate knowledge of accounting, finance and auditing to perform as an auditor.

The Government handed out its new proposal for new Audit Act (HE 194/2006). It was based on EU directive 2006/437EY regarding legislative auditing. Parliament passed on in February 2007 and it became effective on 1st of July 2007.

The main difference to the previous Act, was the auditor itself. According to 2 §, clause 1, only qualified auditor (HTM/KHT-auditors) can act as auditors. The use of auditor was also limited to those companies, which had either balance sheet of over 100 000€, turnover over 200 000€, or employed on average over 3 persons in current or previous financial year. (HE 194/2006)

The use of the same auditor was also limited to seven years in publicly trading companies, according to 27 §. These auditors are also obligated annually to disclose in writing to their audit client's board certification on their independence and some information about their audit corporation. 16 § is replaced with 13§ regarding good auditing practice. Based on that, auditors are expected to follow international auditing standards, e.g. IFAC's ISA-standards if these are approved by EU. In the audit report, there will not be notes or reminders. However, there needs to be an observation if the liable person under the disclaimer is guilty for an act that will most likely create indemnity or has broken the law. Based on 17 §, the audit fee cannot be determined they it could jeopardise auditors independence. (HE 194/2006)

Interestingly, Virtanen (2002) studied how the profession understood good auditing practice. Auditors felt that the responsibility was enormous and usually before signing the letters of engagement they made some risk analysis, assessments and selections. During the audit, documentation was considered to be pivotal to support their audit opinion and to cover themselves for any liability charges, which usually arise from situation resulting from liquidation. However, it would be interesting to get some statistics how often in liquidation cases, the auditors failed to get their fees from their client. Or where they in a "convenient" position where they could ensure they would be paid first? However, if the big audit firm's client is involved with liquidation, once the money has run out from the client, eyes turn into the one who has the money, the auditor.

Viitanen (2000) studied Finnish disciplinary cases against auditors. This study suggested that disciplinary cases are usually filed against auditors from large audit companies. Auditors found themselves more often involved in a disciplinary case if their experience as an authorised auditor was longer, they issued qualified audit reports more often, their client firms were larger or their client firm's Z-scores were lower than the industry average. Also, if they were male auditors or auditors of a housing company, they found themselves more often in the defendant's chair. On the other hand, his study implied that disciplinary cases which resulted in some sanctions being imposed on the auditors were raised against those whose client firms have higher leverage, have changed their top management, changed their auditors and whose case received some level of publicity. Interestingly, auditors were more likely to be acquitted if the auditors' actual representation on the Auditing Board handling the case was proportionally larger than what their formal proportion of the total Board composition was. (Viitanen, 2000)

There is no specific fraud standard currently in Finland. One could expect to categorise detection of theft or misappropriation of corporate assets by company directors, and any related deficiency the same way as the general fraud duty is classified, that is, not being an existing duty of the auditor in Finland. However, according to Auditing Act (936/1994, chapter 4) auditor should examine and report as to whether actions taken by the board or managing director are in divergence with the law applicable to the company form of doing business, the articles of associations or any other regulations affecting the company. Fraud committed in a company is often committed by the management but many times carried out by other personnel also. So referring to Auditing Act mentioned earlier, the focus is solely on company directors, not other levels of personnel. Generally accepted auditing practice in Finland does cover examination of internal controls (KHT-yhdistys 1997, 24-25 and 1998, 31). However, this only covers examining, not actual reporting of the findings in the audit report. Possible findings are only reported to directors. (Troberg & Viitanen, 2001) So how is this working out? Auditors only examine fraud at director level and only report their findings to directors? And how in practice, the ISA 240 will effect on this?

Consequently, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and with management of the entity. However, the individual responsibilities of those charged with governance and management may vary by entity and from country to country. But overall, prevention and detection of fraudulent activities involves a company culture of honesty and ethical behaviour. Such a culture is rooted in a strong set of core values that provides the foundation for employees as to how the entity conducts its business. Creating a culture of honesty and ethical behaviour includes creating a positive environment, setting an example, hiring, training and promoting appropriate employees, requiring periodic confirmation by employees of their responsibilities and taking appropriate action in response to actual, suspected or alleged fraud. It is important to understand that decisions done at upper management level will have an effect on employees motivation, moral and hence their behaviour. Fast structural changes, downsizing, quick staff turnover, outsourcing and temporary staff are all factors that create unsteadiness. Mergers and acquisitions have lead to a group of employees who know how the systems work and weaknesses of the existing controls. And in worse scenario, these frustrated employees are the targets for organised crime. (Samociuk, Iyer & Lehtosuo 2004)

3 FINANCIAL FRAUD

3.1 Occupational Fraud and Economic crime

Fraud itself is very vast subject and a broad legal concept. What is the difference between fraud and error? The distinguishing difference between these two is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional. Commonly fraud is associated with terms such as forgery and scam. Occupational fraud can be defined as “The use of one’s occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization’s resources or assets”. (ACFE, 2006, 6). Occupational fraud schemes can be as simple as filching of company supplies or as complex as sophisticated financial statement frauds. All occupational frauds fall into one of three major categories: asset misappropriation, corruption or fraudulent statements. (ACFE, 2006)

Economic crime can be defined as a crime in the context of economic life, where offences take place within the framework of what is in itself legal business activity in order to obtain economic benefit. So, economic benefit is generally the primary motive for the crime and the methods to commit the crime are often planned and rational. There are considerable amount of opportunities for crime in the complex organisations in economic life. It is irrefutable that economic crime serves as a measure of legal system’s credibility. However, the existing control has been believed to be insufficient and is able to detect only a small proportion of economic crime. The investigations are difficult and time-consuming and the threshold to raise charges is high. Also the sentences imposed by the courts of justice have been criticised for being too lenient. The losses are vast sums of money, but the detection and punishment of the offenders and the confiscation of the proceeds of crime have been considered to be random. (Lehtola & Paksula, 1997)

In 2006, 2289 financial crime and fraud cases in total were referred to law enforcement in Finland. The most common form of fraud refers to fraudulent statement, to be more specific clearing tax. There was an apparent tendency that when the companies were making profit, there was an increase in tax fraud cases. In 2002, it was calculated that 72 % of all companies

in Finland countered fraud during the past 5 years. Frauds were more common in bigger companies. However, most cases are handled within the company and fraudsters are not prosecuted. And therefore they are not in statistics. Losses were estimated to be somewhere between 0,7 to 1,7 billion Euros. The amount from criminal case that went to court of justice were between 150-200 million Euros, half of which were charges from tax authorities. (Poliisiammattikorkeakoulun tiedote, 2002)

Legislation on business injunction came into force in 1986. This injunction can only be ordered if the entrepreneur has entered into bankruptcy. According to this legislation, “an entrepreneur who in the course of an offence has seriously violated the provisions on the conduct of business in order to obtain financial benefit at the expenses of his or her creditors can be prohibited from conducting business for a period ranging from two to five years”.(Tala, Jaakkola & Tuokila, 1995)

So what is the difference between an audit and fraud examination? Wells (2005) identified six diverse subjects where these two differ. These were presumption, methodology, timing, scope, objective, and relationship. Professional skepticism is the presumption and different audit techniques are the methodology for auditors to detect fraud. Audits are recurring, and their scope and objective is to form general opinion. The relationship with the client is non-adversarial. Where as fraud examination’s presumption is proof and the methodology is more designed for fraud examination. They are nonrecurring, their scope is more specific and the objective is affix blame. Furthermore, the relationship is adversarial.

