A meta-theoretical analysis of commercial crime prevention strategies in the BRICS countries

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"*But they that wait upon the LORD shall renew their strength; they shall mount up with wings as eagles; they shall run, and not be weary; and they shall walk, and not faint."* – Isaiah 40:31

SUMMARY

Title: A meta-theoretical analysis of commercial crime prevention strategies in the BRICS countries.

Keywords: BRICS; commercial crime; corporate governance; corruption; ethics; forensic accounting; fraud; fraud prevention.

Prior research on combating commercial crime has focused predominantly on the responsibilities of auditors and *ex post facto* forensic investigations. This dissertation aims rather to delve into the meta-theoretical philosophy of commercial crime prevention and the role that forensic accountants can play in this regard, postulating that proactive prevention of commercial crimes is a more effective approach.

The BRICS countries (Brazil, Russia, India, China and South Africa) were chosen for deeper level analysis, based on their strong growth potential coupled with high levels of commercial crime. While the majority of the research centred around commercial crime prevention strategies for the BRICS countries, a secondary objective was to expand the research field associated with forensic accounting, so as to encourage research into incorporating more preventative strategies. Subsequently, from the literature review and philosophical analysis performed, this dissertation establishes that developing prevention strategies for commercial crime is a philosophical and also a feasible possibility in the BRICS countries.

LIST OF ABBREVIATIONS

ACFE	**Association for Certified Fraud Examiners**
AFU	**Asset Forfeiture Unit**
AICPA	**American Institute of Certified Public Accountants**
AML	**Anti-Money Laundering**
ASBE	**Accounting Standards for Business Enterprises**
BRICS	**Brazil, Russia, India, China and South Africa**
FATF	**Financial Action Task Force**
FCPA	**Foreign Corrupt Practices Act**
IAASB	**International Auditing and Assurance Standards Board**
ICAI	**Institute of Chartered Accountants of India**
IFRS	**International Financial Reporting Standards**
IRBA	**Independent Regulatory Board for Auditors**
ISA	**International Standards of Auditing**
OECD	**Organisation for Economic Co-operation and Development**
SABRIC	**South African Banking Risk Intelligence Centre**
UNTOC	**United Nations Convention against Transnational Organized Crime**
WEF	**World Economic Forum**

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1. A META-THEORETICAL ANALYSIS OF COMMERCIAL CRIME PREVENTION STRATEGIES IN THE BRICS COUNTRIES

1.1. Introduction

1.1.1. Background

Jim O'Neill, then Chairman of Goldman Sachs Asset Management, coined the term BRIC in 2001. This acronym refers to Brazil, Russia, India and China, four rapidly developing countries that O'Neill suggested would lead world policymakers to reconsider the role of emerging markets on global trade relations (O'Neill, 2001). In another paper in 2003 (Purushothaman & Wilson, 2003), Goldman Sachs expanded on the findings of O'Neill and forecast the evolution of global economic dynamics over the next 50 years. This paper also cemented the concept of the BRIC countries as an economic powerhouse, with the prediction that within 40 years the BRIC economies could become larger than those of the then G6 countries (France, Germany, Italy, Japan, the UK and the USA) combined.

The concretisation of the BRIC group was formalised when the leaders of the respective BRIC countries came together for the first BRIC summit on 16 June 2009 in Russia (Dube & Singh, 2011:7). On 24 December 2010, the economic forum, known as BRIC, was officially named BRICS when South Africa was included in the group of countries (Graceffo, 2011). To date, membership of this group has remained unchanged.

While it was predicted that the BRICS economic forum would be the vanguard of a new era of geopolitics, many critics suggested it was mere hype (Atale, 2012:17). Hallam (2012:13) concurred, stating that any profits for shareholders are eroded by the shadier legal frameworks and poor corporate governance in emerging markets such as BRICS. Blackwell and Stippich (2012) considered that although each of the BRICS countries offers growth opportunities, they all carry significant risks owing to their poor governmental structures, business practices and legal frameworks.

According to Friedman (2012), these countries represent a particular risk to retailers, due to concerns regarding economic stability. The Emerging Europe Monitor reported that generally, in emerging markets a lack of economic openness and a high degree of governmental intervention undermines the business environment (EE Monitor, 2012:2).

In the Transparency International Corruption Perception Indexes for 2011 and 2012 (the 2013 report had not yet been released at the time of this study), all the BRICS countries scored poorly, both on global ranking and on a score awarded out of 10. This is consistent with the 2008 and 2011 World Governance Index findings, compiled by the Forum for a new World Governance (2011), which also place the BRICS countries in the bottom ranks.

The exceptions to the above were Brazil and South Africa, both of which seem to perform only marginally better than their counterparts.

	Transparency International Corruption Perception Index		**World Governance Index**	
	2012	**2011**	**2011**	**2008**
Brazil	69/176	73/183	52/179	69/179
Russia	133/176	143/183	148/179	135/179
India	94/176	95/183	152/179	142/179
China	80/176	75/183	140/179	109/179
South Africa	69/176	64/183	68/179	124/179
	The perceived levels of public sector corruption in the tested countries around the world. Ranking countries from least corrupt to most corrupt.		Evaluating countries based on peace and security, rule of law, human rights and participation, sustainable development and human development.	

Many independent researchers and journalists (Berning & Montesh, 2012; Hebron, 2009; Layak, 2008; Lyons, 2010; MacLeod, 2010; Rathbone, 2012; Weir, 2010) have reported the unethical practices and corruption in these countries and

it has been suggested that there is a lower level of business ethics cognisance in emerging markets. It moreover appears that the increasing level of economic growth, which the BRICS countries have experienced over the last decade, has brought a concomitant and unwelcome increase in corruption levels. This impacts negatively not only on the BRICS economies, but it also impinges on global economic trade in its entirety.

To understand the potential severity of impact, it is necessary first to understand the large contribution made by BRICS to global trade. “Together the BRICS account for more than 40 per cent of the global population, nearly 30 per cent of the land mass, and a share in world GDP that increased from 16 per cent in 2000 to nearly 25 per cent in 2010 and is expected to rise significantly in the near future” (The BRICS Report, 2012:11).

According to the BRICS Research Group, in a report on the 2012 BRICS New Delhi summit (2012:30), the five BRICS countries have, over the past decade, collectively contributed more than 50% of the global economic growth. The prediction made by the BRICS Research Group is even more optimistic than O’Neill’s. They predict that by 2030 the five BRICS countries will overtake the G8 countries (France, Germany, Italy, Japan, United Kingdom, United States, Canada and Russia) in terms of real cumulative GDP. This prediction again emphasises the future economic dominance expected from BRICS.

Trade with BRICS is therefore crucial for the global economy and the negative effect of commercial crimes cannot be ignored. This raises the question about what a global company needs to do from a business ethics perspective, when considering business deals with a BRICS residing company. Should it try to enforce its own, frequently Westernised ethical principles, or should it conform to a “….when in Rome” concept?

According to Michaelson (2010), the question we should be asking is: ‘‘When moral business conduct standards conflict across borders, whose standards should prevail?’’ The business ethics standards of emerging market actors are generally portrayed as "lower" than their Western counterparts, at least according to Western scholars and practice. However, we should consider that the future

dominant economic powers will most likely not be those that reigned supreme in recent past, i.e. North American and Western European markets.

Corporations need therefore to re-examine their global roles so as not to merely reflect the dominant ethical ideologies of the current most economically powerful market actor (Michaelson, 2010). It is essential that global corporations develop independent, multilateral ethical principles; these will not necessarily conform to the current market dominant concept of ethicality, but may organically evolve to represent the majority of their stakeholders' ethical views.

1.1.2. Forensic accountants

To fully grasp the intent of the proposed study, it is necessary to first understand the current role of forensic accountants. Davis *et al.* (2010:55) demonstrated empirically that most forensic accountants are accountants with strong analytical abilities. They also focus primarily on independent, *ex post facto* investigations, although new strains of services have started to become more pronounced, especially those of risk management and fraud prevention services.

Fitzgerald (2011:12) describes forensic accounting as "….the science of gathering and presenting financial information, on perpetrators of economic crimes, in a form that will be accepted by a court of jurisprudence". It must be considered as the service that bridges the gap between accounting and law.

Davis *et al.* (2010) and Fitzgerald (2011) both emphasise the fact that forensic accountants are primarily used *ex post facto* - after the fact. This study, however, aims to determine whether services *before* the fact would not be more effective, leading to a decrease in commercial crimes. The view that forensic accountants are only able to play a substantial role in an investigative capacity is near-sighted and might even impede the progress of the forensic accounting sciences as a whole.

Krummeck (2000:268) writes in support of this position and considers that an alternative strategy to deal with fraud is becoming more and more imperative. He notes, "….the extent to which fraud has grown in recent years has made it

evident that this conventional way of dealing with fraud is not only ineffective, but also too costly to afford any longer."

Sociologist Edwin Sutherland first defined the concept of white-collar crime in 1939 (Sutherland, 1949:9) as "….a crime committed by a person of respectability and high social status in the course of his occupation". Pickett and Pickett (2002) state that white-collar crime consists of several components, it is: deceitful, intentional, breaches trust, involves losses, may be concealed and there may be an appearance of outward respectability.

The purposeful use of the term *commercial crime* in this study's title specifically attempts to avoid limiting the scope of the definition. There is no widely accepted definition for economic or commercial crimes, nor for what specifically constitutes these crimes. For the purposes of this study, the terms white-collar, economic and commercial crime may be interchangeably used.

In their 6th global economic crime report, PwC (2011:20) list the following as types of commercial crimes: asset misappropriation, accounting fraud, bribery and corruption, cybercrime, intellectual property infringement, money laundering, tax fraud, illegal insider trading, anti-competitive behaviour and espionage as well as sustainability fraud. This list indicates the wide scope encompassed by the term, commercial crime.

There is some confusion with regard to the definition of fraud, with various authors having classified corruption as a part of fraud. However these, fraud and corruption, are considered two different offences (Els & Labuschagne, 2006:30). In the South African legal context, fraud is the "….unlawful and intentional making of a misrepresentation which causes actual prejudice or which is potentially prejudicial to another" (Snyman, 2008:531). Its main elements consist of: (a) a misrepresentation; (b) prejudice or potential prejudice; (c) unlawfulness and (d) intention.

According to *Black's Law Dictionary* (2009:731), fraud, in the American context, is defined as "….a knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment".

Although sentencing for the crime of fraud is done according to the legal definition thereof in the applicable jurisdiction, for purposes of this study it is additionally necessary to understand the meaning of fraud in the auditing context.

Fraud is currently a subdivision of auditing, even absorbed into the different auditing standards. Fraud, as defined by the International Auditing and Assurance Standards Board (IAASB) in the International Standard on Auditing No. 240 (ISA 240), is "….an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage". ISA 240 further differentiates between two types of fraud: fraudulent financial reporting and misappropriation of assets. The American equivalent, the Statement on Auditing Standards No. 99 (SAS 99), issued by the Auditing Standards Board of the American Institute of Certified Public Accountants (AICPA), defines fraud as "….an intentional act that results in a material misstatement in financial statements that are the subject of an audit."

On the other hand, corruption, in an abbreviated definition, as distilled by Snyman (2008:411) from the Prevention and Combating of Corrupt Activities Act (South Africa, 2004), is: "….anybody who (a) accepts any gratification from anybody else, or (b) gives any gratification to anybody else in order to influence the receiver to conduct herself in a way which amounts to the unlawful exercise of any duties". In the American legal context, corruption is described as the "….act of doing something with an intent to give some advantage inconsistent with official duty and the rights of others; a fiduciary's or official's use of a station or office to procure some benefit either personally or for someone else, contrary to the rights of others" (*Black's Law Dictionary*, 2009:397).

Corruption is largely governed by national legislations focusing on corrupt practices and organised crime. While there are also a few anti-corruption forums and networks, corruption and the prevention thereof, is largely situated in legislation.

It is further imperative that a description and discussion of commercial crime within the confines of BRICS countries is provided at this point.

Farber (2005:560) found that the results of his study indicated that firms where fraud was detected had poor governance relative to a control sample in the year prior to fraud detection. In reality, a lack of internal controls played a role in more than one-third of the fraud schemes in the ACFE report (ACFE, 2012). Braga-Alves and Morey (2012:1414) also found that in general, better governance is linked to better performing and higher valued firms in emerging markets.

If poor governance and a lack of regulatory controls were present shortly before fraud was perpetrated, it stands to reason that improving the corporate governance structure might decrease the prevalence of fraud.

While this theory sounds straightforward, it becomes more convoluted when seeing it in the BRICS context which comprises differing cultures, differing economic and sociological ideologies and accepted practices and regulatory bodies that are at variance.

In an effort to unify and standardise global accounting, the International Accounting Standards Board (IASB) publishes the International Financial Reporting Standards. The goal of these is to enhance the transparency and comparability of accounting systems globally. However, to cite an example of differing IFRS compliance, the effective implementation date of India's planned IFRS converged Indian Accounting Standards has been deferred without any new date being announced yet. China has devised the new Chinese Accounting Standards for Business Enterprises, which are substantially convergent with those of the IFRS, but still carry certain modifications specific to the Chinese context. In Russia, the IFRS was only officially endorsed from 25 February 2011, and it does not yet replace the Russian statutory rules, with companies required to prepare two sets of consolidated financial statements. Of the BRICS countries, Brazil and South Africa fully endorse the IFRS, albeit South Africa endorses the IFRS as adopted by the European Union (Use of IFRS by jurisdiction, 2012).

The above dissonance between the countries with regards to IFRS compliance means that financial accounting practices that would effectively amount to misrepresentation and eventually fraud in IFRS-compliant countries, are able to be passed off as valid and acceptable in some of the BRICS countries.

Finding perfect, all-encompassing governance and ethical principles that would be acceptable to all these countries would be almost impossible, and so this study rather sets out to lay the philosophical framework for commercial crime prevention in the BRICS countries. The answer to this perceived endemic problem must be found in either a different, or an entirely new, branch of the forensic accounting science.

Based on the above proposition, this study postulates that prevention will be a feasible solution for helping to alleviate the corruption and fraud plaguing the BRICS countries. The role of forensic accounting must be reconsidered to determine the true identity and value of the forensic accounting science in the fight against commercial crime. Furthermore, this study advances the additional proposition that the prevention of commercial crimes will be a more cost effective and efficient method in comparison with the current methodology of starting the corrective forensic measures *ex post facto*.

1.2. Motivation

Blackwell and Stippitch (2012) suggest that for BRICS countries the practice of bribery or corruption is a heavily entrenched, and sometimes culturally accepted (and expected) business practice. A further complication is that the forensic accounting sciences are neglected in emerging markets, including countries such as those in BRICS, according to Hoa (2010:187).

In view of the aforementioned commercial crime perceptions and occurrences and with the BRICS countries currently discussing projects such as a BRICS development bank along the lines of the World Bank (Heinrich, 2013:8; Pillai, 2012), a focused study on commercial crime prevention is both relevant and timely.

Given the above, within the field of forensic accounting there is a practical need to evolve and develop the concept to incorporate an alternative means of combating

commercial crime, i.e. a more preventative stance. The old proverb, “An ounce of prevention is worth a pound of cure”, seems particularly apposite here.

In their definitions of forensic accounting, both Davis *et al.* (2010) and Fitzgerald (2011) assume an historical stance that re-enforces the notion of forensic accountants only being able to do their jobs after a commercial crime has been perpetrated. This is similar to financial accounting and auditing; both being professions where historical data is analysed, so that the results produced are also historical in nature; that is: “tell it like it was”. This study challenges this perception as near-sighted, and analyses the postulate that a preventative stance is able to deter commercial crime before it happens. Almost akin to managerial accounting or risk management, where the focus is future and decision oriented; that is: “tell it like it will be”. A resemblance to the "pre-crime division" from the 2002 Hollywood movie *Minority Report*, where a team of "precogs" (genetically altered humans with precognitive potential) is used to prevent murders before they happen may be seen. This is undeniably a light-hearted, humorous comparison, but nonetheless thought provoking. What if humanity could prevent commercial crimes from ever happening?

This study argues that commercial crime prevention should be emancipated from auditors and legislatures. Whether to fit it under forensic accounting, which would then need a redefining of its core concepts, or whether it should fit under an as-of-yet still undefined and unnamed branch remains uncertain. This will be discussed in this study and hopefully in future research.

If the meta-theory of commercial crime prevention in the BRICS countries can be analysed to the extent necessary, it could perhaps lead to a better understanding of the role of forensic accountants in emerging markets, as well as a clearer understanding of commercial crime in the BRICS countries. It could perhaps also lead to a hypothetical future, where the emerging markets (the BRICS of yesteryear) will become the new economic powers while commercial crime prevention will be the new norm.

1.3. Problem Statement

Is prevention a feasible solution to the commercial crime problem in the BRICS countries? Concomitant to this, what contribution can forensic accountants make in this regard and are they able to be more effective preventing commercial crime than in their traditional *ex post facto* roles?

1.4. Research Objectives

This study will therefore seek to analyse the meta-theory behind commercial crime prevention strategies in the BRICS countries to determine what role, if any, forensic accountants are able to play in this regard. To address the problem statement the following general and specific objectives will be areas of focus:

1.4.1. Investigating the levels of commercial crimes in BRICS countries

Specific objectives:

1.4.1.1. gathering current data on fraud and corruption in BRICS countries

1.4.1.2. analysing the findings in order to better understand the BRICS demographics

1.4.2. Critical analysis of current commercial crime prevention methods

Specific objectives:

1.4.2.1. discussion of commercial crime prevention methods currently utilised in global markets

1.4.2.2. identifying shortcomings of the above

1.4.3. Commercial crime prevention as the new norm in BRICS countries

Specific objectives:

1.4.3.1. discussion of the philosophical possibility of commercial crime prevention implementation in the BRICS countries

1.4.3.2. discussing the current definition of a "forensic accountant"

1.4.3.3. addressing the need for a reform of forensic accounting in order to facilitate more involvement with commercial crime prevention

1.4.4. Conclusion and recommendations.

1.5. Research Methodology

The commonly used hypothesis-deduction research model is inadequate for the purpose of this study as it encourages premature theorising (Locke, 2007:867) and fails to address real world problems (Hubbard and Murray Lindsay, 2013:1337). The research paradigm of this study is therefore formed by a combination of the literature review and critical analysis. The literature review entails a study and critical evaluation of available and relevant legislation, textbooks and journal articles as well as electronic material obtained from various internet sites. The philosophical analysis of the meta-theory behind commercial crime prevention is further justified in Chapter 2.

1.6. Chapter Division

Chapter 1: Purpose and scope of this study

This chapter addresses the following:

- Background to the study;
- Motivation for the research;
- Problem statement;
- Research objectives;
- Research methods;
- Division of the chapters.

Chapter 2: Research Methodology

This chapter justifies and explains the deviation from the traditional factual and technical accounting framework into the realm of philosophical debate and meta-theory.

Chapter 3: Corruption and fraud in BRICS countries

Chapter 3 elaborates on the current corrupt economic climate within BRICS and also analyses the occurrence and prevalence of commercial crimes in order to ascertain their origins and the reasons behind them.

Chapter 4: Critical analysis of current commercial crime prevention methods

Chapter 4 addresses current practices of preventing commercial crime in global markets and it identifies the shortcomings of these practices.

Chapter 5: Prevention as the new norm in BRICS countries

Chapter 5 establishes the philosophical possibility of using preventative methods to impact BRICS's high prevalence of commercial crime. It also critiques the traditional and current role of forensic accountants, with this study's postulation being that there is a much larger demand for preventative tactics and services than for the more traditional *ex post facto* role. A reform or repackaging of the forensic accountant's role is discussed.

Chapter 6: Conclusion and recommendations

A conclusion is drawn regarding whether or not commercial crime may to an extent be prevented by means of implementing different strategies, with specific reference to the BRICS countries. A further recommendation is made with regard to reforming the approach to combating commercial crime, employing a more preventative-centric focus.

2. RESEARCH METHODOLOGY

2.1. Introduction

As stated in Chapter 1, the research methodology of this study is informed by a combination of a standard literature review coupled with an in-depth philosophical analysis of the meta-theory of the subject matter. This is a significant deviation from the commonly accepted technical framework for research (hypothesis-deduction models) undertaken in the accounting sciences. This chapter serves as justification for the combined methodological paradigm used.

In order to fully understand the motivation behind this deviation it is prudent to first explain why it is necessary to rethink the methodology used during business research. To quote the old adage, “Don’t fix it if it’s not broken”, but the argument may however be advanced that it *is* broken.

Hubbard and Murray Lindsay (2013:1377) state that there are numerous complaints about the value of academic business research with regards to addressing real world problems. One of the major reasons to which they attribute this is that of business disciplines subscribing to the notion of a single methodological paradigm, instead of multiple streams of research to supplement the field of knowledge.