3.2 Business students’ attitudes towards financial fraud

The auditing profession will never be the same after the scandals with Enron, Parmalat, WorldCom and the list of scandals goes with no end in sight. Although these incidents had a shattering effect on some peoples’ lives, there might have been a positive chapter to the story. Some say that, in fact this crisis presents an opportunity for the audit/accounting profession. In particular universities and their accounting faculties have changed their course offerings and other aspects of the accounting program to better equip students to cope with the ethical challenges of the accounting/auditing profession. Looking at the course offerings for

accounting combined with ethics in Finland, there are not that many specific ethic courses, though, many courses partly discuss some of the issues. However, in UK and US quite a few universities offer a variety of business and accounting ethics courses.

Titard, Braun & Meyer (2004) examined in their survey non-accounting business students' attitudes toward financial fraud. These business students who were not majoring in accounting typically took at least one, and often two, introductory accounting courses. They generally did not rate accounting as their favourite subject. Using a five-point scale, the study surveyed accounting students about their attitudes toward accounting on each of the following dimensions: boring to interesting, unimportant to important, irrelevant to relevant, worthless to valuable, useless to useful and meaningless to meaningful. Titard et al. (2004) gathered 257 surveys in fall 2002 to measure attitudes following these accounting scandals mentioned above. They asked these students to complete a survey to determine their familiarity with what had occurred. This contained nine questions—three each on Enron, WorldCom and Sarbanes-Oxley.

According to their study, attitudes of students themselves had not changed significantly in the post-scandal period. In general, the more students knew about what had taken place the more positive their attitudes toward accounting actually were. Their conclusion was that instructors need to offer students at all levels the opportunity to explore the social, political and ethical implications of accounting decisions. The results of the study also suggested that, as a whole, the scandals did not have a significant negative effect on the attitudes of non-accounting majors toward the profession. If truth be told, the more knowledgeable students were about the accounting scandals, the more positive their attitudes toward accounting were. In particular, students who answered at least half of the detailed questions about the scandals correctly had considerably more positive attitudes toward accounting than those who did not. (Titard et al. 2004).

3.3 Fraudster profiling and Financial Crime statistics

Study carried out by the Association of Certified Fraud Examiners (ACFE) was based in data compiled from 1134 cases of occupational fraud in the USA that were investigated between January 2004 and January 2006. Asset misappropriations were by far the most common type of occupational fraud in this study, occurring in over 90% of all cases. Meanwhile, cases involving financial statement fraud were least common but had the largest impact when they did occur. In terms of the value of the frauds small and medium size businesses were the most heavily represented group, making up to 56.3% of all frauds in the study. The most common occupational frauds in small businesses involve employees fraudulently writing company checks, skimming revenue and processing fraudulent invoices.

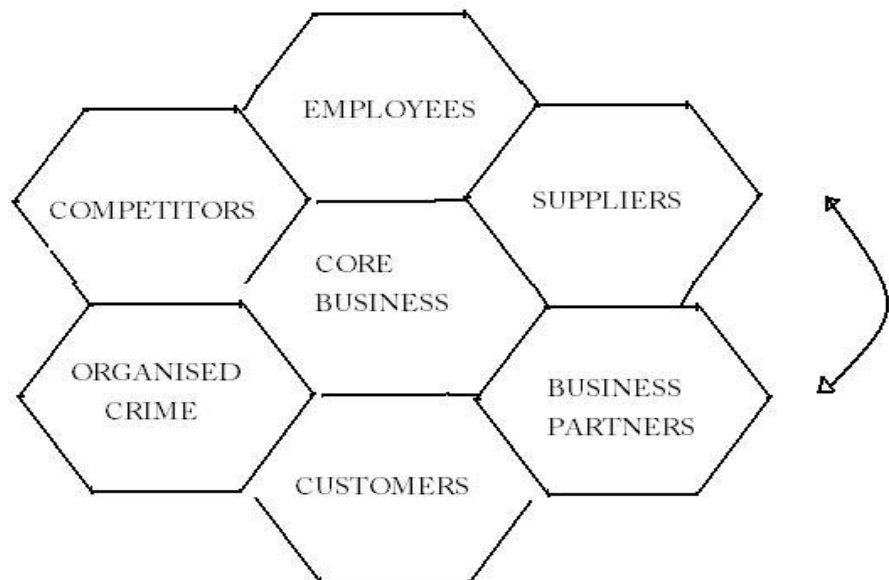
The median estimate was that a typical organisation loses 5% of its annual revenue to fraud. However, even if the fraud has been detected it may not be possible to determine exactly how much was stolen, because many frauds go undetected for years before they are caught. Occupational fraud schemes were considered to be very difficult to detect and the median length of the schemes was 18 months from the time the fraud began until the time it was detected. The industries with the highest median losses per scheme were wholesale trade, construction and manufacturing. Not surprisingly government organisations were among those with the lowest median losses. (ACFE, 2006) However, Samociuk et al. (2004) could lay examples in Finland from all business sectors, public and private sectors and all of them had received some level of publicity in the press.

The size of the loss caused by occupational fraud is strongly related to the position of the perpetrator. Fraud involving one or more members of management or those charged with governance is usually referred to as “management fraud,” fraud involving only employees of the entity is referred to as “employee fraud.” In either case, there may be collusion within the entity or with third parties outside of the entity. Most of the occupational fraud schemes in ACFE study involved either the accounting department or upper management. Accounts totalled 30%, Upper management 20%, Sales 14% and Customer service 11% of all cases. It was also notified that nearly 40% of all cases in this study involved some form of collusion within the company or with outsiders. Less than 8% of the perpetrators had convictions prior to committing frauds. (ACFE, 2006) This was supported by National Research Institute of

Legal Policy study in Finland which suggests that most fraudsters are not career criminals (Niemi & Lehti, 2006)

Fraud relates to moral issues and we all have different view on what is moral and what immoral. In terms of fraud, some of us gross the line easier than others. According to Samociuk et al. (2004) our circumstances in life change and some of the actions we would not normally do, in other cases we would consider somehow to be more acceptable. Employees make up for reason why it is justified to deceive their employer, whether it is because they were not promoted, because of their personal financial circumstances or just because they are fed up. Because people, circumstances and companies change it is very difficult to predict how people will behave. Nevertheless, one of the most common misperception is that fraudulent actions carried out by individual dishonest employees cause largest part of financial losses resulting from fraud. However, most drastic losses result when there is collusion between any of the groups close to the company's core business presented in figure 2.

FIGURE 2 Hazardous combination



Adopted from Samociuk et al. (2004)

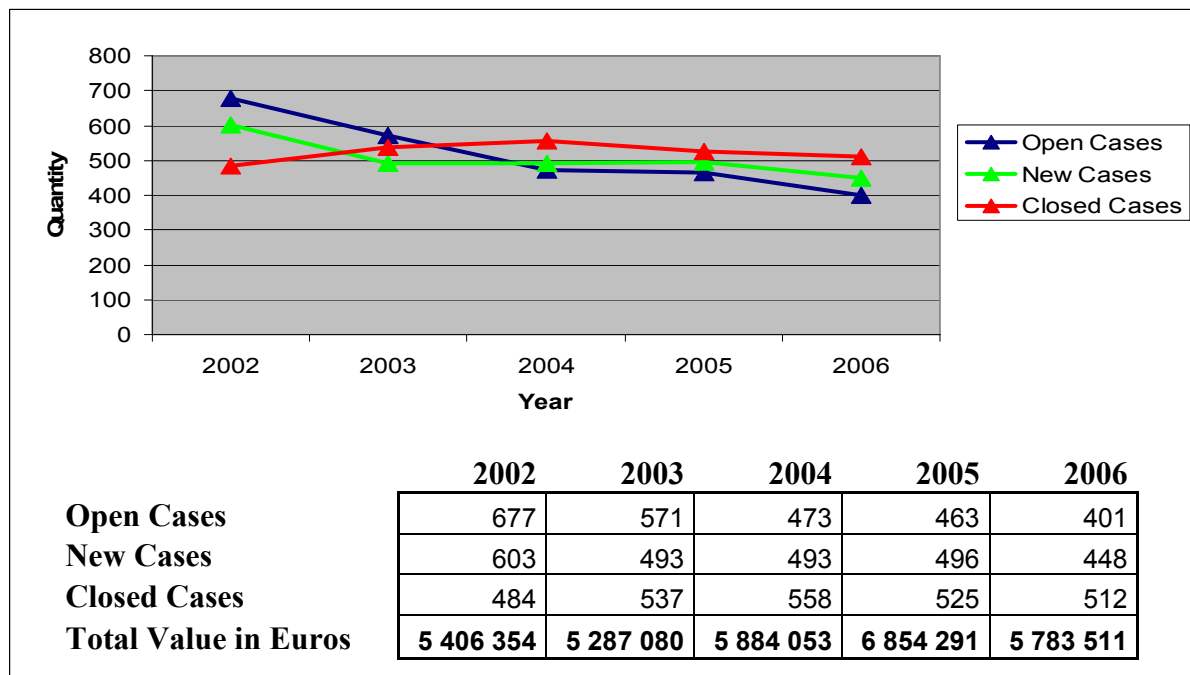
Most of the perpetrators in ACFE study were either employees (41.2%) or managers (39.5%) and owners made less than 20% of the perpetrators, but they accounted for the largest losses by far. There was also a direct correlation between the length of time worked in the organisation and the size of fraud. A person who had worked with the company was usually trusted and had more opportunities. There was also a strong correlation between the gender and number of fraud cases and the value of the fraud. Men accounted for 61% of the cases and this was considered to be a result of the tendency that men hold more management and executive-level positions in many organisations. (ACFE, 2006) The percentage was considerably higher in Finland, where 89% of perpetrators were men and in particular in tax fraud cases men accounted staggering 96%. (Niemi & Lehti, 2006) The effect of age and education were also examined. In both cases as employees' age and level of education rose, so did the losses from their frauds. (ACFE, 2006). In Finland the medium age was 44 years and they were usually working at the upper management (80%), either managing directors or members of board. Entrepreneurs were the second largest group of perpetrators and totalled 13% of the cases. (Niemi & Lehti, 2006).

These conclusions about the gender, length of time worked in the organisation and poor recovery rate were supported by the fraud study carried out by KPMG in Australia in 2004. Their typical fraudster was slightly younger, a 31-year old male, in a non-management position; fraud type was theft of inventory and was detected by a colleague 13 months after the commencement of the fraud. (KPMG, 2004)

One of the conclusions of the ACFE's study was that occupational fraud are more likely to be detected by a tip rather than other means such as internal or external audits or internal controls. Three most common means by which occupational fraud was detected were tip, by accident or internal audit. Tips were received most commonly from other employees, but also from vendors or customers. Although external audits were the most common anti-fraud control among the organisations, in this particular study, organisations that utilised external audits had higher fraud losses than those that did not. Interestingly, there were no supporting data to indicate that external audits were particularly effective at detecting fraud. The external auditors detected only 12% from all fraud cases. It was also remarkable to note that only 70% of the cases were referred to law enforcement and the most common reasons for declining to prosecute was fear of bad publicity (44%), and in 30% of the cases were settled out of court. It was also calculated that in 42% of the cases the victim was not able to recover any of the

losses. (ACFE, 2006) Figure 3 below shows financial crime investigations from years 2002-2006 in West of Finland only.

FIGURE 3 Financial Crime cases in West of Finland



Coming down from the early 2000, the amount of new cases has dropped as well as still open cases. However the value has not. In terms of time spend on investigations in different crime sectors, 4% was spend on IT crimes, 17% violence crimes, 17% on narcotic related crimes and overwhelming 36% on financial crimes. And this time allocated to financial crime is expected to increase. It has been estimated that the society loses roughly 2-2,5 billion euros per year because unpaid taxes and other mandatory payments. It was also noted that financial crimes have become more international and are more related to narcotics. (KRPO, 2004)

4 THE AUDIT EXPECTATION GAP

Audit Expectation Gap is the difference between what auditors actually do and what some sections of society believe they should do. The Commission on Auditors' Responsibilities (Cohen Committee) first used the expression in 1974 (USA). It has a long-standing existence and it is arguably one of the major issues confronting the audit profession in recent years. The gap arose because the public viewed that audits serve as a guard against fraud. Commonly, auditors were expected to be liable to all interested parties, search for fraud and illegalities, prepare the accounts, be independent, assure that financial statements are correct and ultimately guarantee that the company will not fail. This is an issue for the public, investors and politicians because, in a capital economy, the process of wealth creation and political stability depends heavily upon confidence in processes of accountability, of which external audit of financial statements is considered to be important part. The expectation gap is an issue for auditors since the greater the gap of expectations, the lower is the credibility, and therefore earning potential and prestige associated with their work (Sikka et al.1998).

Most commonly, this expectation gap arises when apparently healthy company unexpectedly fails or auditors fail to detect fraud that leads to substantial losses. When companies fail through mismanagement or fraud, there is a tendency to blame the auditors for not giving adequate warnings or that they have failed to perform the audit altogether. Auditors, however, have not considered for instance fraud detection and reporting to be their responsibility. They have been blamed for not being able to keep up with the new technology and systems. In a case of Enron, frauds were considered to be relatively sophisticated involving issues such as special purpose entities and complicated hedge and derivative transactions. (Rockness & Rockness, 2005) However, "it is very clear that every time a fraud is perpetrated and not discovered by the auditors- no matter how skilfully it might have been concealed or how senior the level of management responsible -the competence of the whole audit will be called into question" (Cosserat, 2000). In response to widespread criticisms from the public, the favoured strategy for the profession has been to equate the expectation gap with audit failures and to ascribe such failures to the incompetence of some individual or special circumstance (Sikka et al.,1998) .