The standard hypothesis-deduction model, the traditional research model of choice, “….encourages – in fact, demands, premature theorizing” according to Locke (2007:867). It is exactly this that needs to be safeguarded against: theories defined and finalised over too short a time span, without proper evaluation and testing. This stems from research studies where the researchers feel they need to hypothesise a new theory, collect data, test the theory and conclude everything in the space of one study. To counter this, a methodology needs to be created where theories can, and must, be thoroughly developed, then tested against empirical data and adjusted to stay relevant to the field over the course of many subsequent studies.

The current framework of the accounting field needs to be understood to comprehend the research approach chosen, and therefore a brief explanation of this framework needs to be given.

2.2. Current Accounting Framework

According to the Oxford *A Dictionary of Accounting* (2010), the different fields in the accounting sciences can be defined as:

Financial accounting: "The branch of accounting concerned with classifying, measuring, and recording the transactions of a business. At the end of a period, usually a year but sometimes less, a profit and loss account and a balance sheet are prepared to show the performance and position of a business. Financial accounting is primarily concerned with providing a true and fair view of the activities of a business to parties external to it. Financial accounting may be separated into a number of specific activities, such as conducting audits, taxation, book-keeping and insolvency";

Managerial accounting: "The techniques used to collect, process, and present financial and qualitative data within an organization to help effective performance measurement, cost control, planning, pricing, and decision making to take place";

Auditing: "An independent examination of, and the subsequent expression of opinion on, the financial statements of an organization. This involves the auditor in collecting evidence by means of compliance tests (tests of control) and substantive tests (tests of detail)";

Forensic accounting: "….accounting undertaken in relation to proceedings in a court of law. In such circumstances may be called on to provide expert evidence. Accounting that sets out to determine the nature of past business activity, often on the basis of partial documentation."

Davis *et al.* (2010:55), cited in Chapter 1, demonstrated empirically that forensic accountants focus primarily on independent, *ex-post facto* investigations, while

Fitzgerald (2011:12) described forensic accounting as "…the science of gathering and presenting financial information, on perpetrators of economic crimes, in a form that will be accepted by a court of jurisprudence".

Unfortunately, forensic accounting seems to be located as a sub-heading of accounting, rather than as a full-fledged branch of accounting science in its own right. In this study it is postulated that perhaps forensic accounting deserves its own identity, separate from accounting, and not merely focusing on historic events and court proceedings.

2.3. Paradigm and Lexicon

One of the most influential logical empiricists, Thomas Kuhn, argues in his ground-breaking book *The Structure of Scientific Revolutions* (1970) that science does not evolve according to linear progression. Instead, revolutions, or as Kuhn called them, “paradigm shifts”, occur periodically and rapidly transform the method of scientific inquiry within the specific scientific field.

He argued that these paradigm shifts open up science to new lines of understanding that would not previously have been considered; new lines that could lead to the solving problems in the field more efficiently than had previously been thought possible.

Besides introducing the concept of a *paradigm,* Kuhn (1970:101) also noted that “….insofar as the structure of the world can be experienced and the experience communicated, it is constrained by the structure of the lexicon of the community which inhabits it”.

Kuhn thus proposes that an inadequate terminology may limit the effectiveness of communication within a certain community, leading to failure in the expression of ideas. This can be adapted to mean that an inadequate terminology may also limit the expression of academic ideas within an academic community.

In order to prevent ambiguity or confusion regarding the new direction this study proposes for the field of commercial crime prevention, an innovative terminology must be developed in order to remove the limitations currently in place, owing to the inhibited vocabulary. It is therefore of paramount importance that before future research can be done to address whether the status quo needs to be challenged, a *paradigm,* or *node* first needs to be created within which such research can take place.

Friedman (2001:94) stated that paradigms postulate the empirical possibilities in a given scientific field, and that they are necessary to create a "logical space" for such possibilities to be seriously considered for scientific investigation (Friedman, 2001:95). With such a research proposal as this, it is not sufficient to address the problem statement from within a known paradigm. The key therefore is that a *new* paradigm needs to be created.

A high level analysis needs to be performed in order to refine the creation of the suggested paradigm and lexicon, and the subsequent development of the philosophy and theory of commercial crime prevention.

2.4. The Three Worlds

Popper (1959) proposed to the philosophical community that our world of knowledge consists of three separate worlds:

World 1 is the world of all physical bodies;

World 2 is the subjective state of our minds, the world of all mental and psychological states; and

World 3 is what Popper defined as the products of the human mind. All theorems and other products of the human mind fit here.

Popper further states that all creation which takes place in World 3 is the result of the human capacity of abstraction and generalisation based on observed

phenomena from World 1, and experiences gained from World 2. He argues that all scientific theories are created, not discovered.

In order for new theories about commercial crime prevention to be created, this Popperian abstraction of theories needs to be applied to World 1 observations, as well as the subjective mental states of World 2.

The philosophical practice of thinking about thought, as proposed above, may be likened to a study of a specific field's meta-theory.

2.5. Meta-science

In the philosophical study of knowledge, known as *epistemology*, the term *meta* is used to describe a higher level analysis of theories.

According to *The Concise Oxford Dictionary of Linguistics* (2007) the term *meta* refers to: "….prefix used in terms for constructs or investigations on a higher plane or of a higher order of abstraction. Thus, for theories about theories a study of the character of a science, e.g. linguistics, is a metascience."

The *Pocket Fowler's Modern English Usage Dictionary* (2008) defines *meta* as follows: "In recent use this prefix has been borrowed from the term *metaphysics* and applied to other words with the meaning 'of a higher or second-order kind'."

In the same line of reasoning, a study incorporating a higher level abstraction of the base theorems would be addressing the meta-theory behind the science. It is this link that must be drawn between the World 3 analysis and the meta-theory of the base science of commercial crime prevention. Both these philosophical concepts seek to analyse and expand the foundational principles of a science in order for a higher level understanding to be attained.

The meta-theory for commercial crime prevention has not been developed yet, because it has never been perceived as a standalone concept; rather, it was subjected to the meta-theory of other concepts from the prior accounting

framework. Therefore the basis needs to be constructed from the meta-level downwards, to lay the philosophical groundwork for further studies to develop theories and practical feasibilities.

One way to build these theories is through the above abstraction of known experiences and phenomena. The other method that can, and will be used, is the technique of transcendentalism, introduced by the philosopher Immanuel Kant.

2.6. Transcendentalism

Kant postulated that his transcendental method could reveal the basic conditions of human knowledge. Kant himself defined the concept of transcendental knowledge as follows: “I call *transcendental* all knowledge which is occupied not so much with objects as with the mode of our knowledge of objects, in so far this mode is to be possible *a priori*” (Kant, 1965:A 11/ B 25).

The term *“*A priori*”* as used in epistemology, according to the *Oxford English Dictionary* (2013), means: *“*A phrase used to characterize reasoning or arguing from causes to effects, from abstract notions to their conditions or consequences, from propositions or assumed axioms (and not from experience); deductive; deductively.…Hence loosely: Previous to any special examination, presumptively, in accordance with one's previous knowledge or prepossessions.”

Kant believed that this a priori or transcendental knowledge is created solely in one’s cognitive faculties, and is not influenced in any way by past experiences. This, according to him, is the purest form of transcendental logic.

Relying on these concepts by Kuhn, Popper and Kant refines this study’s philosophical approach to the following: “Insofar as the philosopher of science tries to understand the ways in which scientific problems and theories are rooted in more or less stable, yet changing paradigms in a Kuhnian manner, he can be said to be using a transcendental method in his philosophical reflection” (Philstrom & Siitonen, 2005:93).

Thus, a Kuhnian paradigm and an expanded lexicon need to be created in which new theories for commercial crime prevention may be created. The meta-theory of the science needs to be developed in order to provide a higher level analysis on these theories.

Further to this, a *transcendental philosophical reflection* needs to be combined with the above, as an approach that relies purely on cognitive faculties in order to create knowledge. Mere cognition does not guarantee objectivity, and cognitive faculties therefore need to be carefully employed. This will supplement the analysis of the meta-theory, by evaluating it with a high standard of intellectual objectivity.

As this is a drastic deviation from the normal literature study model for the methodology, the inadequacies of the current model will be discussed.

2.7. Literature study

Based on the theories presented above and viewed within the scope of this study (the development of a new line of science within the accounting field) a mere review of existing literature would harbour several shortcomings, which will be explained below.

Firstly, it would only address existing theories and paradigms, analysing that which has been said before. It would not, as Kant proposed, contain a component based on pure reasoning, but would rather be based on past experiences and existing empirical data. Within the scope of this study, focusing only on empirical data and experiential literature will render the outcome restricted and of less relevance, not adding any measureable value to the epistemology of commercial crime prevention.

Secondly, it would limit the available “logical space” for future research to delve into the matter in order to develop the base theorems and assumptions of the science. There is, within the tight constraints of the technically-centred accounting sciences, little room for philosophical debate. Without creating a new

node from which new research can stem, this study will only serve the purpose of further narrowing the scope of future research because, according to Friedman (2001), paradigms are where new theories are tested.

Lastly, limiting the research methodology to a traditional literature review would render this study's end result a tedious and tiresome read, drawing on obscure and oftentimes near irrelevant theoretical texts in order to try and illustrate a point which has in fact not been proven yet. Opening it up to philosophical debate brings the subject matter to life, with diversely contrasting ideas and open-ended questions in order to stimulate future research and development of the meta-theories of commercial crime prevention and its links to forensic accounting.

Conceding then, that it is not sufficient to merely do a literature review of existing peer-reviewed articles and books, summarising these works and presenting them as a completed research result, as this will not address the dire need for development in the field of commercial crime prevention and forensic accounting. It is for this reason that the author feels sufficiently justified to forego the traditional framework and empirical-based models for research within accounting sciences and to, rather, focus on developing the logical space, or paradigm, which future researchers may extend.

2.8. Conclusion

This study attempts to use the observed phenomenon from the world around us to abstract and deduce new theories in upon which the science may be further expanded. It combines the abstractions and understanding obtained from the above method with transcendental reflections; that is, pure reasoning based arguments. This two-pronged approach of thoroughly analysing existing literature (observed phenomenon), and philosophically debating the meta-science, will hopefully yield the most stimulating and thought-provoking result possible.

Chapter 3 focuses largely on a factual literature study of available resources to elucidate the current nature of commercial crime in the BRICS countries.

Chapter 4 addresses current commercial crime prevention strategies, also reflecting on the philosophy and meta-theory behind current strategies.

Chapter 5 makes the most use of the above discussed methodology, using transcendental reflections to discuss the commercial crime prevention strategies in the BRICS countries and suggests a repackaging of forensic accounting.

As this is only a study to reflect on the meta-theory and philosophy, additional future research needs to be encouraged and stimulated. Methodological authorities such as Popper (1959:45) and Nelder (1986:112) argue that there is virtually no value in the results of a single study, no matter how well constructed it was, or how significant the result was.

Researchers thus need to abstract theories from this study and continue further developing this field of accounting.

3. COMMERCIAL CRIME IN BRICS COUNTRIES

3.1. Introduction

As was indicated in Chapter 1, commercial crime is a problem that has a greatly adverse effect on the economies of BRICS. The fiscal goal of any policymaker for an emerging market should be to preserve or enable a high growth potential of such an economy. While the growth will naturally plateau once the economy becomes more developed, reaching a plateau prematurely could have severe, negative effects on a country's economy. It is already predicted that the period 2012-2016 will see the BRICS markets still growing faster than most developed economies, but at a much slower pace than in the preceding years (Grossi, 2012). This is possibly owing to the global deleveraging forces bearing down on their economies (Neville, 2012:23), which could accentuate managers' desperation to reach their financial goals, in turn, leading to more pressure to commit commercial crimes.

The entry of commercial crime into the economy of a country has the potential of destabilising the political sphere of that country, which may lead to disinvestment by foreign and local investors. A thorough understanding of the nature of commercial crime in BRICS countries will help in determining the scope of preventative strategies that need to be considered.

The World Economic Forum (hereafter WEF) compiles a Global Competitiveness Report (WEF, 2012). This report analyses 12 different pillars of competitiveness, each consisting of different factors. Each of these factors is analysed, graded, and compiled to develop a country's final ranking. This competitiveness ranking is an indicator of many issues, including factors such as the quality of education, infrastructure and health care. Of particular interest to this study, however, is the first pillar - examining the institutions. The factors below were chosen from the first pillar of the 2012-2013 WEF Global Competitiveness Report for comparison between the BRICS countries. The comparison was made on the basis of directly addressing factors influencing the prevalence of commercial crimes. These factors also lend structure to the discussion of five vastly different countries which, if left unordered, could result in an unwieldy chapter:

- Irregular payments and bribes;
- Favouritism in decisions of government officials;
- Organised crime;
- Ethical behaviour of firms (in this study, included in the category of fraud);
- Strength of auditing and reporting standards;
- Efficacy of corporate boards (including corporate governance).

	Brazil	**Russia**	**India**	**China**	**South Africa**
Global Competitiveness Rank (out of 144)	**48.0**	**67.0**	**59.0**	**29.0**	**52.0**
Population (in millions)	**199.7**	**147.1**	**1250.2**	**1367.0**	**50.8**
GDP (in billion US$)	**2 493**	**1 850**	**1 676**	**7 298**	**408**
GDP per capita (in US$)	**12789**	**12993**	**1389**	**5414**	**8066**
GDP as percentage of world total	**2.9%**	**3.0%**	**5.6%**	**14.3%**	**0.7%**
Ranking in selected factors (out of 144 countries)					
Irregular payments and bribes	**65**	**120**	**99**	**67**	**47**
Favouritism in decisions of government officials	**80**	**127**	**92**	**34**	**110**
Organised crime	**122**	**114**	**81**	**98**	**111**
Ethical behaviour of firms	**84**	**119**	**81**	**58**	**48**
Strength of auditing and reporting standards	**42**	**123**	**44**	**72**	**1**
Efficacy of corporate boards	**38**	**124**	**75**	**91**	**1**

From the above 6 factors taken from the WEF report, the following sub-headings were determined and are discussed for each of the BRICS countries. These sub-headings were determined on the basis of presenting a meaningful overview of commercial crimes and factors influencing the prevalence thereof:

1. Corruption: the discussion centres on the occurrence of bribery and favouritism. Relevant anti-bribery and anti-corruption legislation from the countries are also compared.
2. Organised Crime: focuses on the prevalence and severity of existing organised crime structures participating in money laundering activities within the countries, as well as on legislation dealing with this problem.
3. Fraud: discussed with reference to recent, reported fraud in the BRICS countries, as well as comparing the general prevalence of fraud.
4. Audit and Reporting Standards: discussed to determine the similarities between these countries, as well as the degree of their convergence with international standards such as the International Financial Reporting Standards (IFRS).
5. Governance: analysed on the basis of codes of governance implemented in each of the countries.

3.2. Brazil

Brazil is the most popular of the BRICS countries with regard to foreign direct investments (O'Neill, 2011:47). During the global recession, when the rest of the world markets crashed, Brazil saw a boom, indicating just how strong its economy was becoming, on the back of its leaders implementing expansionary policies, inflation targeting, and other clever fiscal policies (O'Neill, 2011:48).

It boasts abundant natural resources, leading to huge potential as one of the BRICS countries (O'Neill, 2011).

In terms of GDP, Brazil overtook the United Kingdom as the world's sixth biggest economy in 2011, with its GDP of $2.5 trillion (Coulton, 2012:100).

These facts all cement the inclusion of Brazil in the grouping of strong emerging markets. There are, however, several factors that could detract from this strong growth potential.

3.2.1. Corruption

According to the WEF report, the 7th most problematic factor for doing business in Brazil is corruption (WEF, 2012:116). Corruption costs Brazil roughly 2.3% of its GDP annually, approximately US$146 billion (E&Y, 2012:20).

Most of the corruption in Brazil entails the bribing of public officials. Refusal to pay bribes for contracts in Brazil is virtually regarded as a barrier to entry (E&Y, 2012:20).

Hernandez and McGee (2013) found that bribery was culturally more acceptable in Brazil than in the other two Latin American countries (Argentina and Colombia) which they studied.

Bribery is currently only defined in the Brazilian Criminal Code (Act 2.848 of 1940), although as yet Brazil does not have specific legislation tackling the issue of corruption (Varriale, 2012:6). While the Brazilian National Congress is in the process of evaluating two new bills that would effectively comprise anti-corruption legislation, it will still be a long time before they are approved (CMS, 2013:11). They are the draft "The Anti-Corruption Law" and "The New Brazilian Criminal Code". Under the current Criminal Code companies cannot be held liable for bribery offences; only individuals may be prosecuted. There is also no section dealing with private bribery (the defined offence only applies to the bribing of public officials). The new bills would criminalise private bribery, and make companies criminally liable (CMS, 2013:11). These new bills, if implemented effectively and consistently, could help to alleviate the bribery problem in Brazil.

Recently, a major media corruption case has made headlines in Brazil. Known as the *Mesalao*, or "big monthly allowance case" (Variale, 2012:6), this case revealed that there has been sustained corruption in Brazilian politics, where elected politicians formed a cabal and distributed public money, via monthly allowances, to opposition parties in order for them to vote with these politicians in support of government proposals (Varriale, 2012:6).

Other than bribery, one of the major contributors to pervasive corruption in Brazil is favouritism. Dunlap *et al.* (2012) compiled an appendix with culturally based favours in BRICS countries. Favours are used extensively throughout the BRICS countries to establish working relationships, conclude deals, obtain jobs, etcetera. On the whole, these favours, according to the Western perception, are regarded as thinly veiled bribes and nepotism.

In Brazil, the use of *jeito* or *jeitinho* is a distinguishing feature of Brazilian culture. In Child *et al.* (2009:212) the authors describe it as "….a particular way in which Brazilians are able to bend rules in their favour and overcome major obstacles". *Jeitinho* has been celebrated by many as flexibility in doing business and organising. However, if stretched too far, *jeitinho* may raise serious legal and ethical issues in which foreign companies prefer not to get involved (Rodrigues & Barros, 2002).

Brazil also has the tradition, which hails from their Portuguese heritage, called *agrado.* While this literally just means a thoughtful and small gift expressing gratitude, in practice, this has become a sum of money paid that facilitates the speedier resolution of problems, or facilitation payments (Arruda *et al.*, 2006:36).

3.2.2. Organised crime

This pervasive problem of corruption also has a direct impact on the success of organised crime, as it depends largely on the corruptibility of public officials (Sverdlick, 2005:90). The problem is that the same officials that are supposed to be preventing corruption are also the ones laundering money that they received in bribes (Sverdlick, 2005:88).

One of the main problems that Brazil faces with regard to combating organised crime is its borders shared with Argentina and Paraguay. This tri-border area is well-known for its smuggling and money laundering, facilitated by the porous border (Sverdlick, 2005:87). Colonel Robson da Silva (2012:177) states that the drug trafficking problem in Brazil is a major transnational criminal problem. Weak and ineffective controls implemented by government facilitate the

infiltration of so called “criminal entrepreneurs” into the system (Sverdlick, 2005:91).

“Laundering money is the ’means’ through which organized crime, transnational terrorists, and corrupted public functionaries can succeed in their illegal activities” (Sverdlick, 2005:87). They use multiple transactions to move the “dirty money” into the legitimate financial market, whereafter they can use it as they please, having disguised the origin of the money.

Brazil signed a new law, the Anti-Money Laundering Law, into effect in July 2012 (Catlett, 2013). The previous Brazilian AML legislation was limited in its reach because the offence of money laundering was predefined and only linked to certain offences. The new law expands this scope so that money laundering now includes the concealment of the proceeds of any criminal offence (Catlett, 2013).

3.2.3. Fraud

Pervasive fraud has a significant impact on the fiscus of Brazil; according to a report by the Secretariat of Economic Law the government loses up to US$20 billion annually because of fraud in government contracts (Economist Intelligence Unit, 2007:1).

E&Y (2012:20) reports in its 12th annual global fraud survey that “….fraud, bribery and corruption are significant issues in Brazil”. Brazil is hosting the 2014 Soccer World Cup as well as the Olympic Games in 2016. There have been fraud allegations made against high profile dignitaries involved in the organisation of both these events; attracting negative attention from the world media (E&Y, 2012:21).

3.2.4. Audit and reporting standards

Brazil is one of the few countries that have fully adopted the IFRS (Carvalho and Salotti, 2013:235-236) with the exception of only a couple of delayed standards which will come into effect soon. According to Lopes (2011:344), the reception of the IFRS among companies was relatively good.

For companies, full adoption of IFRS became optional by 2009, but by 2010 it became a mandatory requirement by the Securities and Exchange Commission of Brazil for all firms under their supervision (Broedel Lopes, 2011:344).

Brazil still faces many challenges with regard to its IFRS convergence, in particular, the focus that now falls (as opposed to its old local accounting system) on informing external users and using the basis of economic substance for transactions (Broedel Lopes, 2011:346).

The main difficulty with IFRS and IAASB convergence is the complexity of some of the standards (especially relating to deferred tax and derivative instruments). Auditors in developing nations often struggle to understand the English standards, and translation is a difficult process as some of the English terms used do not even exist in foreign languages (Morris, 2006).