The audit profession has argued that the problem lies with the public and the users, and their failure to understand the role of auditors and limitations of financial reporting. In recent year, however, the profession has come to recognise that instead of avoiding the responsibility, they need to improve the quality of financial reporting and enhance the independence of the auditors to narrow any parts of the gap caused by inadequate performance. There has also been a need for the audit profession to shift to a greater emphasis on current data and auditing on a continuous basis. This is because investors will gain access to real-time databases and user will create their conclusions from this instantly available data.

It can be argued that that the profession retain a considerable interest in seeking to capture the debate on audit expectations in order to exercise control over its outcome. Research findings have repeatedly underlined difference between the intended and received messages from audit reports. Several studies are based on an assumption that the meaning of audit is unchallenged and that there is only one correct reading of the audit report and that this correct reading is identical to the values preferred by the profession. At the heart of expectation gap there is collide of preferred meaning about the nature, practice and/or outcome of an audit. As sellers of auditing services, audit profession has a stake in securing the material and symbolic value of their work. In contrast, the buyers and regulators of auditing labour have a stake in ensuring that audit delivers whatever quality of practice is deemed to be necessary to secure the confidence of the public, and investors in particular. And that this fundamental difference in orientation, they suggest, is the main reason why this gap continues to exist despite the numerous institutional attempts to reduce or eliminate it (Sikka et al 1998).

It has been considered that longer form of reporting does not appear to have been effective in terms of reducing the expectation gap. A number of firms are offering additional fraud reviews and evaluations of systems of internal control. However, these are made available as extras, not as something within the audit leading to an expression of opinion on the credibility of the financial statement. These are services to management, not to financial statement users. The problem does not lie with the auditors' failure to report fraud but to detect it in the first place. Non-auditors did express concerns about the role of the audit, but these did not reflect lack of knowledge of the formal audit responsibilities and their limitations. Concern appeared to derive from general feelings about the justifying role of an audit rather than the specific service or activities auditors carried out (Humphrey et al. 1992).

Certain results gave evidence from a performance gap in respect of fraud. One major element of this body of literature relied upon questionnaires and opinion surveys to draw attention to the gap between the profession's preferred meanings of audit and the public expectations. Humphrey et al. (1992) sent a questionnaire to auditors, accountants, financial directors, investment analysts, bankers and journalists. Preparers, users and even auditors considered auditors to have a role to "ensure all significant fraud is detected", but they did not feel that audits currently offer "significant protection against fraud". Their study also revealed that auditors believed themselves to be more successful than finance directors, investment analysts and journalists believed them to be at diagnosing problems, acquiring information, detecting and preventing errors and irregularities, complying with professional rules and even forming correct judgements. (Humphrey et al. 1992)

Porter (1993) challenged others and felt that classification "expectation gap" was not clearly enough defined, because it did not identify that auditors may not accomplish what they "can and reasonably should", and therefore should be called more precisely the expectation-performance gap. In Porter's classification there are two components in expectation gap:

- 1) A gap between what the public expects the auditors to achieve and what they can reasonably be expected to accomplish, designated the "reasonableness gap".
- 2) A gap between what the public can reasonably expect auditors to accomplish and what they are perceived to achieve, designated as the "performance gap". This component was further subdivided into:
 - a) A gap between what can reasonably be expected of auditors and auditors' existing duties as defined by law and professional promulgation, designed "deficient standards"
 - b) A gap between the expected standards of performance of auditor's existing duties and auditors' perceived performance, as expected and perceived by the public, designated "deficient performance".

Troberg and Viitanen (1999) studied the audit expectation gap problem in Finland. They examined similarly to Huphrey et al. (1992) study, the perceptions of auditors, financial directors, bank loan officers, business lawyers, shareholders and financial analysts regarding

auditors' duties and performance. Also their study was carried out with a questionnaire. Troberg and Viitanen (1999) used Porter's classification when evaluating the audit expectation gap in Finland. In their study, duties contributing most of the reasonableness gap were to examine and report whether the company is managed effectively, to detect and report misappropriation/theft of company's assets by non-managerial employees, to detect and report illegal acts by company employees which do not directly affect the company's accounts and to detect and report the future prospects of the company. In regards to deficient performance gap most dissatisfaction was presented with respect to detecting and reporting illegal acts by employees which affect the company's accounts, completing the financial statements when necessary and going-concern reporting.

Furthermore, fraud and fraud related issues contributed most of the deficient standards gap, more precisely 85%. The results of their study in regards to the auditor's responsibility to detect and report material fraud showed that all respondent groups considered fraud detection as a duty of the auditor. However, the auditors were least in favour of considering fraud detection as a duty of the auditor but still 76% of the auditors responded positively on this issue. Regarding how well the duty was perceived to be performed by the auditors, there was a clear dispersion between the perceptions of the different groups. The financial directors and the shareholders viewed the auditors' performance more favourably. However, 31% of the bank loan officers were dissatisfied, 42% of the bank loan officers were neutral and 27% positive on the performance issue. Troberg and Viitanen (1999) felt that the dissatisfaction among bank loan officers was not surprising when considering the recession in Finland in the beginning of the 1990s and the consequential bank crisis. The business lawyers were not that positive with regarding the auditor's performance although 48% had a positive perception. Even among auditors 22% were negative regarding the profession's performance.

5 IMPLEMENTATION

The aim of this dissertation was to lay a soil where the auditors and managers are currently and will be working in the future, when the graduate students enter the business profession and some of them become managers and executives of the companies. These students will have an access and opportunity to commit fraud. And also, how do they value the seriousness of different forms of fraud and the punishment? The other area of the dissertation concentrated on audit expectation gap. And once again the focus was on graduate student. To find out weather the results are as worrisome as they were in the US, and if there is an audit expectation gap between auditors and student, student were approached with a survey.

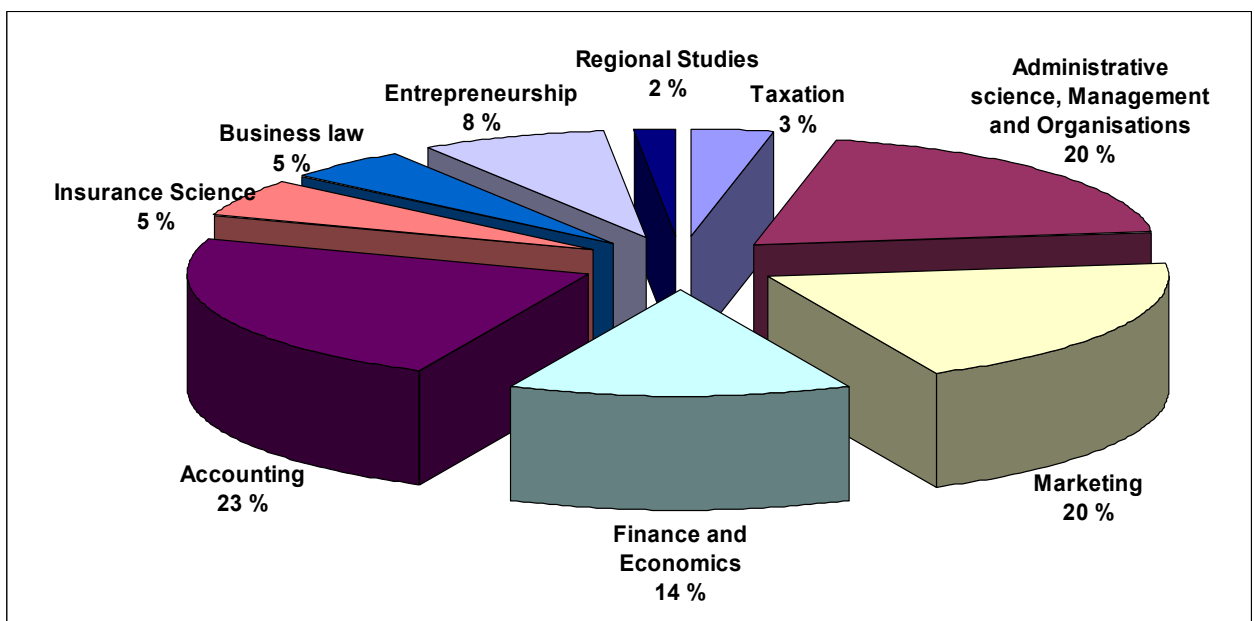
A survey program Digium Enterprise was used when forming the questionnaire for this survey. Overall, there were 58 questions in the survey. The questionnaire was compiled from four different parts. In the first part, there was a string of questions about students' background; their sexes, level of accounting and auditing studies and main field of studies. In the second part, graduate students were asked series of questions about typical fraudsters, what kind person in their opinion is most likely to commit fraud, what sort of fraud and why. This second part was constructed so that the results could be compared to 2006 ACFE study from occupational fraud and their fraudster profiling. In the third part, 14 different imaginary examples of occupational fraud cases where explained and each of them were followed by two questions; Is this a fraud and if it is, how serious? And; were they willing to commit this fraud themselves? These covered all the three areas of common occupational fraud; asset misappropriation, corruption and fraudulent statements. The last part concentrated on students' views on auditors' work and responsibilities. Was there a perceptions gap between students and auditors? This part used modified framework from studies carried out by Humphrey *et al.* (1992) and Viitanen (1995). In these surveys different parts of society who used audit reports, were asked to value the work of audit profession and what they considered to be auditors' main responsibilities. The survey was first piloted in December 2007 for group of 5 students. Feedback was received and the survey was discussed overall. How had they understood the questions, was the most important question. Hence, some of the questions needed to be more specified. And making sure respondents would have the time and interest to answer so many questions, in this pilot phase, time to complete the survey was measured and some questions taken off. Six movie tickets were rewarded randomly between all the respondents.

5.1 Respondents

To narrow this survey just for graduating students, subjects were limited to those who had at the time of the survey obtained at least 120 credits. This is the limit to have a BA degree in Finland. Actuary units from both Universities in Jyväskylä and Tampere provided the list of e-mail addresses for those 954 students. 429 of these students were from University of Jyväskylä, 525 from Tampere University. On the 17th of February 2008 they were sent an e-mail with cover letter and link to this questionnaire. The questionnaire and cover letter can be found in APPENDICES 1 and 2. However, 26 errors in delivering mail or messages responding that the person can not be reached came from the original list and therefore these students were therefore disqualified from the survey. 928 students could reasonably be expected to receive this e-mail. This survey expired on the 31st of February 2008. Between these dates, two reminder e-mails were sent to obtain a higher amount of replies.

Overall, 183 student filled out the questionnaire, giving a response percentage of 19.7. Summary reports from the results can be found in APPENDIX 3 and 4. Based on data gathered from the first section of the survey 97 (53%) of responses came from University of Jyväskylä and 86 (47%) from University of Tampere. In terms of gender, 55.7% of replicates were women and 44.3% were men. Figure 5 below presents the respondents by their majoring subjects.

FIGURE 4 Respondents by majoring subject



Over 66% of these students had minimum of minor studies from accounting and only 4.4% had not taken any accountancy courses at all. However, in terms of auditing, less than half (45.9%) of these students had taken at least one auditing course.

5.2 Fraudster profiling

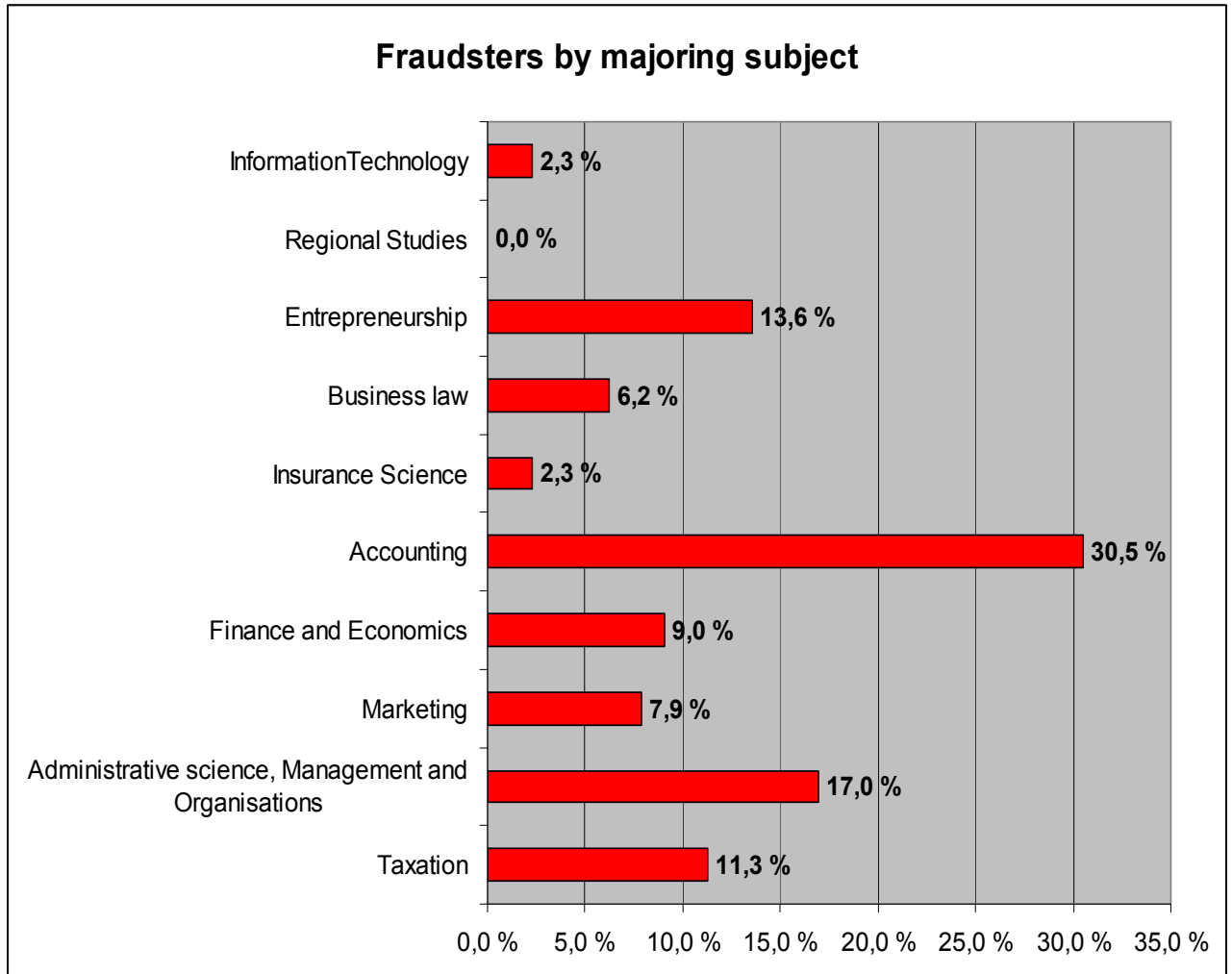
Based on the data collected from the second section of the survey, staggering 96.7% of the respondents believed fraudster to be a male. This was also in line with the criminal statistics in Finland and ACFE study. The average profile among all respondents was that a typical fraudster is 36-45 years old (59.3%) male with a higher education (60%). He works in accounts/finance department or administration and has been working with the company for 5-10 years (54.4%) at middle or top management level (75.7%). What he did was a bookkeeping or tax-fraud (64.3%), and he was motivated to carry out this fraud by the opportunity that his position in the company provided him (40.6%) or pure greed (27.8%). He was either caught in inspection from public authority (34.3%) or internal audit (33.9%). Only one in five believed in external auditors to catch fraudster and less than 9% in tip from colleague. This result was not in line with ACFE's study where the most common source to prevail fraud was a tip from colleague.