3.2.5. Governance

Prior to 2000, there were major concerns over the protection of minority shareholders, which was seen as weak in Brazil (Black, De Carvalho and Sampaio, 2012:2). The São Paulo Stock Exchange set out to create three markets with higher levels of governance (Novo Mercado, Level I and Level II). Black, De Carvalho and Sampaio (2012:2) report that governance practices in Brazil significantly improved from 2004 to 2009, mostly owing to firms with higher governance principles listing on the new markets. Alexandru *et al.* (2008) praised the implantation of the Novo Mercado high-governance market in Brazil.

3.3. Russia

Russia is an enthusiastic proponent of the BRICS group, even hosting the first summit for the BRICS heads of state and government in 2009 (Rowlands, 2013:635), yet it is also one of the BRICS countries that analysts are generally less optimistic about (O'Neill, 2011). Fund managers and economists are discouraged by Russia's atrophying demographics, endemic corruption and the Kremlin's policies (Farzad, 2010).

Detractors point to the above, adding that there is an excessive dependence on raw materials and energy. This situation is compounded by a weak legal system and poor governance (O'Neill, 2011:57).

3.3.1. Corruption

According to the WEF, the foremost challenge to doing business in Russia is corruption (WEF, 2012:304).

Laura Brank, a partner working in the London and Moscow offices of the international law firm Deschert, affirms that corruption is part of the Russian culture. She says that "….there's this feeling that the good times will end, so people try to make as much money as they can in the short term" (MacFadyen, 2011). This attitude is counterproductive to the socio-economic goals of these countries, as the focus for the BRICS countries should start shifting to the sustainability of their growth, not the short-term enrichment of a few key individuals.

Osuntokun (2006:6) states that it is not enough for governments from first world countries to advise governments from developing countries to do more about confronting corruption. The worst offenders with regard to corruption, and especially bribery, are emerging economies, such as Brazil, Russia, India and China.

Major Western corporations entering Russian markets must do so with the knowledge that the odds are very good that they will encounter, and be caught up in, corruption on their way to success. Firms like Ikea, Starbucks, Daimler and BP have seen executives threatened, their operations infiltrated by gangs or even shut down, all because of resisting the culture of corruption in Russia, or for refusing to pay kickbacks (Behar, 2012:123).

A PwC survey showed that in terms of employee theft and extortion by public officials, Russia has the worst statistics globally. PwC further asserted that the occurrence of government grafts in Russia is double the global average, with 48% of responding Russian executives reporting bribery or corruption during the last 12 months (Nicholson, 2009:1).

Russia has several laws dealing with corruption, including legislation that was only recently passed into law. The primary new one is the Federal Law on Anti-Corruption, which came into effect on 1 January 2013. This makes provision for prosecuting the bribing of public officials as well as the management of commercial companies.

Semins and Yasinow (2013:2) state that this new Russian anti-corruption legislation shares features and scope with the US Foreign Corrupt Practices Act (FCPA) and the UK Bribery Act. There are also certain measures prescribed to companies in order to prevent corruption, such as "….appointing a compliance officer or a compliance department to be responsible for preventing corruption and related offences" and "….developing and implementing standards and procedures aimed at doing business in good faith" (CMS, 2013:33). The previous Russian anti-corruption legislation did not impose any obligations on organisations to implement anti-corruption measures (Semins and Yasinow, 2013:1), so this new law imposed by the Russian government may be regarded as a major improvement, if implemented correctly.

With regard to favouritism, Russia uses what is known as *blat* or *sviazi*. *Blat* is the Russian term for "….an unofficial system of exchange of goods and services based on principles of reciprocity and sociability" (Fitzpatrick, 2000). *Sviazi* is the Russian word for "connections" (Yakubovich, 2005). Using *blat* or *sviazi* within one's personal network of family and friends, as well as different institutions one belongs to, is culturally expected. This leads to undue influence being exerted at times in order to maintain the reciprocity principle of these networks.

3.3.2. Organized crime

Russia signed an undertaking to become a party to the United Nations Convention against Transnational Organized Crime (UNTOC) in November 2000 (Burger, 2009:62). Besides its perpetually corrupt government officials, Russia additionally harbours highly organised and sophisticated crime groups (Burger, 2009:41). Moreover, Russia, until recently, had not yet implemented or

developed an effective system to combat money laundering, or an anti-money laundering (AML) system.

The Financial Action Task Force (FATF) performed an assessment of Russia's AML system compliance with the FATF recommendations. Their finding was that Russia was one of the worst performing countries with respect to preventing and combating money laundering (FATF-GAFI, 2008). In the 6th report that FATF compiled on the Russian Federation's compliance with its AML recommendations (FATF-GAFI, 2013), FATF however found that Russia has addressed many of the deficiencies previously reported on (FATF-GAFI, 2008).

Governmental officials are supposed to help combat the spread of corruption and money laundering, but there appears to be no action taken, when those profiting from the laundering of the funds are Russian politicians or members of the economically elite group (Burger, 2009:58). One of the other main reasons why money laundering is so pervasive in Russia is the fact that its banking sector is not yet highly developed.

3.3.3. Fraud

Findings by PwC in their 2009 report revealed that Russia reports the highest prevalence of company fraud globally, with 71% of all companies reportedly being the victims of fraud. One of the legacies remaining from Russia's economic transformation is that individuals, especially powerful "oligarchs" (individuals at the head of empires, owning numerous other companies), use fraudulent practices to enrich themselves (Beitman, 2013:2).

A study carried out by the Russian Chapter of the Association for Certified Fraud Examiners (ACFE, 2011) found that that the second most significant threat to business, according to the experts they interviewed, was fraud, second only to commercial corruption, as discussed above. Many of Russia's largest enterprises are in natural resources, and generate revenue through exporting these. Burger (2009:47) states that this revenue is being skimmed off and deposited in foreign bank accounts.

The ACFE also concluded that the percentage of annual turnover lost through fraud is, on average, 15.8% for Russian companies. More than half the respondents were of the opinion that the fraud level in Russia is rising (ACFE, 2011). This is a staggering statistic for a country with a GDP of US$1850 billion, translating to an estimated fraud loss of over US$280 billion.

The two most significant causes of the pervasive fraud in Russia are the top management's indifference towards combating fraud and the flawed legislation, making it difficult to prove guilt and liability (ACFE, 2011).

3.3.4. Audit and reporting standards

The previous Russian accounting reporting standards were sub-par with regard to the quality of disclosure required by IFRS (Bagaeva, 2008:158). As indicated, Russia only started officially endorsing IFRS after 25 February 2011 (Use of IFRS by jurisdiction, 2012), but it has not yet replaced the old standards and companies are required to now prepare two sets of consolidated financial statements.

3.3.5. Governance

In Russia, 40% of its industry is still controlled by only 22 business groups, who are themselves owned by aforementioned oligarchs (Beitman, 2013). Conflicts do not normally arise between shareholders and managers, but rather between majority and minority shareholders. As indicated, Russia has weak legal institutions, a government that uses its influence on businesses to further its own private interests and a poorly developed corporate governance structure. Russia does however offer potentially great returns if and when the dormant value is unlocked, but is also a great risk for foreign companies wanting to invest in Russia (Woeller, 2012:1334).

Russia released a revised draft of its new corporate governance code in 2013 which is expected to be adopted in the summer of 2013. This new code has substantially more closely aligned the Russian corporate governance structure to global standards.

However, as may be seen from the WEF report (WEF, 2012:304) Russia has a history of deficient implementation of its existing corporate codes, so there is reason to doubt whether the updated code will bring any real changes to the implementation thereof.

3.4. India

India is the BRICS country with the most favourable demographics. To put this into perspective, over the next two to three decades it may increase its working population by the same number of people who currently live in the United States of America, namely 300 million (O'Neill, 2011:70). Predictions point to India possibly increasing its economic size thirty fold by the year 2050.

Unfortunately, the unrivalled growth potential competes with severe poverty, endemic corruption and slow bureaucracy, making it extremely difficult to carry on a trade (O'Neill, 2011:75). Bhattacharyya and Jha (2011:2) also observed that corruption and economic growth, in the 20 Indian states they investigated over the period 2005 to 2008, are negatively related. Although they concluded that this might not be a direct causal relationship, they are not the first to have made this connection. Mauro (1995) argued that corruption discourages investments and that this has a damaging effect on growth in the long term.

3.4.1. Corruption

The overwhelming statistics concerning corruption may be viewed with reference to the World Economic Forum's Report, stating that in India the second most problematic factor for doing business is corruption (WEF, 2012:198). According to Antoine van Agtmael (2012), author of *The Emerging Markets Century*, corruption in India, the world's largest democracy, still overwhelms politics.

The findings of KPMG in their 2012 India Fraud Survey (KPMG, 2012) indicated that 71% of respondents to their survey, 293 chief executive officers from Indian companies, believe that commercial crime is an inevitable cost of doing

business in India. 83% of their reported cases involved bribery and corruption, while 59% also involved financial statement fraud.

India has promulgated a law, “The Prevention of Corruption Act 1988” that governs offences relating to corruption, and has tabled “The Prevention of Bribery of Foreign Public Officials and Officials of Public International Organisations Bill 2011” before parliament for approval. This new bill, which is still pending final approval (Press Information Bureau, 2013) will specifically punish the offering and acceptance of bribes to/from foreign public officials or public international organisations. This is in line with international legislation such as the UK Bribery Act and the US FCPA that will be discussed in Chapter 4. However, India’s weak institutional enforcement detracts from the promising legislation.

In India there is prevalent favouritism, or *Jaan-pehchaan*, loosely translated as “….you get something done through somebody you know”. Bhat *et al.* (2005) define *jaan-pehchaan* as “….who you know” and emphasise that this concept reinforces the importance of “familiarity” and the “right connections” in order to improve one’s business prospects. Schuster (2006:413) found that it is difficult for outsiders to do business in India, as its society favours *jaan-pehchaan* business connections: those based on gender, language and religion.

3.4.2. Organised crime

Organised crime in an Indian context mostly involves illegal drugs, arms and human trafficking as well as money laundering (Chandran, 2003:1), the most prominent of these being illicit drug trafficking (Singh, 2012:572), the epicentre of which is Mumbai, the commercial capital of India, where it is worst (Singh, 2012:570).

One of the Indian mafias’ biggest growth activities has become property and real estate development, aggravating the rising land prices (Weinstein, 2008:26). Construction activities have become a fertile environment where builders are used to launder money (Singh, 2012:571).

There is also an exponential growth in the prevalence of cybercrime related incidences, with many Indian syndicates expanding their operations to include this too (Singh, 2012:582).

Besides money laundering, currency counterfeiting is also a major problem in India, with new technological developments allowing gangs to produce notes which look very similar to legitimate currency (Singh, 2012:582).

Many of the gangs additionally specialise in so-called “protection money”, where they charge citizens and business owners money for protecting them from other gangs (Singh, 2012:571).

The Indian government ratified a United Nations convention relating to transnational organised crime (United Nations Convention against Transnational Organized Crime – UNTOC) in May 2011 (Press Information Bureau, 2011). This Convention is the first global, legally binding instrument, to specifically address and combat crime of this type.

3.4.3. Fraud

There has been an increase in the number of major frauds reported in India over the last few years. These include cases like the Satyam Computer fraud, estimated at US$3 billion, and the interbank lending rates manipulation, estimated at several hundred billion dollars (KPMG, 2012:6). Shareholders in India companies had already lost more than US$2 billion from fraud and poor governance, even before the said Satyam scandal in 2009 (Rajagopalan and Zhang, 2009:545).

The biggest rising fraud risk for India is cybercrime, followed by counterfeiting and piracy, followed by identity theft (KPMG, 2012:28). Investigators have been challenged by the increasingly sophisticated fraud schemes over the last couple of years (KPMG, 2012:10).

Ahmad *et al.* (2010) state that the Satyam fraud scandal is the biggest corporate fraud scandal in India’s history, and has even been equated with, and referred to, as “India’s Enron” (Bhasin, 2011:28). The Satyam fraud continued for almost 9 years and involved both the manipulation of income statement and balance

sheet items. During this time their auditors, PwC, failed to uncover any of the fraudulent activities (Bhasin, 2012:34).

3.4.4. Audit and reporting standards

While the Institute of Chartered Accountants of India (ICAI) made the decision to formally implement IFRS-convergent Indian Accounting Standards from April 2011 in India (Bhutani & Srivastava, 2012:7), as noted the effective date has been deferred without a new date being announced (*Use of IFRS by jurisdiction*, 2012).

The results of Bhutani and Srivasta's study (2012:27) however indicate that companies are not yet on a par with the required conversion process. Most of them are still unsure about the contents of IFRS, and what they need to change to comply. The authors also find that the problem in India is not the implementation of IFRS, but rather the training of Indian accounting and other finance professionals. Better awareness about IFRS is required in order to successfully complete the conversion.

3.4.5. Governance

Even though India's old corporate governance system provided excellent investor protection *on paper*, the significant corruption and overburdened courts were detracting from this (Charabarti *et al.*, 2008:23). Organised crime in India has typically thrived on this poor governance (Chandran, 2003:1).

In another instance, the said Satyam scandal violated all the rules for good corporate governance during the course of the fraud (Chakrabarti *et al.*, 2008:59). It failed completely in respect of protecting the interests of its shareholders and stakeholders, while this same corporate, Satyam Computer Limited, won awards for the company that was best governed in 2007 and 2009 (Bhasin, 2012:27). From this, Bhasin (2012:37) concludes that there is a dire need for corporate governance principles to be stronger and better implemented.

The Securities and Exchange Board of India launched into an initiative to try and achieve just that. They plan to strengthen the corporate governance

standards of India for publicly traded companies, and have proposed a number of changes (Mukherjee, 2013). These changes include, *inter alia*, new legislation as well, making it compulsory for companies to have a specifically appointed individual fulfilling the role of chief executive and chairman (Mukherjee, 2013; Raja, 2013). Although this is already common practice in many companies applying the Anglo-Saxon governance model, the development is welcome in India.

3.5. China

China is the world's largest, non-democratic country (O'Neill, 2011:81), ruled by a communist regime. Zwieg (1999) labelled China as an "undemocratic capitalist" country. China's economic progress surpassed even Jim O'Neill's predictions, in that its GDP was US$1.3 trillion in 2001, the size of France' GDP, while by 2011 it had increased to US$7 trillion, or the size of both France and Germany's GDP together (Coulton, 2012:100). It overtook the GDP of Japan, and is now the world's second largest economy, next to the USA (Morrison, 2013:1).

However, Balding (2013) authored a report in which he states that some of China's GDP figures are "blatantly fraudulent", asserting that inflation data is "wilfully fraudulent", concluding with his estimation that its real GDP should be reduced by at least US$1 trillion.

One of the factors that will have a severe detrimental effect on the growth potential of the BRICS countries is their unfavourable demographic trends (Farzad, 2010; O'Neill, 2011). China's slowing population growth is largely owing to its one child policy (Coulton, 2012:103). This sets a limiting factor on the economic growth rate, as its working population is aging and is set to peak soon. China can only expand as fast as it can increase economic productivity.

According to the WEF report (WEF, 2012:138) China rates poorly in organised crime, the strength of its auditing and reporting standards and the efficacy of its companies' boards.

3.5.1. Corruption

According to the WEF report (WEF, 2012:138) the fifth most problematic factor for doing business in China is corruption. Third is policy instability and fourthly, its inefficient government bureaucracy. Government officials often indicate that corruption within the realm of the Chinese government is the greatest threat facing the state (Morrison, 2013:34).

China has a little legislation dealing with corruption and bribery; most notably the People's Republic of China (hereafter PRC) Criminal Law; PRC Anti Unfair Competition Law and the Interim Rules of the State Administration for Industry and Commerce on the Prohibition of Commercial Bribery (CMS, 2013:15). These laws deal with both active and passive bribery: where active bribery is paying a bribe to public officials or private sector personnel to gain improper benefits and passive bribery, more commonly referred to as kickbacks, also exists. Small gifts, amounts deemed to be "reasonable", do not constitute an offence. This can be exploited as this "reasonability" threshold is not clearly defined.

Expanding on this small gift, China also has the favouritism practice of *guanxi*. *Guanxi* is translated as *guan*, to do someone a favour, and *xi*, to extend long-term relationships. While traditional *guanxi* connections were centred on family and friends, in business there is a much more utilitarian aspect to forging these long-term relationships (Fan, 2002). Michailova and Worm (2003) describe the ultimate goal of *guanxi* in business networks as granting favours when "the going is good" (when things are running smoothly) and seeking reciprocity in times of need. These "favours" oftentimes exceed the reasonable threshold stipulated by legislation and constitute bribes.

3.5.2. Organised crime

Organised crime has been considered a serious problem in China for centuries (Antonopoulos, 2013:1; Wang, 2013:49). Among its organised crime groups, the members are mainly ordered into mafia-like gangs, traditionally known as *triads*. These criminal organisations have infiltrated society all across the world,

and engage in counterfeiting, extortion, human and drug trafficking and other offences (Berry *et al.,* 2003).

Government officials serve as political back-up for the gangsters (Wang, 2013:50). "Red Mafia" is a term that has been attributed to corrupt public officials, who use and sell their power to supply extra protection for the criminal underworld (Wang, 2013:69). Organised crime gangs, such as the triads, require protection from prosecution. The main pieces of legislation dealing with organised crime structures in Hong Kong are the "Societies Ordinance" and the more recently instituted "The Organized and Serious Crime Ordinance". These laws have been used to tackle the triad problems that mainland China faces (Kwok & Lo, 2013:90).

Political corruption has been a driving force behind the strengthening organised crime network in China over the last decade (Chin & Zhang, 2007). Due to this corruptible governmental structure and the lack of the rule of law, many mafia-like groups in the structures of government have themselves formed that serve this need by abusing their power to provide legal protection to the underworld (Wang, 2011).

One of the major organised crime activities in China, besides money laundering, counterfeiting and drugs, is human smuggling (Chin and Zhang, 2008:182). Antonopoulos *et al.* (2013:31) state that in the last decade a new area of crime, that of trafficking in children, has emerged. Members of the Chinese criminal underworld consider it a profitable business, more so than trafficking in women (Zhang, 2006:19).

Just as China's economy is going from strength to strength, so too are its transnational criminal enterprises (Chin and Zhang, 2008:177). Berry *et al.* (2003:47) note that "….law enforcement authorities in many countries have come to the conclusion that the transnational activities of ethnic Chinese criminal groups constitute a serious threat to the societies where such groups have gained a foothold".

3.5.3. Fraud

China is well known for fraudulent activities among companies listed on its capital markets (Ding *et al.*, 2009:562; Li and Wu, 2007:6), experiencing an increasing number of corporate fraud scandals over the last few years (Firth *et al.*, 2005:367).

Ding *et al.* (2009:563) explain that in China, a listed company is given a "special treatment" order if it has been operating with a deficit for two years consecutively. This order declares the company as one which may possibly be delisted. Firms, and especially their managers, are motivated to manipulate their profits out of fear of receiving such a "special" notice, as this may negatively influence the market's perception of their value.

China's socio-economic climate is unfortunately ideal for fraud to be perpetrated. It has weak legal enforcement and investor protection, and the media and labour unions are tightly controlled (Chen *et al.*, 2013:72). This leads to poor transparency and public accountability.

In recent years China experienced bank fraud to the value of US$1.1 billion (Goodman, 2006); international company, Caterpillar, had to write-down US$580 million after realising the company they acquired had fraudulently misstated its financial statements (Boesler, 2013) while, according to Haixin *et al.* (2012:1) the online fraud exceeded US$850 million in 2011. The total value of fraud perpetrated in the securities and futures markets is estimated at over US$30 billion since 2002 (Dasgupta, 2010). Recently, credit card fraud has become one of the main financial crimes perpetrated in mainland China (Bai and Chen, 2013:267).

3.5.4. Audit and reporting standards

China implemented the Chinese New Accounting Standards on 1 January 2007 (Chen *et al.*, 2012:27). This change included major revisions of the basic standards and also, in an effort to converge Chinese accounting with the IFRS, the adoption of 38 new accounting standards, or Accounting Standards for Business Enterprises (ASBE's) as mentioned in 1.1.1. A few standards are not

yet converged, most of which are those that reflect China's accounting profession's caution in allowing some of the discretionary-dependent IFRS to be implemented (Peng and van der Laan Smith, 2010:30). It was also made mandatory for firms to adopt these new IFRS-convergent standards (Bu *et al.*, 2013:78). This attempt of harmonisation of accounting standards with the rest of the world has been welcomed by investors and financial analysts, who feel that the implementation of IFRS-like standards will improve the attractiveness of Chinese listed firms for the global market (Chen *et al.,* 2012:27).

Harless *et al.* (2008:448) state that this convergence of China's accounting standards has at least created an environment for effective convergence of accounting practice.

Bu *et al.* (2013:90) however, point out that the IFRS-convergent ASBE are incompatible with the Chinese economic and institutional environments and full convergence will be difficult to implement effectively.