So then how are the most trustworthy employees? According to respondents they are female, under the age of 27 years with secondary school background. They have been with the company for less than a year, work in marketing department and in non-management position.

In question 13, students were asked to value their fellow students and determine in which majoring subjects the fraudster would most probably be in his/her career? Results are in figure 6 next page. Over 30% percent considered fraudster to be from accountancy major. However, it is important to keep in mind that many people associate "fraud" immediately with money and that ones who are dealing with the money are the accountants. Administrations, entrepreneurship and taxation were the next most popular groups. Less than 1 out of 10 considered students from finance to be involved with fraud and less than 3% from insurance science. In all major respondent groups accountancy students were considered to have a

highest likelihood of being involved in fraud. Even the accounting students themselves recognised this.

FIGURE 5 Fraudsters by majoring subject



The third section of the survey concentrated on examining more closely what sort of frauds would the students be willing to commit and what they would not do in any circumstances. 14 different invented examples of occupational fraud cases were explained and each of them were followed by two questions; Is this a fraud and if it is, how serious? And; were they willing to commit similar frauds themselves? Let us start with the acts the students would not carry out themselves or they regarded them as very serious fraud.

There was an example of payroll fraud, where the payroller had created a fictive employee to the payroll and paid small amounts regularly to this person's bank account which was in fact the payroller's own account. 98.9% of the respondents replied they could never carry out this

fraud. Why? This survey does not give answers to more profound reasoning behind the answers, but at least three things might have had an effect on this. First, payroll fraud can be very difficult to carry out successfully. This fraud would have most probably resolved in a routine examination by external auditors just simply comparing the list of registered employees overall and list of peoples who were paid. So maybe the risk of getting caught was too high. The other thing could be documentation; there is clear trace from this transaction, because the final destination for this money is the payroller's bank account. It is far easier to dispose cash. The last reasoning might have been the amount. Even though this would have totalled 1800euros/year, if succeeded, risk and reward might have not matched. Relating to payroll as well there was a scenario where an employee returned imaginary travelling expenses to payroll. 93.3% of the respondents could not carry out a similar act. If the company has a poor internal control, travel expenses are one of the easiest way of committing fraud, especially if you are a sales representative with flexible working hours. Is it possible that the students are not yet that familiar with this expense category? From all different scenarios, it was slightly surprising that it was so high and what could have been the reasoning behind it?

Two other scenarios reached the level of over 90% of respondents who were not willing to carry out the act. In the first setting, there was an item delivered to the shop that was not included in the packing list or delivery list. The person took it home and spoke nothing of it to anyone else. What made this type and level of asset misappropriation more serious than other examples in the survey is a slight mystery. Is it because the item was new? So it would less judging to steal used items like in the second scenario in the survey, where items were old and unused. And also, who are you stealing from; your employer or from outside supplier? Does that make any difference? In the second setting, failure to compile statutory accounts based on receipts, the person decides to destroy all bookkeeping material. Why were they so judgemental about this? She was an entrepreneur and bookkeeping was merely to determine tax. This was an offence toward tax authorities, so at the end she was stealing from the government, and in fact from taxpayers. But why was this more serious than for example paying someone in cash and therefore not clearing taxes or filing personal expenses as company's expenses?

Moving along to the subject of seriousness. 66.7 percent of the respondents considered this "imaginary employee in the payroll" –fraud mentioned earlier to be very serious fraud. As

well as 53.3 percent considered destroying bookkeeping material and 48.9 percent manoeuvring financial statement to reach the same level. On the contrary, shocking 41.9% of respondents considered gaining personal wealth through bribery not being a fraud. Or 41.1 % regarded plot where you would buy from your employer items using discounts limited to personnel, then selling it forward with a margin, not being anything to judge about. If your employer gives you a laptop because you travel a lot, 94.4% thought it was ok to download material and use it for personal purposes. More than every tenth did not find anything fraudulent about borrowing money from the petty cash for few days without telling anyone or paying salaries without clearing tax. Interestingly, these were mainly men.

So what had they already done or what sort of acts were they planning to carry out if an opportunity prevails itself? Roughly 92% continue to use their laptop as if they would own it, regardless of the risk of catching a virus. No less than ever tenth will use petty cash box as their personal wallet and over 46% will keep on or are planning to continue their profitable business of selling forward goods they have bought with personnel discount. As long as there will not be tax inspection and with increases on petrol price, almost every third will use company's petrol card for personal driving. Even if they do not work in this particular company or 88% of them do recognise this as fraud. Not that you would get any money from old computers anyway, but now you will not get the spare parts either. Make certain you have erased everything from the motherboard, because every fifth of the respondents is at least planning to hand out your company's desktops and laptops forward, and not tell you about it. And when caught in cold not being able to explain and balance transactions in company's accounts, 5% will destroy the material.

Do not forget to book your tickets to next Formula 1 Grand Prix in Monaco in advance, because if an opportunity arises for getting involved with corruption, it might be quite busy. Every fifth from our business students is there in the pit lane ready to smile with Kimi Räikkönen. But there was a clear conflict, because 41.9% did not consider this to be a fraud, but only 21.2% would actually do it. Correspondingly, even though 86.1% recognised paying under the desk to be a fraud, astonishing 34.6% was still willing to do it themselves.

There was no indication that majoring subject or sex would have had effect on evaluating one fraud to be more or less serious. Nor there was there an indication that students from certain majoring subject or university would have been more appliquéd to commit fraud.