3.5.5. Governance

As is evident from the WEF report (WEF, 2012:138), China has the second weakest governance structure, in terms of measures of the efficacy of a company's board, second only to Russia. Goa and Kling (2012:19) state that China is trying hard to reform its corporate governance, with its current "Code of Corporate Governance for Listed Companies in China" clearly defining requirements that mandatorily need to be disclosed in a focused effort to try and improve board transparency and efficacy. Despite its poor governance environment and weak legal system, China still manages to generate much foreign direct investment, largely because the growth potential remains worth the risk for investors (Li, 2005:297).

Gu and Humphrey (2008:288) discuss the fact that as China is becoming more and more of a driving force in the global market, it will also become a global governance force. China's global influence cannot be denied but many improvements need to be made to the Chinese corporate governance structures before it will be able to be a driving example for the global market.

3.6. South Africa

South Africa is the latest country to join the BRICS group, and also one of the most controversial. Jim O'Neill himself, author of the article that inspired the wide use of the acronym BRIC, has major reservations relating to the inclusion of South Africa. O'Neill's arguments are based on the fact that according to his original specifications for big emerging markets, South Africa does not even qualify. South Africa ranks 5th amongst the BRICS countries in both population (50.8 million, whereas the average is over 600 million) and GDP (US$ 408 billion, whereas the average is US$ 2 745 billion).

During his keynote speech at the 10th annual conference of the African Venture Capital Association, held on the 9th of April 2013, Jim O'Neill stated:

"In one year, China's GDP increased by $1.4 trillion. This translates into creating another South Africa every four months. For South Africa to belong to BRICS – and being in the same club as China – is quite something," he said. "In that context your political leaders deserve an enormous amount of credit for persuading them to allow you in."

"But to be really big as an economy you need lots of people. South Africa doesn't have that many people."

Many other detractors exist with regards to South Africa's inclusion. However, looking at the information from the WEF Report (WEF, 2012) can help clarify perhaps why they might have been included. South Africa is the world leader in auditing and accounting, in terms of the strength of the standards and their application. It also has the King Code of Corporate Governance that governs how corporations should approach the issue of good governance, as is later discussed.

Even though South Africa (and Brazil) was largely not affected as much by the recession as the other BRICS countries, it nevertheless saw a large decrease in growth figures as well as expectations. According to Nick Chame, head of emerging market research at RBC Capital Markets, "What happened in South

Africa was a domestic event linked to the ANC leadership convention. It has nothing to do with global pressures." (Neville, 2012:23).

3.6.1. Corruption

Corruption is recognised as one of the main challenges facing the South African public sector (Naidoo, 2012:656; Quinot, 2013:218). While Burger *et al.* (2012:8) reported that commercial crime (corruption, fraud, money laundering, and embezzlement) has been increasing consistently year-on-year. 88 050 cases were reported during 2011/2012, they also state that the public and private sectors are both known to be notoriously bad at reporting incidents to the police. The actual rate of occurrence of commercial crime is commonly accepted to be substantially higher than the reported cases (Burger *et al.,* 2012:8).

In South Africa, corruption concerning public procurement is such a common occurrence that the term “tenderpreneurs” has been jokingly used to describe officials involved in these cases (Quinot, 2013:215).

Corruption and the police involvement in organised crime are two of the major contributors to the state crisis (Volkov, 2006:331).

South Africa implemented transformational policies such as black economic empowerment (BEE) and affirmative action (AA) shortly after the advent of democracy in 1994 (Kruger, 2013:19). What BEE and AA amount to is preferential treatment of previously disadvantaged persons or groups, with the aim of restoring inequalities perpetrated by the previous apartheid regime (Kruger, 2013:19).

Referring to the very prominent public case of the Gupta family commandeering a private military airbase to land their private aircraft in order to transport their wedding guests, the Secretary General, Gwede Mantashe, of the African National Congress (the governing party of South Africa) blamed “name-dropping” as the cause. This is a common problem in this country, with many public officials willing to act just because the name of a powerful politically involved person was used, without following due course and acquiring the appropriate authorisation (Newham, 2013).

Newham (2013) additionally states that there is a general weakening of the rule of law in South Africa. For instance, South African Minister of Intelligence, Siyabonga Cwele, allegedly stopped investigations into the Gupta case because members of the family were friends of the President Jacob Zuma.

This prevalence of cronyism, favouritism and nepotism is the main contributor to the alleged R30 billion (more than US$3 billion) that is misappropriated from the state each year (Newham, 2013).

3.6.2. Organised crime

Organised crime in South Africa is mostly dominated by car theft syndicates, armed robberies and drug trafficking (Volkov, 2006:330). An influx of foreigners into South Africa also stimulated an illegal trade in arms, as well as drug trafficking into and out of South Africa (Reitano & Shaw, 2013:12). South Africa is also one of the transhipment points in Africa which facilitates the smuggling of illegal substances, both to and through the country's harbours (Adamoli *et al.,* 1998:30).

Unlike traditional mafia groups, South African criminal groups are structured in "….loose and shifting associations and alliances with others or in a network without clear hierarchy" (Goredema, 2003:2).

South Africa's state agencies have also been corrupted by organised crime. In July 2010, the country's police commissioner, Jackie Selebi, also former head of Interpol, was convicted of being corrupted by drug traffickers and was sentenced to 15 years imprisonment (Reitano & Shaw. 2013:15).

South Africa's legislation dealing with the prevention of organised crime is known as the Prevention of Organized Crime Act 121 of 1998. The Asset Forfeiture Unit, a division of the National Prosecuting Authority, plays a very important role in combating organised crime by seizing property that was wrongfully gained by criminals. Its purpose is to decrease the profitability of crime (Kruger, 2008:9).

3.6.3. Fraud

By means of responses to his questionnaire, Makgabo (2007) found that there are gaps in the fraud prevention measures for South African companies. He mentions that there is not an acute enough focus on proactive measures, namely fraud risk assessments and data mining tools and that employees are not receiving adequate ethics training either.

Budgram (2012:31) cited the South African Banking Risk Intelligence Centre (SABRIC) as reporting that credit card fraud had increased 53% year-on-year from 2010 to 2011. From 2011 to 2012 the prevalence of such fraud decreased (SABRIC, 2012:3). In 2013 Nyambura-Mwaura from Reuters (2013) reported that South African banks had recently been defrauded through fraud syndicates stealing credit card details through point-of-sale terminals, to the value of millions of dollars.

3.6.4. Audit and reporting standards

South Africa fully endorses IFRS as adopted by the European Union (Use of IFRS by jurisdiction, 2012). From the WEF Report (WEF, 2012:324) it may also be seen, as earlier commented, that South Africa has a very strong auditing and reporting framework, relying on internationally accepted standards.

3.6.5. Governance

To gain an understanding of the corporate governance principles of the South African business sphere, reference to the King Code of Corporate Governance for South Africa (IoDSA, 2009) - colloquially known as King III - is essential. This code is prescribed and recommended by the newly implemented Companies Act (South Africa, 2008).

King III focuses on a stakeholder approach as opposed to the simpler shareholder approach, and also has a system of *apply or explain*, meaning a firm can still be compliant even if it does not follow the Code precisely, as long as it explains its deviance. King III also calls for integrated reporting and disclosure, where financial information is reported together with sustainability issues of social, economic and environmental impact (KPMG, 2009:2).

As can be observed from the WEF report (WEF, 2012:324) South Africa ranks the highest worldwide for the efficacy of its companies' boards, largely due to the effective implementation of King III.

3.7. Conclusion

According to Atale (2012) all the BRICS countries are exposed to the same systemic issue of corruption. More than 70% of the respondents to a KPMG survey are in agreement that there are countries in the world where, unless they engage in bribery and corruption, businesses struggle to compete with others that do take part in corrupt activities (KPMG, 2011). "Bribery introduces inefficiencies in the international business system that put a drag on economic progress." (McKinney and Moore, 2008:109). These authors add, "It is detrimental to less developed countries for it can discourage the direct foreign investment that is so beneficial to economic growth and technology transfer."

As may be deduced from the above discussed points, commercial crime in BRICS countries is a massive threat to their respective economic growth figures. While there are sound principles in many of their pieces of legislation and standards, lack of enforcement of these is letting them down. The following chapter considers methods of crime prevention.

4. CRITICAL ANALYSIS OF COMMERCIAL CRIME PREVENTION METHODS

4.1. Introduction

In order to effectively combat commercial crime, understanding the motivation behind this particular group of crimes is necessary. Much of our current understanding of the reasons people commit fraud is based on a theory called "the fraud triangle" (Dominey *et al.*, 2010:18). This is defined as "….the convergence of perceived pressure, perceived opportunity, and rationalization to facilitate fraud" (Dominey *et al.,* 2010:18).

The three different elements may be defined as follows:

- Perceived pressure: "non-sharable financial need";
- Perceived opportunity: "opportunity to commit and conceal the fraud act"; and
- Rationalization: "morally defensible justification for actions seemingly out of character for the fraud perpetrator" (Dominey *et al.,* 2010:18).

This definition of the fraud triangle also became part of SAS 99 (Dominey *et al.,* 2010:19). Examples of non-shareable financial pressure include:

- "sudden financial shortfalls;
- living beyond one's means;
- greed;
- poor credit standing and inability to obtain credit;
- unexpected significant medical expenditure;
- large education expenditure;
- family or peer pressure;
- gambling losses;
- cost and lack of productivity due to drugs or alcohol; and
- cost of extramarital affairs."

Opportunity may present itself due to several circumstances:

- "poor internal controls;
- poor training;

- poor supervision;
- lack of prosecution of perpetrators;
- ineffective antifraud programs, policies, and procedures; and
- weak ethical cultures (e.g. poor tone at the top).” (Dominey *et al.*, 2010:19).

Rationalisation is necessary for the fraudster to commit the crime, as he/she does not necessarily view themselves as a criminal. Many fraudsters rationalise their crimes by thinking that it is just a temporary “loan” and that they will repay it once things are going better for them (Dominey *et al.,* 2010:19).

Dominey *et al.* (2010:19) state, however, that the fraud triangle is an inadequate tool to prevent fraud effectively, as two criteria – pressure and rationalisation – are unobservable. It is not possible to see the thoughts of a fraudster with regard to the financial pressures that they feel, or how they attempt to rationalise the crimes in terms of their own morality.

There are certain instances where the pressure might be observable, in the sense that top executives might be expected to feel pressure from financial analysts and shareholders expecting good returns, especially when their remuneration is linked to their company’s financial performance.

Analysis also requires differentiation between a person committing fraud for the first-time and the habitual fraudster. It merits attention, in so far as the habitual fraudster only needs an opportunity, and does not require pressure or rationalisation in order to commit the crime (Dominey *et al.*, 2010:21).

The fraud triangle moreover does a poor job of explaining fraud when it is not committed by an individual, but rather by a group of people colluding together. Prevention and early detection of fraud require thorough consideration being given to management override of controls and of collusion of staff members.

All of this means that the anti-fraud expert must exercise an increased professional scepticism, and should not merely rely on the possibility of people committing fraud based on the traditional elements from the fraud triangle. Career criminals, or “predators” (Dominey *et al.*, 2010) skew these expectations.

Dominey *et al.* (2010:23) present a checklist for fraud detection, including items such as good controls, policies that involve punishment, protection of whistleblowers, proper tone at the top and an ethical culture. The problem that once again presents itself is constrained by the auditing perspective of checklists and tick-boxes, and the checklist mentality should be avoided by auditors (Holstrum, 2010) as it decreases the quality of the audit (Giugliano, 2013). Auditors who have such a mentality of only ticking the appropriate boxes will not perform the necessary work (McCall, 2013:195). There is no one-size fits-all solution or checklist that can be compiled to effectively deter or prevent commercial crimes. The sooner that regulators, auditors and forensic accountants realise this and move away from checklists, the better.

Although this study focuses specifically on commercial crime *prevention*, mention must be made of criminal justice sentencing theories. Commonly accepted theories include rehabilitation, restoration, retribution and deterrence (Mellon, 2009:352). However, there is also a general lack of evidence regarding the efficacy of any of these theories in decreasing recidivism (Mellon, 2009; Paternoster, 2010).

There might be some merit in the deterrence theory for purposes of this study, as a preventative measure, specifically for non-violent commercial crimes. Deterrence theory is based on the postulation that human beings are rational and have their own self-interest at heart. They will therefore, in theory, take the risk and cost of getting caught into account (Paternoster, 2010:819) and carry out a cost-benefit analysis for themselves. Noted criminologist, Von Hentig (1938), however, states that deterrence theory is doomed to fail as the gain from a crime is a “near object”, whereas the criminal law is a “long-distance danger”. It is therefore pertinent to improve the celerity, or “swiftness”, of prosecution. Another aspect of effective deterrence was noted by the philosopher Becarria (1764:36), stating that crimes “….are more effectually prevented by the certainty, than the severity of punishment”. This important axiom has ever since then been part of criminal deterrence theory (Paternoster, 2010:769).

The most effective deterrent system thus focuses on three variables: certainty, severity and celerity (Paternoster, 2010:784). The narrative for commercial crime

deterrence should therefore focus on improving the prosecution and conviction rate; making sure the severity of sentencing is proportional to the crime; and decreasing the latency of the delay between the committing of the crime and the detection and subsequent prosecution thereof.

On the aspect of sentencing severity, in the South African lawsuit S v Zinn (1969) it was determined that courts need to take three aspects, or what has become known as *Zinn's triad*, into consideration in determining the severity of the sentence imposed. Courts should consider the personal circumstances of the accused; the nature of the crime and the interests of society. With evidence showing that imprisonment does not have a restorative or rehabilitative effect (Mellon, 2009:344), courts must take into account the non-violent nature of commercial crimes when imposing sentences. It is not in the interest of society that non-violent commercial criminals are incarcerated and exposed to violent criminals in prison. The primary objective for sentencing commercial criminals should be that of deterrence, in order to prevent such crimes from happening again.

Although deterrence may be regarded as a preventative measure, Paternoster (2010:822) states that the most effective method to ensure compliance with laws is not through any sort of legal sanction, but rather through proper education and prevention.

Thus, for the sake of this chapter, strategies that lead to early detection of fraud are also considered as "preventative" measures.

Bucy *et al.* (2008) found that fraud is discouraged in organisations when four characteristics are present:

- The company must not only be focused on the bottom line;
- There must be a plan for effective corporate compliance;
- Good corporate governance and other internal controls must be implemented; and
- Criminal activity, encompassing all crimes including commercial crimes, must not be tolerated in the corporate culture of the firm.

Gottschalk (2011:36) identified two main methods for the prevention of commercial crime. There are reactive strategies, such as "….efficient and effective control routines, transparent guidelines, reactions and consequences for offences and misconduct". There are also proactive ones, such as "….the ability to influence, by means of values and ethics, recruitment and hiring processes, attitudes of integrity and accountability, and visible and determined leadership".

If we consider this, then the commonly used commercial crime prevention strategies may be broken down into the following categories:

- Legislation and conventions;
- Governance;
- Ethical codes and training;
- The use of Information and Communication Technology (ICT); and
- Auditing and controls.

4.2. Legislation and Conventions

There is a considerable need for international collective partnerships between countries to help combat commercial crimes (Choo, 2012:24). Opportunities to take part in transnational criminal activities have increased owing to globalisation and the increasing use of internet and mobile payment methods (Choo, 2012:22).

In order to combat commercial crime, various countries and organisations have drafted legislation and conventions in order to prevent and prosecute crimes. In this section, some of the prominent ones are discussed.

4.2.1. Sarbanes-Oxley Act

Following scandals like Enron, and in an attempt to help prevent similar future events, the U.S. House of Representatives implemented the Sarbanes-Oxley Act in 2002 (Gao, 2011:933). The main purpose of the Act was to improve accountability of companies, in order to prevent corporations from misleading investors by deceptive accounting practices.

It may, however, be argued that the Sarbanes-Oxley Act is not as effective as it could have been, due to it being a strictly rule-based system. Severe penalties are imposed on companies if they overstep one of the various rules as defined. The rigid, rule-based prescriptions laid down by Sarbanes-Oxley foster the compliance-mentality, where the end goal becomes complying with the legislation, instead of actually preventing financial crimes from occurring. This has resulted in the focus being shifted in the wrong direction: instead of focusing on the intended purpose of the Sarbanes-Oxley Act, firms are now so intent on not being reprimanded for a misstep that they lose sight of the initial goal. Sarbanes-Oxley also led to more conservative decision making for firms, thereby limiting innovative thinking (Kipperman *et al.*, 2010:25).

Kang *et al.* (2010:304) find that their research supports the hypothesis that the implementation of the Sarbanes-Oxley Act had an unintended negative effect on the investment decisions of US firms, with the latter becoming more and more cautious about investing. At face value, this might appear a sound policy, but being overcautious has a negative impact on the economy.

One other of the unintended consequences of Sarbanes-Oxley is that in an effort to enforce transparency, it has in actual fact led to less transparency, as firms now focus disproportionately on one aspect of transparency, such as internal controls, and neglect other transparency promoting measures. Perhaps the implementation of principle-based legislation would have achieved the goal more effectively (Kipperman *et al.*, 2010:25).

Another problem for US businesses required to comply with the Sarbanes-Oxley Act is that they may be held liable even if they only had knowledge of the corruption taking place. This becomes especially problematic when dealing with foreign countries less informed about the specifics of Sarbanes-Oxley. When dealing with such countries, there are certain issues, or red flags, those firms should look out for:

- “Payments are being requested in cash;
- The agent is both an independent businessman and a government official;

- The joint venture foreign partner is partially owned by either the foreign government or a government official;
- The payment is unusually large compared to payments made elsewhere for similar services;
- False documentation or invoicing has been requested with regard to the payment;
- The business is being conducted in a country or industry notorious for corruption; and
- A request is made that part of the payment be made to a third party." (McCubbins, 2001:31).

Zhang (2007:110) also found that the overall cost imposed by Sarbanes-Oxley on companies has a significant negative monetary effect on them.

The strongly regulated Sarbanes-Oxley Act encourages the adoption of a checklist mentality, to the detriment of its main objectives (McCall, 2013:197). Standards that are too prescriptive, using words like "should" and "must", foster the creation of a checklist mentality (Lajara, 2007).

4.2.2. Whistleblowing

One more aspect of combating commercial crime is the use of channels for whistleblowing. The protection of whistleblowers is embedded in legislation and will therefore be discussed here.

An anonymous whistleblowers' hotline was indicated as the most effective method to encourage compliance with the ethics code of an organisation (Bucy *et al.*, 2008). The second most important factor to discourage commercial crime was the influence of top management, in enforcing the corporate culture in a top-down approach.

Whistleblowing policies are however, only effective if the protection of the whistleblower can be adequately assured, minimising the possibility of retaliation. This will also ensure that if the whistleblower was mistaken, damage to the organization or individuals purported to have been involved is limited (Auriacombe, 2004:668).

Unless the particulars of the whistleblowing policy are known to employees, they will assume they risk victimisation from their organization or fellow employees, or that it could have detrimental effects on their careers if they raise the alarm (Auriacombe, 2004:658).

A further problem with the whistleblower approach is that the organisation is dependent on external factors (i.e. the willingness of employees to report) in order for the channel to be effective. According to Kaplan *et al.* (2009:16) it is important to examine the intentions and willingness of employees to be whistleblowers within the financial reporting context, especially since oftentimes the employees are aware of the fraud being perpetrated. Then they need to be morally "moved" to report the crime.

Lassar and Sonnier (2013:153) found that the "….perceived seriousness of the wrongful act had no direct effect in our study on an employee's intention to report." Therefore, the only motivation for employees to blow the whistle will be their internal "personal ethics", as influenced by the corporate ethical culture of the firm. Personal ethics will be discussed in more detail under the topic of Ethical Codes and Training later on in this chapter.

The inefficiency of whistleblowing systems may be illustrated with data from the PwC 2011 global economic crime survey. PwC reports that a meagre 5% of the reported fraud cases were detected through corporate whistleblowing systems (PwC, 2011:25).

4.2.3. US Foreign Corrupt Practices Act

The US Foreign Corrupt Practices Act (FCPA) was originally introduced in 1977 and has seen a rise in enforcement in the last couple of years (Yockey, 2013:332) although some critics consider it to be encouraging the wrong kind of behaviours. Sivachenko (2013:395) notes that the FCPA's ambiguity, which leads to unpredictability, is hurting businesses. It enforces a static programme, instead of a programme adapting to the dynamic risk of corruption and suffers from the same limitations as the Sarbanes-Oxley Act, in that its rigidity lessens its effect.

The US Department of Justice (DOJ) and the Securities and Exchange Commission released a guidance report on the FCPA on the 14th of November 2012 (Maleske, 2013:24).

As per this official FCPA guidance document, the aim of the FCPA is to "….prevent corrupt practices, protect investors and provide a fair playing field for those honest companies trying to win business based on quality and price rather than bribes" (FCPA, 2012:90).

Radke and Unger (2013:58) note that although there cannot ever be a formula for compliance to acts such as the FCPA, what the US DOJ achieved by releasing the FCPA guide was to create a pragmatic starting point from which firms are able to build their own compliance programmes. Other observers, however, have noted that the guide is mostly just a compilation of publicly available information, and that it provides little in the form of new information (Savichenko, 2013:395).

It remains to be seen whether this guidance and its implementation will improve the prevention of corrupt foreign activities.

4.2.4. UK Bribery Act

The United Kingdom eventually followed international trends and pressures by officially bringing the UK Bribery Act (2010) into force on 1 July 2011 (Kirk, 2011:157).

The provisions within the UK Bribery Act are in many instances wider than the equivalent provisions in the FCPA (Goodwin, 2010:22).

The more extensive approach in the former statute is welcomed in that it substantiates that "(c)orruption control policy…should move beyond improving the quality of institutions - regulative, normative, and cognitive - and beyond a focus on bureaucrats who demand bribes, to include entrepreneurs and business owners who supply bribes, middlemen who grease the wheels of bribery, and state allocative systems upon which entrepreneurs rely to actualize bribery" (Boland *et al.*, 2012:2451). The UK Bribery Act is an attempt to promote the above.

4.2.5. Anti-money laundering legislation

The International Monetary Fund (IMF) has estimated the extent of global money laundering to be as high as 2% of the global domestic product (Nair & Vaithilingam, 2009:19).

In 1989, the G7 countries formed an anti-money laundering task force, the Financial Action Task Force (FATF) (Vleck, 2011:417) with its mandate being to identify how money was laundered and to suggest methods to prevent these activities (Alldridge, 2008).

FATF has a certain amount of power to influence countries to align with its anti-money laundering initiatives owing to the fact that it is removed from politics and is unrepresentative of any specific jurisdiction by its design (Allridge, 2008:445). One of the inherent limitations in persuading countries to conform to anti-money laundering policies is that for any individual jurisdiction, the benefits they derive from the investments made in their country potentially outweigh the negative effects of money laundering. Whether or not funds are illicit, money from any source is objectively speaking, the same. This might seem beneficial to them, but is indeed to the detriment of long-term societal and fiscal policies.

Different countries have different definitions of what constitutes money laundering (De Koker, 2009:347). Money launderers in cash-based, developing economies will not share common laundering methods with those in developed countries (De Koker, 2009:347).

The rise in the number of citizens with internet access in a country corresponds to an increase in money laundering activity (Nair & Vaithilingam, 2009). This correlation is due to the fact that ICT, especially mobile technology, may be used to commit transnational financial crimes and to launder money through international bank accounts. As noted, money launderers do not share common behavioural patterns (De Koker, 2009:347).

The sophistication of money laundering activities over the past several years has demonstrated an increasingly technical knowledge of accounting principles (Compin, 2008:595). Although the extent of the direct involvement of

accountants in money laundering activities is unknown, it would make sense that combating these criminals would require an equally or superior technical accounting knowledge, paired with a sceptic's mentality.

Delston and Walls (2012:740) are of the opinion that FATF missed an opportunity to stay as relevant as possible in terms of international money laundering standards. Despite incorporating the Nine Special Recommendations on Terrorist Financing into the existing Forty Recommendations, FATF did not take the opportunity to revise the recommendations to address trade-based international money laundering.

There are some deficiencies in the FATF guidance document in respect of its addressing of low value transactions (De Koker, 2009:347), using the value of the transactions as an indicator of the risk-level. This is especially problematic in the BRICS countries, where initiatives such as mobile banking have become more widespread, averaging lower values but higher risk.

With the ever-changing face of money laundering, it is essential that the regulations combating it stays as cutting edge and responsive as possible.

4.2.6. Conventions

The Organization for Economic Cooperation and Development (OECD) released the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions in 1997 (OECD, 1997), with its implementation occurring in February 1999 (Pacini *et al.*,2002:121).

Upon the joining of Colombia in January 2013, there are now officially 40 countries that have ratified the anti-bribery convention (Crane-Charef, 2012). Out of a total of 75 OECD member countries, 35 of these, as well as Argentina, Brazil, Bulgaria, Russia and South Africa. India and China have thus far not ratified the convention because of certain disagreements they have with some of the policies implemented (Crane-Charef, 2012).

The power of the OECD convention does not stem from countries ratifying it, but rather from countries amending their domestic legislation to conform to the convention (Pacini *et al.*, 2002:146).

Consequently, “The success of this type of international instrument does not depend on the skill of the drafters, but on the political will of the government of each State Party, and the resources that can be made available” (McClean, 2007:30).

In one study it was shown that the OECD anti-bribery convention decreased bilateral exports between countries by as much as 5.7% where one has higher corruption levels and the other relatively lower levels of corruption (D’Souza, 2012:85).

4.3. Governance

4.3.1. Corporate governance

User confidence in the reliability of financial statements is a paramount requirement for an effective capital market (James & Seipel, 2010:1). Corporate governance is an important aspect that determines the level of trust.

The reason why corporate governance has become so significant is that in the past there was an overemphasis on the facilitation of business rather than business accountability (Muchlinski, 2011:704). The corporate environment must move away from the “asocial corporation”, the corporation focusing only on enhancing shareholder value, and must return to the “socially embedded corporation” (Muchlinski, 2011:704).

The overarching topics of corporate governance, as defined by the OECD (2004:7), are the following:

1. “Ensuring the Basis for an Effective Corporate Governance Framework;
2. The Rights of Shareholders and Key Ownership Functions;
3. The Equitable Treatment of Shareholders;
4. The Role of Stakeholders in Corporate Governance;
5. Disclosure and Transparency; and
6. The Responsibilities of the Board.”.

One of the main principles of good governance, as may be seen from the above, is the protection of the interests of absentee stakeholders (Balasaubramanian, 2009:555). The board of directors has the primary responsibility to perform this task. The stakeholders' approach views companies as not just a bundle of assets, but rather as institutions that must consider the needs of both internal and external stakeholders (Muchlinski, 2011:700).

Another determining factor of the success of a corporate governance structure is the transparency of the structure as regards the various market forces (Choi *et al.*, 2005:163).

Imposing good corporate governance across the board on all firms serves a dual purpose. Not only does it lead to better governance; but better governed firms also tend to perform better (Sami *et al.,* 2011:112). It also indicates which firms are opposed to the implementation of these recommendations (Balasubramanian, 2009, 574). Firms who are involved with practices that would be considered against good governance will be hesitant to ratify governance conventions.

Of the different corporate governance functions, four are critical for preventing financial statement fraud: an ethical tone from the board, proactive fraud prevention from the managerial functions, internal auditors knowledgeable about fraud and risk-based external audit tests (Kedia & Rezaee, 2012:183).

Looking at worldwide governance codes, a widely regarded benchmark for governance practices is the UK Combined Code of Corporate Governance. This code follows an "apply or explain" approach (Arcot *et al.*, 2010:193). This is in contrast to the Sarbanes-Oxley Act which prescribes certain mandatory requirements.

Arcot *et al.* (2010:200) found that the flexible approach, "apply or explain", used by the UK Combined Code of Corporate Governance encouraged better compliance. However they also established that care must be taken with companies abusing this flexibility by relying on managerial discretion to explain deviances from the governance best practices.

Kedia and Rezaee make the point that a code should therefore not be too flexible, but it can no longer be so strict as to only be an issue of compliance (2012:176). The compliance-mentality decreases the effect that a strategy may have, as it is implemented to comply instead of being implemented to combat/prevent.

4.3.2. State governance

Occupational positions that present the potential fraudster with the capacity to commit fraud, also create the needed opportunity. Dellaportas (2013:37) argues that opportunity to commit fraud is a better predictor of fraud than the motivation to do so. Thus, following this reasoning, the most effective way to prevent fraud would be to remove the opportunity to do so.

The relative bargaining power of parties is a very important determinant of the corruptibility of the business relationship. Bribes are lower in value where the firms have higher bargaining power than the officials, as opposed to situations where the officials have the ultimate say (Ryvkin & Serra, 2012:475). Good governance should therefore strive to equalise bargaining powers between parties, be the situation a state-individuals, state-organisations or organisations-individuals relationship.

Certain functions of public administration departments are more susceptible to corruption, such as tender functions. As per Ababio and Vyas-Doorgapersad (2010:424) and Masiloane (2007:55), rotation of public officials, especially through these high-risk functional departments, should be implemented in order to prevent corruption.

Another method to decrease corruption amongst public officials may be to offer attractive and market-related remuneration packages (Ababio & Vyas-Doorgapersad, 2010:424), so as to encourage loyalty and commitment and discourage a mentality of self-entitlement.

In certain Commonwealth countries it is a prerequisite for public officials to qualify for a Diploma in Public Administration (Ababio & Vyas-Doorgapersad,

2010:424). This element of education and training should be the cornerstone of any campaign to increase awareness of ethical issues.

In order to encourage transparency and ethical conduct from public administration departments, the municipal financial statements must be publicised for public scrutiny (Ababio & Vyas-Doorgapersad, 2010:425) in an understandable and objective report (Fourie, 2007:742).

4.4. Ethical Codes and Training

Ethical codes and training are perhaps some of the most effective ways to deter people from committing commercial crimes. The reason for this statement is that if a person is experiencing financial pressure, and if he is able to rationalise committing a crime to himself, eventually, no matter how effective the company controls are, the opportunity to commit such a crime will present itself. However, if his personal ethic is of such a standard that he cannot rationalise the crime to himself, then no number of opportunities will be able to dissuade him from making the ethical choice.

Krummeck (2000:272) expresses this best: "….fraud prevention without ethics is an idle dream. Ethics provides a foundation for such a strategy and is simultaneously an integral building block thereof."

4.4.1. Corporate vs. personal ethics

An important distinction needs to be made between the ethics of a person and that of a corporation. Personal ethics is concerned with how one behaves in relation to oneself (Kolb, 2008:857). One’s moral compass and ethical perceptions, are according to the definition of ethicality advanced by Aristotle (Dames, 2009:20), part of one’s character (Hughes, 2001:13).

The ethics of a corporation, or business ethics, on the other hand, are "….defined as the critical, structured examination of how people and institutions should behave in the world of commerce. In particular, it involves examining appropriate constraints on the pursuit of self-interest, or (for firms) profits, when the actions of individuals or firms affect others" (Macdonald, 2009).

Imperative for the effective implementation of ethical codes is the commitment from top management to act and lead ethically (Fourie, 2007:742, Naidoo, 2012:656). An ethical culture needs to be created, not merely a compliancy-based code that every employee must sign when they enter employment, never to be relevant again.

4.4.2. Ethical codes

A code of ethics is not just about creating a formally outlined policy, but rather about creating a value-based culture in an organisation (Messmer, 2003:13). Ethics codes and compliance programmes only work effectively when they are not just viewed as check-boxes for the sake of compliance (Hopkins, 2013:45).

According to Li and Persons (2011:11) a corporate code of ethics typically covers nine common areas, outlined below:

1. “Accurate accounting records

2. Conflict of interest

3. Confidential information

4. Proper use of company assets

5. Compliance with laws

6. Competition and fair dealing

7. Trading on inside information

8. Anti-nepotism policy

9. Reporting illegal and unethical behaviour.”

Codes of ethics are more effective when there is a public declaration by the manager or official stating that they will adhere to the code (Davidson and Stevens, 2013:51). This declaration shows a certain level of managerial commitment to the cause, filtering down into the organisation and having a positive impact on the ethical culture of the organisation as a whole.

Ababio and Vyas-Doorgapersad (2010:425) assert that an official Code of Conduct, as well as effective implementation thereof, is also imperative to regulate public departments.

4.4.3. Ethical training

Any fraud training is better than no fraud training, no matter how short the duration of the course (Arunachalam *et al.*, 2013:140).

Methods including lectures, class and group discussions, case studies, assignments, and examinations lead to a possible long-term positive effect (Canary, 2009:206).

However, the hypothesis of Arunachalam *et al.* (2013:140) which suggested that the increase in efficiency obtained from experiential training will exceed that of only lecture-based training showed positive results.

Educators must therefore strive to expose students to ethical case studies. Frank *et al.* (2010:137) proposes that exposure to real life examples demonstrating where ethics went wrong is an effective teaching aid to help students internalise the consequences of such violations. Educators must however also expose the students to the anticipated emotions associated with the different ethical decisions (Clements & Sawver, 2012:32). This could lead to another deterrent aid for unethical decisions, as sympathy and empathy may be developed for those faced with ethical dilemmas.

The required level of moral and ethical reasoning does not develop quickly or even at an equal pace (Frank *et al.*, 2010:138). In addition, O'Leary (2009:515) discovered that there is an erosion of the positive effect of ethical training over time, so students must be tested on a continuous basis to ensure that their perceptions remain the same.

According to Clements and Shawver (2012:21) emotions are also an important part of decision-making; Klein (2002:347) states that “(e)motions can help resolve certain ethical dilemmas”. In this respect, “(t)he anticipated emotions associated with choosing each option and the judged relevance of particular justifications to each specific situation help shape the choices made by

individuals facing ethical dilemmas" (Connolly & Coughlan, 2008:354). During the making of ethical decisions, emotions such as regret can be useful as a deterrent from making an unethical choice (Clements & Shawver, 2012:31).

4.5. Use of Information and Communication Technology

Using the limited human capacity to analyse transactions becomes inadequate as the volume of data increases (Ghorbani & Lei, 2012:137). Fraud in the IT area of companies is rated as one of the business areas with the greatest potential for substantial losses (Burnaby *et al.*, 2011:212).

The banking sector is also at major risk from potential fraudsters. Their financial IT platforms create a large potential monetary value for fraud. Fraudsters target weak authentication controls, where access can be gained by compromising the integrity of the authorisation mechanisms (Edge & Sampaio, 2009:382).

The major issue using fraud detection systems is to reduce the fraud detection latency; that is, the timing difference between when the fraud is perpetrated and when it is first detected (Edge & Sampaio, 2009:393). Real-time screening of transactions may be effectively used, but the disadvantage of this approach is that the period during which the evaluation takes place is very limited. In addition, the tolerance of the system must be tuned in to avoid failures in fraud detection but set to avoid picking up false-positives, leading to erroneous stopping transactions, losing revenue and potentially, even clientele.

With particular regard to servicing online customers making use of e-commerce sites, fraud prevention techniques must strike a balance between providing the necessary protection against fraud and excluding legitimate customers based on erroneous assumptions (Excell, 2012:10). It has been suggested that fraud detection is sometimes not cost effective and may be difficult to implement in that it might put willing clients off, especially if it creates a lot of red tape for them to get through, in order to go through with the deal or transaction (Asuk & Kirlidog, 2012:989).

4.5.1. Data mining

Using large sets of data, data mining tools are able to be effectively used to detect fraud (Asuk & Kirlidog, 2012:989).

Data mining techniques to detect fraud can be divided into two categories: misuse detection and anomaly detection. Misuse detection has the major drawback of not being able to predict new events that are not encapsulated in the data with which the system was trained. Anomaly detection may be used to determine normal patterns, making it easier to determine when events are deviating from the norm (Ghorbani & Lei, 2012:136).

Unfortunately, data mining tools are only able to be effectively used in the cases where a large amount of data has been collected from prior instances (Asuk & Kirlidog, 2012:993). In other words, data can only be analysed to accurately determine outliers if sufficient records have been kept.

One of the drawbacks of data mining models used for fraud detection, which rely on adaptive neural networks, is that their algorithms must be constantly updated in order for the technique to remain relevant in the rapidly changing fraud environment (Edge & Sampaio, 2009:382).

This retraining is time-consuming and costly, as historic fraud data needs to be compiled, labelled and inputted into the software.

However, data mining systems are not mathematically accurate in determining the occurrence of certain defined events. Rather, the software can only be used to detect outliers based on the defined data used from prior cases, to flag certain events for further investigations. Manual interference is then needed in order to further investigate this flagged event (Asuk & Kirlidog, 2012:990).

4.5.2. Behavioural analytics

Behavioural analytics are also able to be effectively used to combat fraud (Excell, 2012:10). Other than data mining, computers may also be effectively used to pick up anomalies that deviate from the normal ranges (Asuk & Kirlidog, 2012:989).

Behavioural analytics, grounded in Bayesian inference, is used by many companies to create a fraud prevention system that learns from past behaviour and adapts to make its predictions more accurate. Bayesian inference is a concept derived from the theories of mathematician Thomas Bayes (c.1701 – 1761). Bayes defined three separate components of this theory: the past, the present and the future. Prior knowledge is used and combined with what is presently being observed to extrapolate and anticipate future events (Excell, 2012:10).

Research carried out into the field of computer-based auto detection of financial statement fraud focused largely on the use of supervised learning methodologies (Asuk & Kirlidog, 2012; Bailey, 1996; Doumpos *et al.,* 2002; Ghorbani & Lee, 2012; Persons, 1995). These models consist of two steps: the first, where the machine is trained, using sample data from prior financial statement fraud scenarios, and the second, where it is used on real world data, and the model classifies events based on the labels and attributes assigned to data in the training sample.

Owing to the unpredictability of fraud, and with fraudsters not always following known behavioural patterns, one of the biggest challenges for proactive fraud prevention is accurately predicting events (Edge & Sampaio, 2012:9982).

Although statistics based fraud detection systems have been effective in the past, the nature of fraud is such that its perpetrators will soon adapt to find ways to circumvent these measures (Kapoor & Zhou, 2011:570).

The signature-based method of proactive fraud detection, as proposed by Edge and Sampaio (2009) is based on creating a “profile” of each account user’s normal activity, transactions, timing, and amounts. This must be continuously updated to evolve, through active profiling, so as to accurately portray the true usage signature of the client. However, if properly implemented, this approach can yield effective fraud detection results.

4.5.3. General

Lou and Wang (2009) found in their study that a simple logistic model based on the risk factors indicated in ISA 240 and SAS 99 can be used to evaluate the probability of fraudulent financial reporting, and might be used by practitioners as a first-level screening tool for investigations.

Financial statement fraud, however, is becoming increasingly more difficult to detect, using methods techniques based on data mining, like regression, Bayesian inference, neural networks, etcetera. (Kapoor and Zhou, 2011:570).

As Kapoor and Zhou (2011:574) also suggest, there is a need for a fraud detection system that is able to stay ahead of the fraudsters. They propose a methodology that will use historical data to make informed predictions about fraud types, methods and probabilities, instead of merely helping to detect fraudulent instances.

The disadvantage of cutting edge fraud detection methods is that they are only at their most effective in their earliest stages. Once they become part of the public knowledge domain, the fraudsters have access to these methods too and they can understand the methodologies and adapt their own *modus operandi* to avoid detection.

The occurrence of fraud could possibly be decreased by improving the access that the general public has to the disclosed data of entities (Dimmock & Gerken, 2012:172). This can be effectively accomplished through the use of the internet.

4.5.4. ICT controls

One of the sections in Sarbanes-Oxley, dealing with IT security issues, requires companies to be able to prove when users modified or attempted to modify data (Foote & Neudenberger, 2005:516).

Digital forensic software can be used to determine whether the users that access a firm's data are legitimate, authorised users, or not, and also what they do with the data that they access (Brozovsky & Luo, 2013:38).

The technological advances made with multifunctional devices however, pose a significant risk with regards to unauthorised persons gaining access to unsecured organisation data (Dippel & Marcella, 2012:273). These devices include smartphones, tablets, personal computers, office copiers with hard-drives and network access and other technology that is vulnerable to exploitation by criminals.

Foote and Neudenberger (2005) found that passwords offer almost no protection, and although they meet the requirements as stipulated by Sarbanes-Oxley, they are not enough to prevent unauthorised access. Without some form of two-factor authentication, such as using biometric systems to identify the user combined with a password, there will be no benefit for firms in complying.

This is a case of a deficiency in the compliance-mentality adopted by certain firms as a reaction to legislation, such as Sarbanes-Oxley. They comply with the minimum requirements, but never really exert an effort in order to actually improve internal controls and governance to the extent that they are effective.

4.6. Auditing and Controls

4.6.1. Auditors vs. fraud

External auditors are not the best, or most effective, way to deter or detect fraud (ACFE, 2012; ACFE, 2011). Yet Gullkvist and Jokippi (2013:57) state that much of the current research surrounding fraud detection is limited in scope to external auditors. This needs to be expanded to a more comprehensive approach. Auditors of financial statements are merely not fraud examiners (Chui & Pike, 2013:204).

“Auditors will not become first responders to financial fraud following their practice guidelines” (Smith, 2012:301).

Why are auditors not well suited to combat commercial crime?

Chui and Pike (2013:205) quote a convicted fraudster, Sam Antar, as saying the following about auditors: “….most large accounting firms use relatively inexperienced kids right out of college to do basic audit leg work. They are

supervised by slightly more experienced senior auditors who unfortunately depend on feedback from these inexperienced kids in making informed decisions."

One of the inherent flaws in using external auditors to detect commercial crimes is their need for, and reliance on, client co-operation (Dyer, 2012:288). Auditing standards allow trust to be placed in assurance received from clients (Smith, 2012:301) - clients who will say anything, so as not to implicate themselves in crimes they may have committed.