5.3 Expectation gap among business students

The other area of the dissertation concentrated on audit expectation gap. The final part of the survey covered this area with 27 targeted questions using modified framework from studies carried out by Humphrey et al. (1992) and Viitanen (1995). One question was a duplicate. Students were presented a string of questions and asked to value them in Likert's scale from one (1) to five (5). In this scale, one stands for totally agree and five totally disagree. The questions were grouped in three areas. In the first group there were question about auditors and related interest parties. Second group targeted the audit report itself, and the final group on auditors and fraud. Averages from all questions were calculated and Likert's scale divided into three categories; positive, neutral and negative. Positive being the ones who on average agree (1-2,5) are highlighted in a green base. Neutrals are those averaged between 2,51 and 3,5, and are highlighted in a yellow base. The negatives are who did not agree, averaged between 3,51 and 5, and are highlighted in orange base.

They clearly did not see a conflict in taking extra services for their audit clients and auditors losing their independence. Graduate students were quite positive about auditors being able to obtain relevant information from the management and drawing correct opinions. This neutrality in their answers could also reflect the state of the matters. They were unsure if the auditor is responsible for the correctness of the financial statement. Table 1 presents all questions from this group. Students did not agree on limiting the use of the same auditor for over period of time. Overall, they did not consider audit report to be a useful tool in decision making, however they were very hesitant that adding special information and focusing the report to meet different sectors would make it more useful. It is very hard to follow what is according to students exactly wrong with the audit report. Clearly something, because they did not see it as import in their decision making. Or are their decision mainly based on current or future information, not information from the past?

TABLE 1 Auditors and related parties

Without jeopardising their independence, auditors can perform as an auditor as well as provide other services to the same company.	2,18
Auditors are successful in obtaining all relevant information from the management to draw correct opinion.	2,67
It should be prohibited for auditors to carry out any extra services for their audit clients.	3,28
After performing an audit, auditors are responsible for the correctness of the financial statement.	3,28
Auditors have taken into consideration wishes and expectations from different interest parties when developing the role of auditing.	3,47
The use of the same auditor should be limited for instance so that every four years, company should choose another auditor to carry out the task.	3,56
Audit report would be more useful if it would expand to meet the current circumstances and special features of different sectors and would include more information about audit methods and results, instead of being the short standard form.	3,68
An audit report is important and useful tool in decision-making.	4,01

In Table 2, the focus was on the audit report itself. It was astonishing to find out that on average students agreed quite heavily that a clean audit report would guarantee will not go bust during the next financial year. There was also a conflict in their views on agreeing that auditors draw correct opinions (Table 1), but they disagreed that auditors draw correct conclusions on companies' performance.

TABLE 2 Audit report

Clean audit report guarantees that the company will not file for insolvency during next financial year.	1,96
Auditors should assess managements' efficiency and competence and make recommendations to improve them.	2,6
Clean audit report guarantees that company is managed according to law.	2,98
Clean audit report guarantees that the financial statement is reliable.	3,02
Auditors should verify also other documentations such as forecasts, budgets and annual reports.	3,25
Clean audit report guarantees that the financial statement includes all material information to assess company's financial circumstances.	3,28
Clean audit report guarantees that the financial statements is free of material fraud and illegalities.	3,38
Clean audit report guarantees that the financial statement is based on legislation.	3,66
Clean audit report guarantees that the financial statement is free of errors.	3,75
Auditors succeed commonly draw correct conclusions on companies' performance.	3,75

They did not agree that clean audit report would guarantee it either free of error or based on legislation. However they were neutral that the financial statement would still be reliable.

Table 3 present the grouping of auditor and fraud –related questions. Students were very neutral about whether auditors should take more responsibility on detecting fraud and on the other hand if the quality of their work has in fact improved over the past years. They felt that the scandals have not had an impact on professions creditability, and disciplinary cases have been handled publicly enough. This was interesting, because it was not easy to find disciplinary against auditors that would have reached the headline. It is that there has not been that many over the past year, or have these been settled out of court and therefore have not reached the headlines? Also auditors have the same liability as the management in terms of covering the losses and they were more appliquéd to recognise detection and prevention of fraud and illegalities to be responsibility of auditors than for management. However, there was no strong indication that students regarded auditors to be responsible for detection of fraud. It seemed they did not consider fraud detection to be primarily either auditors or even less managements’ responsibility. So it was not clear who then should. And they did expect auditors to plan or carry out their audit work so that it would discover all material fraud and illegalities.

TABLE 3 Auditors and fraud

Auditors have the same liability to cover losses as the management	2,54
Past auditing scandals with Enron, Parmalat and Töölön matkatoimisto have not had an impact on auditors’ creditability.	2,69
Disciplinary cases against auditors are handled publicly enough.	2,78
In the lines of normal auditing procedures, if they come up with something to look more closely, auditors are willing to increase resources to investigate. Even though this means that the auditing is carried out with a loss.	2,82
The responsibility of detecting and preventing fraud and illegalities rests primarily with the auditors.	2,9
Auditors should take more responsibility for discovering material fraud.	3,39
The quality of auditing has improved in recent years.	3,47
The responsibility of detecting and preventing fraud and illegalities rests primarily with the management.	4,26
Auditors need to plan and carry out their work at the level where they can be confident enough that they have discovered all material fraud and to a certain extent illegalities.	4,44

6 CONCLUSIONS

The aim of this dissertation was to lay a soil where the auditors and managers will be working in the future, when the graduate students enter the business profession and some of them become managers and executives of the company with access and opportunity to commit fraud. The study carried out in the US for students was not as specific on different cases of fraud as the survey carried out in this dissertation. Would Finnish students be more or less appliquéd to commit fraud than US students? Based on this survey, they would not be willing to commit that sophisticated fraud as US students, however, everything does not seem to be all that black and white to them either.

In the US survey the word pressure was mentioned and emphasised and under this, students would have been willing to commit several types of fraud. Even tough this element was mentioned also in this survey, most of them still would have not carried the act. Furthermore, students were not willing to commit payroll offences and they regarded these as the most serious in nature. Nor they would destroy accounting material or steal new goods. So what is stealing? Over 40 percent would have bought goods from their employee and sold it forward with a margin, so keeping the profit to themselves. Would this not be stealing? Or handing out your employees' old computers out to your siblings. The most worrisome result from this study however was students' attitudes toward bribery; over 40 percent did not recognise this as a fraud and every fifth would have accepted it, and allowed it to influence their decision. Also 10% would have used company's cash as their own and paid salaries without clearing tax. These 10% constituted mainly from men.

It would have been interesting to have the results from this survey from previous decade or repeat this in ten years time. Would the results been different or had there been a change in attitudes or moral? Or has it always been like this? There have been discussions in the media that your people's moral and work ethic has weakened. Is this one implication supporting this inclination? It was also interesting to notice that less than half of the respondents had taken auditing courses, but over 66% had taken several accountancy classes. Auditors communicate with the management/directors, and evitable most of the students are aiming to that level at some point in their career. However more than half had no background information about

auditors or their own responsibilities for that matter. On the other hand, students did not put much weight on the audit report itself.

Students believed that the opportunities associated with specific roles are the most common motive to commit fraud. They did not believe in external or internal audits for exposing frauds. This was clearly not inline with ACFE study, where tip from colleague or vendor was the most common way to disclose fraudulent activities. It is very typical that some “minor” fraudulent activities in the workplace soon become a culture. And many are then involved. And after a while this is something we should not do, but everyone does it any way. Often there are no ways in the organisations to communicate anonymously suspicions on colleagues or the management. Fraudster would get caught during specific inspections from a certain public authority. Then again students had a very clear view on fraudster. He was an early middle-aged male, working in accounts department at management level and had work with the company for several years. This was also in line with ACFE study.

The other area of the dissertation concentrated on audit expectation gap. Fraud detection and liability is not particularly clear for students. They were not able to make clear indication who was responsible for it. Students would not limit auditors from providing other services to their audit clients or limit the use of the same auditor. However, there were mixed signals regarding auditors’ ability to draw correct audit opinions and opinion regarding company’s performance. They did not give much value for the audit report in decision making, however, even though they recognised auditors would not be able to guarantee it being free of error or fraud or based on legislation, they would still assumed clean audit report to guarantee that the company will not clear for bankruptcy during next financial year.

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LEGAL CASE: Kingston Cotton Mill CO 1896

[http://en.wikisource.org/wiki/Re_Kingston_Cotton_Mill_Company_\(No.2\)_ \(1896\)](http://en.wikisource.org/wiki/Re_Kingston_Cotton_Mill_Company_(No.2)_ (1896))

20.10.2006

LEGAL CASE: Ultramares 1931





http://www.eejlaw.com/materials/Ultramares_v_Touche_vT08.pdf 27.10.2006

APPENDIX 3 Results from expectation gap questions

N=184

25% 50% 75% KA

	25%	50%	75%	KA
Tilintarkastuksen laatu on parantunut viime vuosina.	3,00	4,00	4,00	3,47
Tilintarkastajat ovat ottaneet eri sidosryhmien toiveet ja odotukset huomioon tilintarkastuksen sisältöä kehittäessään.	3,00	3,00	4,00	3,47
Tilintarkastajat ovat tilintarkastuksen suoritettuaan päävastuussa tilinpäätöksen oikeellisuudesta.	2,00	4,00	4,00	3,28
Tilintarkastajien laiminlyöntejä ja muita rikkeitä koskevia kurinpitoasioita käsitellään riittävän julkisesti.	2,00	2,00	4,00	2,78
Tilintarkastajien tulee suunnitella ja toteuttaa tilintarkastus niin, että he voivat olla riittävän varmoja kaikkien olennaisten väärinkäytösten ja tiettyssä määrin myös muiden laittomuuksien paljastumisesta.	4,00	5,00	5,00	4,44
Vastuu väärinkäytösten ja muiden laittomuuksien paljastamisesta ja ehkäisemisestä on ensisijaisesti tilintarkastajalla.	2,00	3,00	4,00	2,90
Vastuu väärinkäytösten ja muiden laittomuuksien paljastamisesta ja ehkäisemisestä on ensisijaisesti yritysjohdolla.	4,00	4,00	5,00	4,26
Tilintarkastajalla on sama vahingonkorvausvastuu kuin yhtiön johdolla.	2,00	2,00	3,00	2,53
Tilintarkastajien tulisi ottaa enemmän vastuuta olennaisten väärinkäytösten paljastamisesta.	3,00	4,00	4,00	3,39
Tilintarkastuskertomus on tärkeä ja hyödyllinen apuväline sidosryhmien päätöksenteossa	4,00	4,00	5,00	4,00
Puhdas tilintarkastuskertomus takaa, että tilinpäätös on luotettava.	2,00	3,00	4,00	3,02
Puhdas tilintarkastuskertomus takaa, että tilinpäätös on yhtiölainsäädännön mukainen.	3,00	4,00	4,00	3,66
Puhdas tilintarkastuskertomus takaa, että tilinpäätös ei sisällä tahallisia olennaisia väärinkäytöksiä tai muita laittomuuksia.	2,00	4,00	4,00	3,37
Puhdas tilintarkastuskertomus takaa, että yhtiön johto on hoitanut tehtävät lain mukaisesti.	2,00	3,00	4,00	2,98
Puhdas tilintarkastuskertomus takaa, että tilinpäätös ei sisällä olennaisia virheitä.	3,00	4,00	4,00	3,75
Puhdas tilintarkastuskertomus takaa, että tilinpäätös sisältää kaikki yrityksen taloudellisen aseman arvioimiseksi tarvittavat tiedot.	2,00	4,00	4,00	3,27
Puhdas tilintarkastuskertomus takaa, että yritys ei mene seuraavalla tilikaudella konkurssiin.	1,00	2,00	3,00	1,95
Tilintarkastuskertomuksen merkitys kasvaisi, jos lyhyestä vakiokaavasta luovuttaisiin ja sitä laajennettaisiin vastaamaan vallitsevia	3,00	4,00	4,00	3,68

olosuhteita ja yrityksen erityispiirteitä ja se sisältäisi enemmän tietoa tilintarkastuksen metodeista ja tuloksista.							
Tilintarkastajat ovat ottaneet eri sidosryhmien toiveet ja odotukset huomioon tilintarkastuksen sisältöä kehittäessään.	3,00	3,00	4,00	3,25			
Tilintarkastaja voi toimia samanaikaisesti yrityksen tilintarkastajana sekä tarjota yritykselle muita asiantuntijapalveluita riippumattomuutta vaarantamatta.	1,00	2,00	3,00	2,18			
Tilintarkastajilta tulisi kieltää lisäpalveluiden tarjoaminen tilintarkastusasiakkailleen.	2,00	3,00	4,00	3,28			
Tilintarkastajan tulisi arvioida yritysjohdon tehokkuutta ja ammattitaitoa ja pyrkiä keksimään keinoja sen parantamiseksi.	2,00	2,00	3,00	2,59			
Tilintarkastajan tulisi tarkastaa myös muita kuin perinteisiä tilinpäätöstietoja esim. tulosennusteita, budjetteja ja vuosikertomuksia.	2,00	3,00	4,00	3,24			
Tilintarkastajat onnistuvat pääsääntöisesti muodostamaan oikean kuvan yrityksen toiminnasta.	3,00	4,00	4,00	3,75			
Viime vuosien tilintarkastus-skandaalit (esim. Enron, Parmalat tai Töölon matkatoimisto) eivät ole vaikuttaneet tilintarkastajien työn uskottavuuteen.	2,00	2,00	4,00	2,68			
Samana tilintarkastajan käyttöä tulisi rajoittaa esim. niin, että joka 4 vuosi yrityksen tulee vaihtaa tilintarkastajaa.	3,00	4,00	4,00	3,57			
Tilintarkastajat onnistuvat saamaan yrityksen johdolta kaiken olennaisen tiedon oikean mielipiteen muodostamiseksi.	2,00	2,00	3,00	2,67			
Mikäli normaalin tilintarkastuksessa ilmenee jotain normaalia poikkeavaa, tilintarkastajat ovat valmiita käyttämään enemmän resursseja asian selvittämiseen, vaikka se tarkoittaisi, että alkuperäinen tilintarkastuspalkkio ei kata kaikkia kustannuksia.	2,00	3,00	4,00	2,82			
Yhteenveto	2,23	2,86	3,34	2,82			
	 1,00–1,82	 1,83–2,66	 2,67–3,49	 3,50–4,32	 4,33–5,16	 5,17–6,00	