Chui and Pike (2013:224) found that even though auditors are not best suited for combating fraud, auditing standard-setters tend to issue additional standards in an attempt to combat the prevalent fraud cases. They furthermore noted that there has been a persistent decrease in the percentage of fraud cases detected by external auditors over the years.

Relying on auditors to be aware of risk factors pertaining to fraud, and expecting them to be on the lookout for fraud, is not enough to actually detect it, as auditors lack the specific skills set that forensic investigators develop in order to detect fraud (Chui & Pike, 2013:206).

There is an expectation gap between the public that expects auditors to prevent and detect fraud, and the fact that in reality, auditors do little to directly do so (Marais & Odendaal, 2008:42).

The considerable problem that this raises is, is that although reasonable assurance is supposedly attained by relying on the work done by the auditors, how qualified are the auditors really to detect fraud? Fraud is ever evolving and becoming more sophisticated and nuanced as time passes. How can it be expected of auditors, with no formal training in advanced fraudulent financial reporting, to detect these events?

In particular, in larger companies, where the reporting function is already very complex, it is perhaps unrealistic to expect auditors to detect fraud. Conceding the fact that specialist fraud investigation experts undergo rigorous training and education before they have sufficient expertise to qualify, it is unreasonable to

place assurance on the anti-fraud measures undertaken by audit firms. At best, the auditor might be able to identify possible high-risk areas which should receive further, detailed investigation by fraud experts.

Based on the above, it is probably a sound concept to introduce more fraud-specific education for auditors on a tertiary level (Marais & Odendaal, 2008:42).

In an interesting study, Dibben *et al.* (2010:155) found that trusting individuals are more likely to advance in audit firms, even though having a more trusting disposition might make them less effective auditors and more likely to develop relationships based on trust with their clients. The auditors that are less trusting, a skill that might actually make them better auditors and good at fraud detection, are not favoured for promotions to managerial and partner positions, leading one to the possible conclusion that the focus in these firms appears to be on client management and retention, instead of on effective auditing (Rose & Rose, 2008).

When considering financial statement fraud, findings from a study done by Gullkvist and Jokipii (2013:56) to examine fraud risk indicators used by commercial crime investigators as well as by both internal and external auditors, revealed that there are no universal factors that all parties consider equally important. However, as may be expected, auditors placed higher value on internal control related red flags, whereas commercial crime investigators focused more on those specific red flags that indicated fraudulent financial reporting.

Bayou and Reinstein (2001:401) state that auditors need to learn the intricacies of fraud if they want to stand a chance of detecting or deterring it. They also state: "….this knowledge is unattainable from viewing fraud as a historical event, or by following the reductionist and holistic approaches to audit risk." Auditors must become knowledgeable about how fraud starts, how it exists, how it repeats and the patterns that it follows.

The emergence of "counter fraud specialists" is of special importance. These individuals are trained and educated to prevent fraud and investigate fraud allegations (Button *et al.*, 2007:192).

4.6.2. ISA 240

Financial statement misstatements may be caused by inadvertent error or by fraudulent reporting (ISA 240, 2009). ISA 240 divides fraud into two distinct categories: misstatements arising from the misappropriation of assets (i.e. theft), and misstatements from fraudulent financial reporting.

To distinguish between mistake and fraud, one needs to look at the intent of the deceiving party (Saare *et al.*, 2007:144). Errors are regarded as unintentional misstatements, while fraud is regarded as stemming from intentional misstatements (Chen *et al.*, 2011:2). Therefore, to establish fraud, intention to deceive needs to be established.

The difficulty arising, when establishing intent, is that it is impossible to observe, and therefore very difficult to prove (Hennes *et al.*, 2008:6). This is one of the limitations of ISA 240, as it is left to the auditor's discretion to decide whether misstatements happened through inadvertent error, or purposeful fraud.

Furthermore, ISA 240 does not offer a complete solution for fraud, as the auditors only explore the fraud risk factors. Although ISA 240 was redrafted to refocus the old perception that auditors are only "watchdogs" and not "bloodhounds" (Lee, 2012:30), it is still the primary responsibility of those charged with governance to lead the fight against fraud, and there is no explicit responsibility placed upon auditors to detect fraud (Cleaver & O'Connor, 2009:26).

Although the implementation of auditing standards relating to the auditor's responsibility with regard to fraud, such as SAS 99 and ISA 240, has led to an increased expectation from the general public for auditors to detect fraud (Victoravich, 2010:573) there is no empirical evidence to show that auditors are now better equipped to actually detect fraud. Indeed, the opposite seems to be true, with PwC stating in its 2011 global economic crime survey that the percentage of fraud detected by internal auditors decreased from 26% in 2005 to 14% in 2011 (PwC, 2011:25). To put this into perspective, from the PwC 2011 survey, 8% of the fraud cases were detected purely by accident (PwC, 2011:25).

4.6.3. Auditor's materiality

Of common use in the auditing profession, materiality figures can be accepted in an audit-centred setting, but there is some concern over their application in the pursuit of fraud detection (Gullkvist & Jokipii, 2013:57).

The commonplace quantitative materiality threshold used in auditing should not be used as an indicator for whether a misstatement is material or not. While, during an external audit, it suffices to state there is reasonable assurance that even if misstatements below a certain threshold exist, they may be regarded as insignificant enough not to affect the decision-making of stakeholders, this approach is not sufficient for investigating fraud.

Other indicators should be developed, specifically in an environment focused on fraud prevention to determine what constitutes a "material" factor and what may be disregarded, as uncovering the fraud is of more importance than the decisions made by stakeholders (Dezoort *et al.*, 2006).

Auditors' abilities to detect fraud must be developed and new methods should be explored if the credibility of the audit profession is to be maintained (Chui & Pike, 2013:207).

4.6.4. Controls

Spatacean (2012:235) concludes that the more effective an organisation's internal control measures over its financial system are, the lower the expected prevalence of fraudulent financial reporting becomes.

In a study concerning the effectiveness of internal control systems in public sector enterprises, Nagaraja and Vijayajumar (2012) established that a strong internal audit system is effective in preventing and detecting fraud and errors in their early stages. It was also found that strong internal controls lead to reliable financial reporting (Nagaraja & Vijayajumar, 2012:7).

The Sarbanes-Oxley Act, section 404, requires companies to implement procedures that periodically test their internal control systems (Epps & Guthrie, 2010:67). This, if implemented correctly, could help by ensuring an almost constant review process over the internal control system. Importantly though, the

controls need to be tested to ensure that they work correctly and have a defined purpose, not simply to comply with the requirements of testing them.

Other controls that seem to be effective in preventing fraud are controls such as job-rotation, which may well be a very effective anti-corruption tool, as it creates uncertainty over the corruptibility of colleagues (Ryvkin & Serra, 2012:475). Abbink (2004) also found staff rotation to be a very effective tool in combating bribery, with an almost 50% improvement over no staff rotation, where bribes are prevalent. Rotation of public officials has also been found as a method that can be effectively used to counter corruption (Masiloane, 2007:55).

While rotation of staff is important as a control, rotation of auditors themselves is also important. According to Anastasopoulos and Anastasopoulos (2012:475), where the risk of material misstatement is 80% or higher, the auditor's tenure should not exceed three years before he is replaced.

Another control, also required by section 407 of Sarbanes-Oxley, requires firms to have at least one financial expert on their board.

However, the implementation of additional measures that have increased the professional and financial liability of such directors has led to difficulty in finding a financial expert willing to serve as director on the board. This Catch-22 situation has led to a common practice of firms appointing former audit partners to fulfil this role (Naiker and Sharma, 2009:560). This practice raises certain concerns over the independence of these directors and is yet another example of the over-enforcement of Sarbanes-Oxley, and its rule-based system, leading to a compliance-mentality.

Summarising the use of controls, they seem to only be effective in detecting about one third of the fraud cases, mostly catching those fraudsters not familiar with the specific control structure within the entity where the fraud was perpetrated (Goode & Lacey, 2011:712).

4.6.5. Proactive auditing for fraud

Principle-based legal systems are more effective than codified, rule-based systems (Holm *et al.*, 2012:93) because of the continuous need for change effected by the evolving sophistication of commercial crimes.

Anastasopoulos and Anastasopoulos (2012:470) introduce their interpretation of the fraud detection “game” played in auditing, making use of evolutionary game theory. Their system is based on the fact that there are two players in the fraud detection game, i.e. the client and the auditor. Each of them has two choices. The client can choose to commit fraud, or not to do so. The auditor on the other hand can follow the procedures of a basic audit, or choose to follow extended audit procedures.

The problem that Anastasopoulos and Anastasopoulos (2012) formulated was that when the client commits fraud and the auditor decides to only to adhere to the basic audit procedures based on his risk assessment procedures, then the fraud will go undetected, and the auditor indirectly will pay the “penalty” for losing the auditing “game”. The argument against the auditor always just relying on the procedures of an extended audit is one of cost-effectiveness and efficiency.

There is therefore a fine line that needs to be drawn between keeping an audit effective, both in terms of cost and detection of misstatements. One more reason to perhaps include a fraud expert on each audit, as the expert’s experience should lead to enhanced effectiveness.

4.7. Conclusion

Davani and Rezaee (2013:223) suggest the following ways in which the capability and opportunity to commit fraud may be monitored:

- “Establishment and enforcement of anti-corrupt and bribery laws, regulations and policies.
- Effective implementation of antifraud policies, procedures and practices including anti-money laundering.
- Pay attention to early fraud signals and red flags.

- Use basic analytical tools such as common size analysis and ratios to identify abnormalities that need to be further investigated.
- Rededication to ethical values and moral principles and practices.
- Strengthen responsibility and tone at the top including improved accountability for all corporate gatekeepers.
- Restrict compliance with all applicable laws, rules, regulations, standards, and best practices.
- Utilization of credible and objective external and internal audit functions.
- Promotion of whistleblower policies and procedures.
- Effective and efficient internal controls to prevent detect and correct errors, irregularities, fraud and non-compliance with applicable laws, rules, regulations, standards and best practices.
- Promotion of integrated internal control and financial reporting including risk management.
- Implementation of more effective corporate governance measures including vigilant audit committee and adequate internal audit."

As may be seen from the above, the strategies discussed in this chapter are very relevant and current. The limitations applicable to almost all of these strategies however are the compliance-mentality assumed by firms in order to prevent possible prosecution of themselves, and the overuse of auditors in combating commercial crime.

Firms should strive to create cultures rather than policies and rules. This is applicable to governance, ethics and compliance with legislation. They should also endeavour to create sound internal control systems that limit the opportunity to commit fraud.

The auditing profession should perhaps reconsider its reliance on auditors to detect and combat fraud. Future research should be done based on the possibility of including a fraud expert in every audit, or perhaps only audits with a risk level initially assessed to be high.

5. PREVENTION AS THE NEW NORM IN BRICS COUNTRIES

5.1. Introduction

There is a school of thought that tries to equate the collective wealth of a country and the distribution thereof with the level of corruption. Kimbro (2011:172) points out a very important aspect with regards to these corruption statistics. Even though there is an inverse statistical relationship between a country's wealth and the levels of corruption (Kimbro, 2002; Mauro, 1995; Svensson, 2005), with most corrupt countries being poor, this should not be misconstrued. There is merely proof of a correlation, not of causation.

Poor countries are more likely to maintain less effective legal (investigative and prosecution) systems, poorer education and public health systems, weaker infrastructure and capital markets and less established financial reporting systems (Kimbro, 2011:172). Or, to put it another way, to further emphasise this point, "….in developing countries, the control of corruption is mainly associated with the institutional capacity of the national administration and the citizens' education" (Gallego-Alvarez, 2011:194). This is why such a large section of this chapter is focused on the need for training and education of citizens.

Kimbro (2011:181) established that although there are certain correlations between corruption and religion, culture and other economic variables, the root cause of corruption seems to be the lack of institutional development above any other factor, as pointed out above as well.

Although overcoming the obstacle of commercial crime requires a balance to be maintained between "….a nuanced view of individual markets and cultural norms" and the "….statutory language" of anti-commercial crime laws (E&Y, 2012:28), quantifying cultural differences for all of the BRICS countries is outside the scope of this study. Such a task would be a colossal undertaking and would require the involvement of multiple research partners spread across the countries studied. This is perhaps an area for future research.

Kimbro (2002) also found correlations between countries with above average growth or high growth expectations and elevated corruption levels. Once again only correlation is able to be indicated here. This might be because of the

greater pressures that decision-makers experience in trying to increase or maintain a certain level of growth.

What may be agreed upon, however, is that the lack of institutional development coupled with the expectations of high growth might be a good indicator of corruption, more so than mere poverty.

A further problem regarding the increased pressure to maintain growth, especially in countries such as the BRICS, where great expectations of future growth have been created (O'Neill, 2011), is the prevalence of commercial crime.

Currently, in many developing countries, such as those of BRICS, the costs associated with committing commercial crime are relatively low and the benefits that can be gained are high. The costs are low because of weak law enforcement whereas the benefits are high because rapid expansion and growth is possible (Rajagopalan & Zhang, 2009:551). Decision-makers are therefore more easily swayed to commit these crimes, as the benefits thereof outweigh the possible punitive measures.

The problem is not necessarily that the cost of commercial crime is not high but that it is not deemed to be high by corporations. For instance, Button (2011:263) states that fraud is probably the most expensive problem for society. Corporations, however choose to ignore this when they focus only on their own profits, perhaps hoping that fraud will not affect them. They disregard the cost of fraud until it truly impacts on their organisation.

One of the problems in discouraging commercial crimes is that the benefits of committing them are immediately realised, whereas the negative impact is deferred to an uncertain future date, or in the "best" case scenario, never. To put it another way, as Von Hentig (1938) described it, the gain from the crime is a "near object", whereas the criminal law implications are a "long-distance danger".

There is also an attempt to justify commercial crime by arguing that it is a "victimless crime" (Croall, 2001:8; Marx, 1992:155; Schur, 1965). Manning (2005:13) states, however, that "….there is no victimless crime" and Sutherland

(1949:230) points out that rather than corruption having no victim, it is "….a victim that is resigned because of his position and knowledge". Corruption is decidedly not victimless (Hydoski, 2007:42), with the victim most often being the general public interest (UNODC, 2002:183).

By decreasing the potential benefit that corporations can gain by partaking in commercial crime and "neglecting" governance, and simultaneously increasing the "cost" (or punishment) of fraud in corporations, the most sustainable and effective solution can be obtained (Rajagopalan & Zhang, 2009:552). The problem with decreasing the benefits that may be obtained from commercial crime however, especially in developing countries, is that it may lead to limiting the ambition of individuals in terms of seeking growth (Rajagopalan & Zhang, 2009:551). This is a delicate balance which needs to be maintained.

Another indirect cost of commercial crime that companies fail to take into consideration is the long term reputational damage which occurs when commercial crime is eventually discovered. Abdolmohammadi *et al.* (2010:16) found that companies where fraud was detected are still viewed in a sceptical light by financial analysts three years after the fact. This has a negative impact on issues such as a company's share price, ability to obtain finance from investors, and so on. This clearly shows that if fraud is detected, the financial and reputational effects thereof are compounded for years to come – reputational damage that BRICS firms cannot afford.

A clear message is only delivered to companies if they are willing to comprehend and take cognisance of the fact that the costs do in fact outweigh any possible benefits. This can only be accomplished through a multipronged approach to combating commercial crime. Attacking the latter, based on the three legs of the fraud triangle: opportunity, pressure and rationalisation, is perhaps, as mentioned in Chapter 4, not the perfect method, but it does serve as a solid starting point. Therefore, preventative strategies discussed in this chapter focus on attacking one or more of the fraud triangle factors, with the discussion centring on those same core preventative measures discussed in Chapter 4:

- Legislation and conventions;

- Corporate governance;
- Ethical codes and training;
- Using ICT; and
- Auditing and controls.

The current role of the forensic accountant and its possible repackaging will also be discussed.

5.2. Legislation and Conventions

It is easy to say that it is the purpose of corporate legislation to set standards and rules for disclosure for companies. However, this statement presupposes strong legal and financial institutions (Choi *et al.*, 2005:168), areas in which BRICS countries are known to be vulnerable. It is not the drafting of legislation that is the challenging part, but rather the effective implementation and prosecution thereof. The establishment of moral and competent leadership is one of the key goals required for combating corruption in the public sector (Naidoo, 2012:679). Furthermore, a strong political will to combat corruption is an imperative (Naidoo, 2012:675), without which the fight against corruption is almost certainly doomed to fail (Olivier & Van Niekerk, 2012:150), no matter how good the laws and regulations.

The FCPA and the UK Anti-Bribery Act as discussed in Chapter 4, serve as good global standards on which to model legislation to combat corruption. Some of the BRICS, such as China, have started conforming to these laws. The Eighth Amendment to the Criminal Law of the People's Republic of China (E&Y, 2012:22) was passed into law in 2011 specifically to criminalise bribes paid to foreign government officials, similar to that of the FCPA.

South Africa passed into law the Prevention and Combating of Corrupt Activities Act 12 of 2004 (Sibanda, 2005:2). This Act, similar to the FCPA, places a duty on people in positions of power to report corrupt activities, even if they only suspect corruption (Els & Labuschagne, 2006:29).

A positive approach would be for the other BRICS countries also to amend their anti-corruption legislation to encompass some of the scope of the above laws. This would further facilitate and encourage international trade, especially with companies that are required to comply with the FCPA or the UK Anti-Bribery Act, as it would alleviate some of their compliance issues when trading with emerging markets (KPMG, 2011:2).

As referred to earlier, as a means of diminishing the benefits of organised crime, South Africa has put in place a unit known as the Asset Forfeiture Unit (AFU), which falls under its National Prosecuting Authority. The AFU's foremost mandate is the removal of profits of organised crime (Manyathi, 2012:6), with corruption being only one of its focus areas. Implementing such a unit in other BRICS countries could be very effective in attacking the core motivator of corruption or fraud: the proceeds/benefits.

Removing the proceeds of commercial crime automatically increases the associated cost of committing these crimes, as potential commercial criminals now need to weigh up punitive measures (incarceration, fines and/or penalties) as well as losing out on the proceeds from their crimes. Asset forfeiture also increases the swiftness of prosecution as discussed under deterrence theory. Where the formal criminal prosecution procedure can take many years to reach the sentencing phase, seizing the gains made from commercial crimes is able to take place quickly.

However, concerning the implementation of ideas such as those mentioned above and creating the necessary anti-corruption entities and forums, it is important to take heed of the following: if there is more than one anti-corruption entity in a governmental structure, it is important to ensure that they do not have overlapping mandates. This leads to no single body taking direct and full responsibility (Olivier & Van Niekerk, 2012:150) and also makes keeping them accountable difficult. There is a saying that if more than one person is responsible for something, then no one is responsible. Although this is an exaggeration, overlapping mandates do decrease the efficacy of an entity's operations.

There is furthermore the need for more research into cross-border anti-corruption legislation (Lion-Cachet, 2012:58). Properly drafted legislation and the effective implementation and prosecution thereof could boost investor confidence in the BRICS countries, encouraging foreign investments and multi-lateral trade relationships. It would assist in addressing the problems of increasing transnational organised crime and corruption as discussed in Chapter 3, too.

5.2.1. Whistleblower protection and encouragement

A very important aspect previously discussed in Chapter 4 is that of the adequate protection of whistleblowers and the implementation of effective whistleblowing policies and systems to facilitate these policies.

The US signed the Dodd-Frank Wall Street Reform and Consumer Protection Act into federal law in 2010 (E&Y, 2012:15). This law uses a financial "bounty" to incentivise whistleblowers. Prosecutors in the US have reported a large increase in the quality and quantity of whistleblower claims (E&Y, 2012:15). Implementation of such a whistleblower incentivising-policy in BRICS countries, coupled with adequate whistleblower protection, could lead to the same improvements as seen in the US.

The other aspect of whistleblowing policies that is absolutely crucial for effective operation is adequate whistleblower protection guaranteed via legislation (Sanders, 2013). Even though some of the BRICS countries have whistleblower protection legislation, like South Africa with its Protected Disclosures Act (South Africa, 2000), many countries still lack adequate legal protection (Sanders, 2013).

A method for whistleblowing that is non-confrontational would be best, to encourage employees to have the confidence to come forward with unethical issues (Auriacombe, 2005:99).

Transparency International compiled a list known as the International Principles for Whistleblower Legislation (Sanders, 2013). This is a list of 30 recommended best legal practices for whistleblowing legislations. The BRICS countries should

include the comprehensive guidelines as outlined by Transparency International into their individual domestic legislation, in order to enhance the protection of whistleblowers.

5.2.2. AML legislation

It has been observed that: “(t)he majority of the world’s poor does not enjoy access to financial services” (De Koker, 2009:346). De Koker (2009:346) states that in order to provide financial services to the world’s poor, institutions need to rely on initiatives such as mobile phone banking.

A considerable problem with what FATF currently views as “low risk”, mostly low value transactions like mobile phone banking, is that the simplified controls are attracting the attention of criminals (De Koker, 2011:380). As De Koker (2011) also points out, FATF failed to properly address this issue in their most recent amendments.

In order for global AML recommendations, like FATF’s, to be effective, they must be “…aligned to the particularities or dynamics of local development where they are introduced” (Mugarura, 2013:348). The AML regimes must be adapted to suit the conditions in the BRICS countries. BRICS countries then need to amend their legislation to comply with them. Regulators in developing countries often struggle to adapt their AML legislation to address the realities of their economies (De Koker, 2006). This is an expensive and long term process (De Koker, 2011:380), of which the success will largely depend on the strength of the country’s local regulatory environment (Mugarura, 2013:334). Many lesser developed countries suffer from a lack of strong local institutions (Mugarura, 2013:334) a pervasive problem that has been discussed at length in this study.

An additional consideration is that AML policies should not be too difficult to implement, otherwise businesses will find ways to circumvent them (Mugarura, 2013:348). Caution should be exercised not to over regulate AML policies and in the process discourage compliance.

5.2.3. Association of Certified Fraud Examiners chapters

The ACFE has chapters all over the world, including in Brazil, Russia, India, China and South Africa (ACFE, 2013). This could be a starting point for collaboration against corruption and fraud, although the ACFE in itself has little power to effect any change. Getting more auditors both internal and external accredited with the Certified Fraud Examiner (CFE) qualification from the ACFE might however lead to increased fraud awareness during audits, in turn leading to a higher detection rate.

Besides the above, BRICS companies are able to collaborate with entities similar to the ACFE in order to develop effective prevention strategies.

5.2.4. OECD conventions

As previously stated in Chapter 4, none of the BRICS countries are members of the OECD (Lowell & Well, 2013:11) yet Brazil, Russia and South Africa have ratified the OECD anti-bribery convention (Crane-Charef, 2012). India and China have thus far not ratified the convention because of certain disagreements they have with some of the policies implemented (Crane-Charef, 2012).

However, as mentioned in Chapter 4, the power of the OECD convention does not stem from countries ratifying it, but rather from countries amending their domestic legislation to conform to the convention (Pacini *et al.*, 2002:146).

Using international conventions to restrict bribery of foreign officials has a potential economic side effect, as economic theory suggests. Instituting anti-bribery penalties increases the cost of doing business in countries where winning a tender is oftentimes dependent on bribes being paid (D'Souza, 2012:85).

This balance needs to be maintained, but perhaps the benefit BRICS countries can obtain from increased trade assurance with OECD member countries, if they ratify the convention, will outweigh the possible economic side effects.

Nevertheless, it is recommended that the BRICS countries come to some sort of agreement regarding the adherence to the OECD anti-bribery convention.

Another possibility is the formation and drafting of a more BRICS-specific convention against corruption and bribery. The BRICS countries already come together to discuss foreign policy and trade, so they could perhaps create a working group, or forum, with the goal of facilitating open discussions about commercial crime.

South Africa already has such a forum itself, in the form of its National Anti-Corruption Forum (NACF, 2013). Building on the existing structures, the BRICS countries could easily establish such a forum and it should be mandated to draft a BRICS Anti-Corruption Convention.

In so far as all of the BRICS countries will be able to make an input into the drafting process, India and China will be able to table their objections to the OECD convention. The convention can be drafted on the basic principles of the OECD convention, as Brazil, Russia and South Africa already conform to some of the requirements. Convergence with the BRICS conventions should therefore not require much in the form of amending existing legislation, except in the cases of India and China.

The speed at which financial misconduct is investigated in government spheres needs to be improved (Olivier & Van Niekerk, 2012:151). A specific forum, such as the one discussed above mandated to perform this task, will increase the speed and efficiency with which such investigations may be processed.

5.3. Corporate Governance

Good governance leads to better performance, an aspect on which BRICS residing companies should be focussed. A study performed on Chinese listed companies about the relationship between corporate governance and firms' performance and valuation found that firms that are governed better performed better (Sami *et al.,* 2011:112). Iwasaki (2013:30) established that enforcing corporate governance rules on Russian companies not only disciplines the top

management but also increases the likelihood of the firm surviving, or increases its survivability rate. This is an important metric to monitor, especially after the recent worldwide economic turmoil, with many long established firms failing. If good corporate governance can be used to not only decrease the prevalence of fraud and corruption, but to additionally increase the odds that a firm will survive in the economy, then it may be described as a win-win situation.

As previously noted, Claessens and Yurtoglu (2013:25) reported that in emerging markets good corporate governance also leads to greater efficiency.

Aguilera and Cuervo-Cazurra (2004:436) found that worldwide, there is some convergence in corporate governance practices, mostly based on the Anglo-Saxon model of governance. In a comparative study between the corporate governance codes of the BRICS countries the biggest distinction noted was the dual board structure followed by Russia and China, as opposed to the Anglo-Saxon model followed by Brazil, India and South Africa (Banerjea *et al.*, 2012:151). The dual board structure has a separate supervisory and managerial board, whereas in the Anglo-Saxon model the board is in the centre and has the full responsibility to maintain good governance.

When striving for convergence, developing countries trying to establish a governance structure are faced with the problems that globalisation presents. Multinational economic actors oftentimes dictate the performance of developing economies. If these actors exert significant influence over these developing countries, they can easily impose their preferences for governance on these economies leading to decision-making that would not have been tolerated had the developing countries possessed a developed governance structure. This (potentially) undue influence must also be considered when trying to establish what a global governance code must contain (Reed, 2002:244). Behaviour of multinational companies may to a large extent be seen as prescriptive of the institutional culture in their base country of operation (D'Souza, 2012:86).

A holistic approach to governance is needed, because currently, no country has a perfect system (Choi *et al.*, 2005:171). Although this study agrees with this statement, a holistic approach still needs to start with a strong, if imperfect,

foundation. In this section the reference code for corporate governance will be deemed to be the South African King Code of Corporate Governance III (IODSA, 2009). Indexes such as the Global Competitiveness Index (WEF, 2013) rank South Africa as having the best board governance structures globally, cementing the use of this code as a reference. The King Code is also not just sound theoretically. The King Codes have, through the years and in different iterations thereof, added value to individual organisations as well as the South African economy (Jansen van Vuuren & Schilshcenk, 2013:5).

The King Code, hereafter King III, uses the *apply or explain* approach, rather than the *comply or explain* approach. The key distinguishing feature between these two approaches is that companies under the *apply or explain* approach can still be in compliance even though they deviate from the recommended corporate governance practices. Under the King III code in South Africa, listed companies are required to state if they applied the principles, and to explain their practices if otherwise (IODSA, 2009:1).

King III is divided into the following chapters:

- Ethical leadership and corporate citizenship;
- Boards and directors;
- Audit committees;
- The governance of risk;
- The governance of information technology;
- Compliance with laws, rules, codes and standards;
- Internal audit;
- Governing stakeholder relationships; and
- Integrated reporting and disclosure (IoDSA, 2009).

In order to be comparable across borders, the BRICS countries need to have a standardised code of corporate governance with which they all comply. The complexity of such a code, and taking into consideration all of the cultural, political and geographical differences between these countries, makes the use of an *apply or explain* approach similar to the one employed by King III mandatory.

This will lend the necessary flexibility to BRICS-specific recommended practices for corporate governance still to be effective and relevant.

Black, De Carvalho and Gorga (2012:950) suggests what these authors call "regulatory flexibility", or a system comparable to the *apply or explain* approach as discussed above. This is based on their research which suggests that country-specificity greatly influences the aspects of governance deemed important. Their suggested system relies on voluntary adoption of the best practices: *apply or explain*, with mandatory disclosure of the practices adopted for governance.

While developing recommended corporate governance practices is important, much of the effectiveness of corporate governance codes lies in the enforcement of the latter, with little research being done that addresses this (Claessens & Yurtoglu, 2013:27). More research needs to be done to determine which factors influence the effective enforcement of corporate governance, particularly in the BRICS nations, for the reasons mentioned. What role must the private sector play in this regard, and what should the involvement of the public sector entail?

In order to engage with Choi *et al.* (2005:171), on the premise that no code of governance is perfect, possible strategies for improvement are discussed.

Carver (2007:1033) argues that there is an inherent flaw in basing corporate governance on best practices, in that it is an attempt to fix bad systems, rather than in fact directly addressing the system.

Consequently, "(d)eveloping governance theory requires looking beyond the newest best practices. It requires setting out to discover first principles – the basic building blocks of why governing boards are needed at all. It requires distilling universal principles, ones that apply across all types of governing boards, whatever their industry, their jurisdiction, their company size and their company age" (Carver, 2007:1034).

Claessens and Yurtoglu (2013:25) suggest further research into the impact that corporate governance can have on poverty alleviation. In emerging markets, as they argue, job creation results mostly from small and medium enterprises

(SMEs), and not the listed companies. Most of the current research regarding corporate governance has however been done on listed companies. Perhaps, in order to reduce inequalities, alleviate poverty and to address certain of the endemic corruption issues in BRICS and other emerging countries with pronounced poverty and high corruption rates, more research needs to be devoted to the development and implementation of corporate governance codes, specifically on SMEs.

In many emerging markets, family-owned firms predominate in numerous sectors. Corporate governance issues relating to these firms are very specific, and include issues relating to "intra-familial disagreements, disputes about succession, and exploitation of family members" (Claessens & Yurtoglu, 2013:26). More research needs to be done to fully understand the specific requirements for corporate governance enforcement in family-owned firms.

Carver (2007:1032) argues that optimising shareholder value, the ultimate goal of corporate governance, is a moral obligation. The directors "…inherit an ethical obligation to countless non-owner stakeholders whose lives can be upended by corporate decisions." The moral and ethical integrity of an individual is no guarantee of integrity in the group. "Just as competent individuals can be an incompetent group, ethical individuals can, as groups, fail in their moral obligation." (Carver, 2007:1032). Citizens should also have the responsibility of keeping public officials accountable and monitoring their actions, reporting them to the relevant authorities if necessary (Abdulai, 2009:407).

For this reason the following section on ethics is central to the fight against commercial crime.

5.4. Ethical codes and Training

Before discussing the importance of ethical codes and training, mention must first be made of a crucial topic: the notion of objective ethics in a subjective society.

5.4.1. Objective ethics in a subjective society

How can it be that there is an objective ethical or moral value-system that applies to all of humanity, if human conduct is merely a series of biological reactions to environmental impulses? According to Levy (2007:125), humans should confront themselves on two different logical levels. Firstly as a physical entity in a universe that runs according to the natural laws of physics, and secondly as a human being in a society ruled by other human beings.

How can ethicality be determined or judged on an objective basis, without presupposing the existence of an ethical belief system to use as baseline? For example the business ethics standards of Eastern markets are generally portrayed as "lower" than their Western counterparts, but who determined that the Western standards are “correct”, if there is even such a concept in ethics?

The only way to obtain a semblance of objectivity, in such a widely diverse cultural context as the BRICS countries, is through *consensus.* Keller (1995:13) states that “….shared measures of competence, some degree of consensus about standards, and some notion of academic freedom are certainly necessary to the viability of intellectual inquiry.”

The argument is that when there is consensus over ethical values, then the highest level of societal objectivity has been reached. Therefore it is important not to evaluate the ethical conduct of BRICS countries based on their compliance with Westernised standards. Rather, as will be discussed below, flexible ethical principles must be established for emerging markets, together with an understanding of the cultural, political and corporate backgrounds of each of these countries.

An important extension of the above concept of objective ethics is the distinction between a person’s personal and “public” ethical belief systems.

Malan (2011:1) refers to the concept of a public identity. He argues that an individual's public identity is determined by the state. Individuals have, owing to their involvement with and membership of a diversity of communities and groups, many cultural, linguistic, religious, ethnic, regional and other identities -

but according to the state these are nothing more than private identities. The state and only the state is the exclusive enforcer of the public's identity.

Parekh (2000) expands on the above argument and infers that citizens of the state are all expected to subscribe to the same way of thinking about and relating to each other and the state. They should deem their relationship with the state, i.e. their territorial public identities, as of more importance than the identities they possess stemming from the aforementioned involvement with, e.g., cultural groups. Parekh (2000) feels that the state is a "deeply homogenizing institution".

Incongruity exists when this public identity, and its ethical values, disagrees with the person's private ethical values. This leads to a cognitive dissonance that challenges the objectivity of ethics.

Cognitive dissonance, or the process of struggling with two different beliefs, is necessary to cultivate intellectual growth (Lehman, 2013:143). Accounting students must be made aware of the "….individual and societal greed, the absence of justice, the prevalent corruption, and the systematic nature of our moral crises" (Lehman, 2013:142). This will create the necessary cognitive dissonance between what they are taught and what they experience in the world around them. Individuals should not let their education dominate their perspective, even though they cannot help being informed by it. They should strive for a constant evolution of ideas and perceptions. So it is pertinent that they take care in establishing a network of expert opinions that forces their perspective into a wider field of view, in order not to be limited by their own narrow-minded subjectivity. This uncomfortable stimulus is necessary to encourage accounting students to re-imagine the world as it *could be,* rather than how it is.

Students and professionals should partake in the accounting discourse, because ultimately this engagement contributes to creating our immediate reality and the meaning we attach to it (Lehman, 2013:142). This is the means through which ethicality in the workplace will evolve.

In extension of the consensus-theory discussed above, students and businessmen from BRICS countries must participate in open discussions about ethicality, in order to determine common ethical principles on which to base BRICS-specific ethicality.

5.4.2. Ethics training

Shinde *et al.* (2013:49) stress the importance of fraud education at university level. It should not be taught as just a subsection of the auditing subjects, but rather as a standalone unit. However, though it is not negotiable *that* it should be taught, it is important *how* it should be taught.

Ethics training conveyed only in a lecture-based, theoretical manner, is not as effective as experiential, case-study based training (Arunachalam *et al.*, 2013:140). Porter *et al.* (2012) also found that ethical judgement improved significantly through practical training, more so than with just a purely theoretical ethics course.

When role playing these ethical scenarios with students, it is important not only to have the students rotate through different internal roles, but also through the roles of the external stakeholders (Campbell & MacLagan, 2011:402). During this process they are exposed to the way in which all of the different stakeholders are affected, giving them a far greater perspective on which to base their own decisions.

Only by approaching ethical training from this understanding can ethics be taught and implemented effectively. A disconnected ethical theory, in the form of a written code of ethics, has no impact if not internalised into the daily decision-making of the firm. Just drafting an ethics code for the sake thereof is merely lip-service and another example of the compliance-mentality. It is important to keep the focus on the individual as a moral agent when teaching ethics to students, as this helps them to associate better with the teaching examples, but also because individuals are the cause of conduct in organizations (Campbell & MacLagan, 2011:401).

There is therefore no logical sense in trying to define ethics as merely a theory. It is not the organisation that has to be ethical in its conduct, as it is an inanimate construct of the business world. Rather, the individual employees need to internalise the ethics to such an extent that their conduct as moral agents portrays the ethical values of the organisation.

In a research study exploring the idea of using the internet to teach business ethics via an online course to international students, Fontrodona *et al.* (2003) found it to be successful and an effective way to reach many students simultaneously. It is also recommended for tertiary education institutions and ethics professionals. Further exploration of this idea in order to reach the vast populations of the BRICS countries for ethics education could prove beneficial. Internet penetration is increasing in the BRICS countries, with BRICS accounting for almost one third of the global internet users (Bronkhorst, 2012) and this could be an effective method to inculcate ethics training into more people.

Training should however not be limited only to ethical issues. Ernst & Young established in its Global Fraud Survey (E&Y, 2012) that as many as 42% of the survey respondents have not received any training with regards to the anti-bribery and anti-corruption policies in their firms. Carpenter *et al.* (2011) reported that subsequent to fraud specific training, graduate students had an increased ability to assess the risk of fraud. Their level of fraud-risk assessment was not significantly different from that of fraud experts, and the improved fraud-related judgement was retained for at least 7 months after the completion of the training course.

Therefore it is crucial to ensure that employees are made aware of all the commercial crime related practices and policies, and finance professionals should receive tailored fraud-specific training.

This training will, as indicated above, lead to heightened awareness of commercial crime and ethics, consequently leading to more scrutiny and scepticism which in turn could lead to a greater prevention/detection rate for commercial crimes.

5.4.3. Ethical codes

Written codes of ethics have been found to be a significant deterrent for accepting bribes if correctly implemented (McKinney & Moore, 2008:109), but they also frequently fail. The main reason for this is that corporations fail to incorporate the ethical values into the core principles of the business, so that decision-making throughout the corporation is affected by these principles (Webley & Werner, 2008:413); there is no internalisation of the codified ethical values.

This links with the previous section about ethics training, in that it is crucial to educate and train employees in the ethical codes.

It is also important, instead of having a *rule based* system from which no deviation is possible, to rather have a *principle based* ethical system where the conduct can be adapted, within the framework, to fit into the ethical parameters of the country in which companies are operating. This is especially important within the BRICS countries, as there are numerous different cultures and political ideologies at play. Facilitation payments, acceptable in one country, are classified as bribery in the next.

If the *apply or explain* system works in the setup of a code of corporate governance as mentioned earlier in this chapter, why then could the same system not be effective with a code of ethics? This will encourage the same sort of *regulatory flexibility* as discussed under corporate governance.

Francis and Nardo (2012:138) state that moral values should be captured in "….principles that transcend special times, place, or special pleading". This study argues that ethical values should also be expressed in such principles.

No matter how good the ethical code, ethical behaviour is much more than just having a written code of ethics. It is the top down implementation of the ethical culture in the organisation, so that the ethical values permeate through to every department there.

Inculcating an ethical culture is one of the most important aspects of increasing ethical compliance. An in-depth discussion of all the necessary steps in

creating an ethical corporate culture is outside the scope of this study, but Webley and Werner (2008:413) suggest the following which could be used as a baseline:

- “Agreement on explicit core values;
- A relevant and ‘user friendly’ code of ethics;
- Continuous training and ‘awareness raising’ programmes;
- Means for employees to raise issues without fear of retaliation;
- Employee engagement (consultation and feedback);
- Consistent communication and exemplary behaviour from both top and other levels of management;
- Regular surveys of stakeholder opinion; and
- Board level oversight and reporting”.

As may be appreciated from the above, most of these aspects are also included to some extent in the discussions in this chapter.

The essence of an ethical corporate culture is the top-down approach. If management is unethical, then this would almost certainly permeate the rest of the corporation as well. However, if management is outspoken about ethics and is observed to abide by the ethical code of conduct, then there is a much better chance that the ethical values of the corporation will be internalised by all employees.

BRICS companies should take note of this fact, and focus particularly on improving the ethicality of their managers through case-study based ethics and commercial crime related training.

5.5. Using Information and Communication Technology

As mentioned, with the BRICS countries accounting for more than 40% of the world population (The BRICS Report, 2012), the sheer amount of transactions makes it nearly impossible to manually analyse them (Ghorbani & Lei, 2012:137).

Although their large populations, coupled with extremely diverse cultures and behaviours, will make this task difficult using computers, data mining methods such as the ones suggested by Asuk and Kirlidog (2012:989) can be used to process the vast amounts of data.

Edge and Sampaio (2009:382) criticised the use of data mining tools for fraud detection, saying that it is difficult to keep the algorithms relevant in the rapidly evolving fraud environment. Suggestions like the one from Glandon *et al.* (2012:330), stating that it is important to start including cultural differences as a factor in fraud decision making software, can help keep the algorithms relevant. Further research, specifically into the cultural differences between BRICS countries and the effects thereof on commercial crime prevalence will be needed to collect all this data.

Seeing that manual interference will anyway be necessary with data mining detection tools in order to investigate the flagged events (Asuk & Kirlidog, 2012:990), it would make sense to involve the forensic accountants from the beginning of the process. Experienced forensic accountants can be used to help train the computers using data from detected fraud cases and also to assist in developing better predictability of fraudulent events.

Forensic data analytics can be effectively used in performing due diligence checks on third parties (E&Y, 2012:10). Companies seeking to trade with BRICS countries must leverage these technologies in order to effectively review all the available data. Of course, this method presupposes the availability of sufficient data, which is not always the case.

India has a lack of reliable data on entities and individuals available as a public information source (E&Y, 2012:27). There is also a lack of readily available information on African companies. Several African countries have started forming industry-related working groups to serve as forums and to promote discussions. They aim to establish databases with details of commercial crimes experienced and of which countries were involved (E&Y, 2012:19). Such databases will greatly increase the public accountability of firms and will also greatly help to improve transparency.

China's Supreme People's Procuratorate announced in 2012 (E&Y, 2012:22) that it would create a national database of individuals and companies found guilty of bribery-related offences. Initiatives like this, especially if made public record, help to deter and also prevent corruption. Such a record will also help keep companies and individuals accountable. The data from these databases can then be used as input for forensic data analytic tools.

Another way in which technology is able to assist is in regard to companies struggling with the volume of information they have to process concerning their dealings with third parties globally (E&Y, 2012:10). Technology can be used to great effect to supplement limited human capacity. Using technology to analyse this third party data increases the odds of identifying red flags (E&Y, 2012:10).

Technology can and must also be used in combating money laundering. Vlcek (2011:416) asks, "….why should the subject of global anti-money laundering standards be a matter of concern for developing economies?" Computer networks may also be well used in combating credit card fraud, enabling financial institutions to identify and share trends (Bai & Chen, 2013:270).

There is an increasing trend in developing countries to transfer money via mobile telephones, known as *m-money* (Vlcek, 2011). This method has become popular because of the lower fees charged compared to those of formal banking services. This raises questions, with regards to the misuse of the technology for money laundering purposes, as there is less regulation of these services than of formal banking institutions (Vlcek, 2011:416). As previously pointed out, fraudsters tend to target weak authentication controls (Edge & Sampaio, 2009:382) as it is the easiest way to circumvent access controls. Computer security and control policies may help prevent some of these unauthorised transactions from happening.

5.6. Auditing and Controls

An earlier reference in the text draws attention to the issue that according to the Global Competitiveness Report (WEF, 2013) South Africa is ranked first in the

world on its strength of auditing and reporting standards. South Africa (Use of IFRS by jurisdiction, 2012) uses IFRS as adopted by the European Union. The International Financial Reporting Standards (IFRS) are the most significant coercive influencing factors that are encouraging convergence of accounting systems (Craig & Rodrigues, 2007). With the above taken into account, it would make sense to propose maximum conversion to IFRS for the BRICS countries, in order to enhance the overall quality of financial reporting.

Qu and Zhang (2010) propose a fuzzy clustering analysis to measure the convergence of accounting standards. They used this method to analyse the convergence of the Chinese accounting standards to IFRS, and found that the convergence level is high, even though some differences will continue to exist.

This approach to quantifying the convergence of accounting standards on IFRS can be used to analyse the convergence of the accounting standards in all the BRICS countries on IFRS. Qu and Zhang's 2010 study on China's accounting standards is outdated by now. A need to perform such a quantifying clustering analysis on the accounting standards of Russia, India and China exists, as they are the BRICS countries which are not yet fully converged with IFRS (Use of IFRS by jurisdiction, 2012). This recommended type of analysis also highlights areas that need to be emphasised to improve convergence, which could be used as a basis to amend the semi-convergent standards.

Education regarding IFRS is very important; particularly in light of the move by BRICS countries towards international IFRS convergence and that they have at least started their own drive towards convergence, as pointed out above,. While it is obviously important that accounting students receive adequate instruction in IFRS, a less common, but perhaps more important aspect of IFRS-related education, is teaching IFRS to business (non-accounting major) degree students.

Cherubini *et al*. (2011), in their survey found that the majority of accounting instructors who responded, thought it was important to teach IFRS in non-accounting business degrees. However, not enough time was spent on this topic during the term, with over half the respondents allocating less than 30

minutes of IFRS education to non-accounting students. BRICS tertiary institutions should take note of this and set a new trend where students of all commerce degrees are given adequate exposure to IFRS basic training.

Alon (2012) proposed an active learning course to introduce IFRS to students in a basic accounting course, whereby the students got to assess and learn the implementation of IFRS through case-studies. This might be a very valuable approach, as a basic knowledge of accounting standards, especially one not just based on theory but on practice, could help persons not in the accounting profession to still make sense of the methods and numbers. The same could be applied here with regard to ethics training, in that it seems to be a trend that case-studies are the most effective way to teach these principles.

With more commerce professionals, not necessarily just those in accounting, being versed in the basics of IFRS, the whole accounting profession will be held more accountable. This will not just improve the reporting quality and comparability of BRICS companies, but also decrease the likelihood of fraudulent financial reporting being hidden in plain sight.

5.6.1. Controls

BRICS countries should focus on devising effective internal audit functions in their companies, with strong control systems. However this is not always the case (E&Y, 2012). For instance, Eastern European businesses (Russia was included in the countries surveyed) are for instance less likely to have internal audit functions (E&Y, 2012:25).

BRICS companies should take note of the requirement set by the Sarbanes-Oxley Act to have their internal control system tested periodically (Epps & Guthrie, 2010:67). Put simply, the more effective the internal control systems of an organisation are, the lower the expected prevalence of fraud (Spatacean, 2012:235). By diligently testing these control systems, companies can therefore benefit from a lower commercial crime risk.

As mentioned in Chapter 4, staff and job-rotation is one of the most effective controls in combating both fraud and corruption (Masiloane, 2007:55; Ryvkin &

Serra, 2012:475) by increasing the unpredictability of an individual's behaviour (Abbink, 2004:900).

5.6.2. Proactive auditing

Auditors are not fraud specialists (Chui and Pike, 2013:227); consequently, more comprehensive fraud-specific training for auditors should be considered (Marais & Odendaal, 2008:42). It is also necessary to address the expectation gap (Marais & Odendaal, 2008:42) between what the public expects from auditors with regard to fraud, and what they do in practice. Standards such as ISA 240 and SAS 99 widened this expectation gap (Victoravich, 2010:573) by making the general public expect more from auditors with regard to combating fraud. Auditors should also work in unison with forensic accountants on all audits above a certain risk level (Chui and Pike, 2013:226), not just on fraud investigations.

In Germany, a new assurance standard emerged (E&Y, 2012:7) that seeks to measure companies' Compliance Management Systems (CMS), through the use of external reviewers. External firms are given guidelines with which they must assess the extent of the design of the CMS, the implementation thereof, as well as the on-going effectiveness of the system. Ernst & Young (E&Y, 2012:7) suggest that other companies should use this German standard as a roadmap to make their compliance system more effective. The key feature of this is to place the responsibility for review of the compliance system on an external party. This removes the possibility of companies subjectively "reviewing" the efficacy of their own compliance. BRICS companies should implement such third-party compliance review procedures in order to improve their compliance ratings.

Proactively measuring compliance with standards and conventions, and auditing for fraud together with fraud experts, would enable BRICS companies to hedge their risk against commercial crime effectively.

5.7. The current role of the forensic accountant

As mentioned in Chapter 1, forensic accounting in its current form is primarily a branch of accounting and auditing science with the aim of bridging the gap between accounting and law (Fitzgerald, 2012:12).

Most commentators agree that forensic accountants are used mainly *ex post facto* during fraud investigations (Davis, 2008; Fitzgerald, 2011).

As Krummeck (2000:268) says, "….the extent to which fraud has grown in recent years has made it evident that this conventional way of dealing with fraud is not only ineffective, but also too costly to afford any longer." Note that this was already said in the year 2000, but as the research discussed in previous chapters on fraud prevalence clearly demonstrates, this problem has not been solved yet; *ex post facto* fraud investigations are still the cornerstone of the fight against commercial crime.

The paradigms within which the forensic accountants operate currently focus too much on reactive strategies, and need to concentrate more on preventative ones. If forensic accountants are to remain relevant in the fight against commercial crime, then perhaps a repackaging of their roles is necessary.

5.8. Repackaging of the forensic accountant's role

As alluded to in Chapter 1, the current status quo where forensic accountants become involved only *ex post facto* is both costly and ineffective. A repackaging is needed if the forensic accountancy science is to stay relevant in the changing commercial crime environment.

Forensic accountants should become more proactive in their approach, focusing more on the preventative measures as discussed in this study. The emphasis must move away from the *historic, past events*, "*tell it like it was"* auditing and financial accounting approach, to a more future-centred approach, trying to predict "*how it will be*", akin to managerial accounting.

The participation of forensic accountants may be especially helpful in improving and evolving governance theory. Commercial crime is not just something that affects multinational, listed companies. It also affects small, family-owned SME's. It is important that the governance theory for these smaller firms address their implicit risks, and not just transpose the requirements of large corporations onto them. Forensic accountants should take part in the governance theory discourse, helping to evolve it, to include considerations for the commercial crime risks faced by these smaller entities.

Another crucial factor for the repackaging of the forensic accountant's role lies with training. Education is the backbone of a country, and also one of the most effective ways to ensure compliance with regulations and laws (Paternoster, 2010:822). Forensic accountants can and should become involved with ethics training. As discussed, ethics training and fraud related training are most effective when done on a case-study basis, and the actual experience of these forensic accountants can give structure to the training scenarios so that they represent real-life cases better.

The narrative and discourse of commercial crime also need to become a more prominent feature in the forensic accountancy sciences. The field will only evolve when studies like this one question the *status quo* and attempt to improve on it. Relatively speaking, the forensic accountancy science is still in its infancy, and much development needs to still take place. The cognitive dissonance discussed in Chapter 5 is an issue that forensic accountants will encounter when comparing sound legislation or regulations, with the poor implementation and enforcement thereof.

While the comparison to *Minority Report's* pre-cognitive humans in Chapter 1 was only for illustrative purposes, using technology akin to the ICT measures discussed certainly has precognitive potential. Forensic accountants can become more involved in the training of the ICT system, a crucial factor that determines its efficacy and accuracy. Whether the system is based on Bayesian inference or behavioural and statistical analysis, in order for it to have a high detection rate, it needs to be correctly *trained*.

Forensic accountants can play a crucial role as regards the input of data into the ICT system that as well as with the output assists the latter to identify “instances” based on the profiles and patterns that it was taught. These instances need human intervention in order to quickly eliminate instances that were erroneously red flagged. This will improve efficacy by not spending time investigating every identified exception, but rather narrowing down the scope to the instance with the highest likelihood of involving commercial crime.

While Chui and Pike (2013:226) suggested the inclusion of a forensic specialist on every audit engagement, this researcher is of the opinion that this is not addressing the problem correctly. Auditors themselves need more specific commercial crime training, and should take part in more proactive fraud auditing methods. Their current methodologies will need to evolve if auditors are ever to stand a chance of being effective at detecting fraud. Using materiality figures, placing a lot of trust in the client’s representations, relying on client co-operation and sending inexperienced clerks in to do the audit field work are all aspects that will need to be addressed in the auditing sciences, in order for the latter to become more proactive.

Other roles that need to be considered for forensic accountants’ involvement are synergistic roles with other professions. Taljard (2009:13) suggests that, based on the assumption that fraudsters are unlikely to declare their illegitimate earnings to the tax authorities, there is a demand for a hybrid role to be played by a forensic tax specialist, to determine when tax law is infringed. This could enhance the detection rate and lower the detection latency, consequently leading to lower fraud in financial terms.

Of course, the demand for forensic accountants in their current role, involved with court proceedings and investigations, will not disappear and it is just as important that forensic accountants stay as competent as possible in these fields. Only through successful prosecution of commercial crime offenders can the criminal justice deterrence theory be effective in preventing future crimes.

The above are just a few suggestions that require exploration in order for forensic accountants to remain relevant and effective in the fight against commercial crime.

5.9. Conclusion

The prevention of commercial crime in the BRICS countries is faced with several unique problems, linked to demographics, political ideologies and institutional development. Developing countries such as the BRICS with elevated growth find themselves having become breeding grounds for corrupt practices and fraudulent financial reporting, owing to the enormous pressures placed on them to realise this growth potential.

This need not be the inevitable case, as commercial crime can be prevented. There is however a fine balance that needs to be maintained in order to limit commercial crime, but not inhibit economic growth potential. Sustainable growth needs to be nurtured, in order for the BRICS countries to become the economic powerhouses as suggested by O'Neill (2011). This sustainability should include initiatives like triple bottom line reporting, but should also concentrate on decreasing the prevalence of commercial crime.

Put simplistically, the economic cost (or punitive measures) of committing commercial crimes must exceed the potential benefit thereof for the actors involved. As discussed, the logical approach to prevent commercial crime would be to deal with each of the fraud triangle's legs separately: those of pressure, opportunity and rationalisation.

It is difficult to address the pressure criteria, as there will always be pressure of some kind, especially on executives with regard to company performance. Worldwide economic recessions also contribute to added pressures on companies and individuals. Corporations could perhaps aim at alleviating the intense pressure felt by employees, by introducing such initiatives as counselling or employee assistance programmes (ACFE, 2009:6).

In Chapter 4, the distinction was made between the occasional fraudster and the career fraudster. Whereas the occasional fraudster needed rationalisation and pressure to commit the crime, career fraudsters only require the opportunity. This means that in order to effectively address the problem of repeat fraudsters, fraud should not be perceived as comprising only circumstances where *all* three legs of the fraud triangle are present. Such a view would severely limit the scope of preventative measures, especially those focused solely on limiting the opportunity to commit fraud, which is arguably the most important aspect to tackle.

The best option would therefore be to limit the opportunity to commit commercial crimes, as well as educate and train the individuals so that they cannot easily rationalise the crimes to themselves.

Criminal theory suggests that criminals are not easily or effectively rehabilitated, since a high rate of recidivism is still existing, even with the current punitive measures in place (Mollen, 2009; Paternoster, 2010). This again demonstrates that since attempting to rehabilitate commercial crime offenders is not effective, the more effective method would be to prevent them from committing the crimes in the first instance. The discussion regarding deterrence theory also ties up with this goal of prevention. When there is a certainty that commercial crimes will be prosecuted; when the prosecution commences swiftly; and when the sentencing is severe enough (taking into account *Zinn's triad*) then perhaps deterrence can be effective in preventing future crimes.

Dealing with the opportunity and rationalisation legs of the triangle may be achieved through the following methods as discussed in this chapter:

- Legislation and conventions;
- Corporate governance;
- Ethical codes and training;
- Using ICT; and
- Auditing and controls.

In brief, the BRICS countries should focus on limiting opportunity by implementing stricter legislation with specific reference to their unique emerging

market context. Guidance could be taken from international legislation like the FCPA or the UK Bribery Act, as well as the OECD anti-bribery convention.

Whistleblowers should be encouraged and protected from victimisation. The BRICS countries could model their whistleblower protection legislation on the Transparency International recommended practices, and also incorporate the financial "bounty" as offered by the USA Dodd-Frank Act to encourage whistleblowing.

Other avenues of prevention to pursue are the suggested anti-corruption forum, and entities such as the South African Asset Forfeiture Unit to confiscate the proceeds of organised crime. The obvious risk of high levels of corruption, as experienced by BRICS countries, is not beyond what ethical businesses can manage (Ruth, 2013:18). However, anti-corruption campaigns require strong political commitment to enforce the policies, with a *zero tolerance* stance, or the campaigns are bound to fail (Abduali, 2009).

Rationalisation of commercial crime can be inhibited by BRICS companies through ethical training and implementing good corporate governance principles. The focus should however not be on compliance, which creates the so-called compliance-mentality, but on really creating a culture with values that can be internalised by employees. Companies should focus on creating a top-down corporate culture, containing imbedded values of governance and ethicality. This will aid the decision-making capabilities of employees, as well as facilitating whistleblowing practices.

The principle-based *apply or explain* foundation of the King Code is ideal for the BRICS countries, as there are certain situations where a company might choose to deviate from the recommended practice because of individualistic country-specific requirements. This approach allows these types of deviations, while still classifying the company as compliant.

Ethical training must be made a priority, as it has been shown to directly increase employees' ethical decision-making capabilities and awareness of ethical dilemmas. Ethical codes should not just pay lip-service to ethical principles, but must be made an integral part of the corporate culture.

Information and communication technology must be fully harnessed in the BRICS countries, especially taking into account their large population sizes. The data analytic tools must be trained to incorporate the cultural differences between countries.

Furthermore, auditing should also assume a more proactive approach to fraud. Proactively auditing for fraud, with the cooperation of forensic accountants, could increase the detection rate.

The current role of forensic accountants was discussed and criticised, with suggestions made to move the focus away from *historic* events to focus more on the *future*, more alike to managerial accounting than the current paradigm of auditing and financial accounting.

In closing, it must be noted that "…changes to a company's culture to mitigate the risks of fraud, bribery and corruption cannot be made overnight. Organizations need to make concerted, risk-focused efforts that target areas of potential exposure, and management needs to lead by example. Only then will companies be able to properly balance the priorities of growth and ethical business conduct while seizing opportunities in these highly adverse economic conditions" (E&Y, 2012:28).

This is nowhere more important than in emerging and developing markets such as BRICS. Only through measures like the above will these countries be able to become the new economic powerhouses that will influence the next generation of global economics.

6. CONCLUSION AND RECOMMENDATIONS

6.1. Introduction

Is prevention a possible solution to the commercial crime problem in the BRICS countries? What contribution can forensic accountants make in this regard and can they be more effective preventing commercial crime than in their traditional *ex post facto* roles?

The questions above were those with which this study set out to engage and, hopefully, answer.

The objective of this study was to expand the research field associated with forensic accounting, to encourage research into incorporating more preventative strategies. The argument was advanced that prevention of commercial crime is more effective than the traditional *ex post facto* method.

It was argued in Chapter 2 that the research paradigm of commercial crime prevention is inadequate to properly address the evolution of the field. A new paradigm needs to be developed for future research to be able to expand on this. This study was intended to be a foundational study for rethinking the "knowledge" accepted as fact in the forensic accounting sciences.

In Chapter 2 the deviation from the framework-based, or hypothesis-deduction, research method frequently used in the accounting sciences was explained. In order to create new research paradigms, the tradition needed to be interrogated and broken. Only through this uncomfortable deviation from what is "known" can knowledge truly be developed.

The other argument for the above approach was that even although this study specifically dealt with the BRICS countries, because the majority of the recommendations are of a more philosophical nature than concrete suggestions, they should be applicable to other developing countries as well.

6.2. Conclusions on specific research objectives

6.2.1. Investigating the levels of commercial crime in BRICS countries

Chapter 3 set out to establish the current commercial crime environment in the BRICS countries. The specific objectives were to gather data on commercial crime in the BRICS countries and to analyse these findings within the regulatory context of these countries.

These objectives were addressed by means of a brief general discussion about the individual countries, after which each of them was analysed, based on corruption, organised crime, fraud, auditing and reporting standards as well as governance.

The conclusion reached was that even though there were legislation and regulations in place to combat commercial crimes or aid attempted convergence to IFRS and codes of governance, the prevalence of commercial crimes was still very high. This seems to be mostly owing to poor institutional development and enforcement in these countries.

6.2.2. Critical analysis of current commercial crime prevention methods

Chapter 4 set out to investigate the current strategies employed to prevent commercial crimes. The major objectives of this chapter were to discuss the current global standards for commercial crime prevention and to identify the shortcomings in the approaches used. The prevention of commercial crime was dissected into the three elements of the fraud triangle as discussed, i.e. perceived pressure; perceived opportunity; and rationalisation. Five main categories for commercial crime prevention were distilled from the data, i.e. legislation and conventions; governance; ethical codes and training; the use of information and communications technology; auditing and controls.

The conclusion reached is that although globally, there are many useful initiatives to counter commercial crime, there are disadvantages with the implementation thereof. These include a compliance-mentality encouraged by trying to fix bad systems through over-regulation; not enough focus on ethical

and commercial crime specific training; and not enough focus on developing an ethical corporate culture with top-down implementation.

6.2.3. Commercial crime prevention as the new norm in BRICS countries

Chapter 5 delved into the philosophical and hypothetical World 3 of the meta-theory for commercial crime prevention. Prevention methods identified in Chapter 4 are used here, only as applied to the BRICS countries and with suggestions to improve on the current implementations thereof.

The concept of a more preventative stance being inculcated in and adopted by forensic accountants was analysed; the conclusion reached is that more in-depth studies should be undertaken in this area. It is recommended that forensic accountants evolve to a stance more akin to managerial accounting, in that they should start predicting and analysing future events, instead of merely drawing conclusions based on past events.

It is also necessary for the audit field to develop, in order for auditors to receive more fraud-specific training, so that they can be more proactive in their auditing efforts.

6.3. Conclusion on Problem Statement

This study set out to answer the questions mentioned in 6.1.

The conclusion reached is that prevention is a feasible solution for addressing the prevalence of commercial crime in the BRICS countries, and indeed also for other similar, developing countries. Prevention should prove to be more effective in the long run.

Forensic accountancy should evolve its paradigm in order to stay relevant in the continually changing commercial crime environment.

6.4. Recommendations for future research

There is indeed a need to repackage the role that forensic accountants play with regard to commercial crime and its prevention. More research should be performed in this regard, possibly with a view to examining the following:

- the involvement of forensic accountants in the development of governance theory for family-owned businesses and SME's, taking into account their unique commercial crime risk profiles;
- the involvement of forensic accountants in ethics and fraud-specific training and education;
- the role forensic accountants could play in contributing to the effectiveness of ICT systems, by either providing input data, helping to "train" the systems, or sifting through the red flagged "instances" to identify which ones need manual intervention;
- synergistic roles with other professions, such as that of the tax fraud specialist discussed;
- further links between forensic accountancy and managerial accounting;
- research into how the auditing field needs to evolve in order to be more proactive and effective in its auditing approach with regard to fraud; and
- research into quantifying the cultural differences between the BRICS countries and the effect thereof on the prevalence of commercial crimes.

If the BRICS countries continue to grow in the manner predicted, then the global economic power will presently begin shifting from the traditional Western European and North American countries to their Asian, Eastern European and African counterparts. If these countries are able to overcome the obstacle of prevalent commercial crimes by taking a more preventative stance, then commercial crime prevention might become the new global norm.

It seems to be true that an ounce of prevention is indeed better than a pound of cure.

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