

SAS 99: Deconstructing the Fraud Triangle and Some Classroom Suggestions

Alexander K. Buchholz
Brooklyn College of the City University of New York

This article examines the nature of the fraud triangle, which was one of the components of SAS 99 as well as deconstructs the various underlying principles. The article will examine some of the pitfalls which auditors sometimes fail to consider when planning their audits as well as provide and serve as a planning guide for consideration by auditors. The article takes different viewpoints of the fraud triangle and shows the limitations as introduced previously. It will add to existing accounting literature in that it will stress to both academics as well as practitioners the necessity of educating future auditors in having a heightened sense of professional skepticism while conducting financial statement audits. To that extent, this article will provide some classroom applications involving the use of the case study method as a means to further educate future auditors.

INTRODUCTION

Gordon Gekko, the main character played by Michael Douglas in the 1987 movie *Wall Street*, stated that:

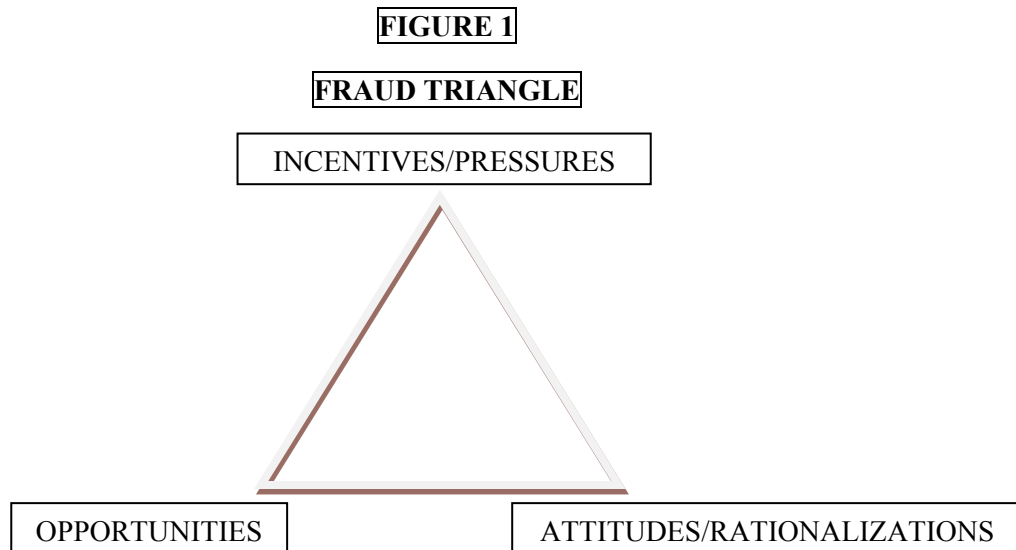
Greed, for lack of a better word, is good. Greed is right, greed works. Greed clarifies, cuts through, and captures the essence of the evolutionary spirit. Greed, in all of its forms; greed for life, for money, for love, knowledge has marked the upward surge of mankind.

However, greed has also become a motivation causing many scandals to have been perpetrated in corporate America over the past several years. Individuals who feel that they can steal from a company without being caught are sometimes prone to engage in fraudulent activities. Such notable instances have been documented in the cases of Enron, WorldCom, ZZZ Best, and Bernie Madoff, to name a few. In an effort to properly plan audits encompassing these circumstances, the American Institute of Certified Public Accountants (AICPA) reexamined the audit procedures used for the consideration of fraud in a financial statement audit. For audits beginning on or after December 15, 2002, auditors implemented Statement on Auditing Standards SAS 99 (AU 316). This standard changed the way audits are being conducted in an effort to further strengthen the consideration and possible detection of fraud. However, nine years later, we still see an abundance of corporate scandals resulting from fraud without detection by the auditor. It is important for the reader to note at this point that an audit is not designed to "find all instances of fraud" nor am I advocating that the public hold an auditor to this standard. Section 110, *Responsibilities and Functions of the Independent Auditor*, paragraph .02, states, "The auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial

statements are free of material misstatement, whether caused by error or fraud." This article examines the fraud triangle, which was one of the components of SAS 99. It examines the nature of the fraud triangle as well as deconstructs the various underlying principles. The article will focus on and examine some of the pitfalls which auditors sometimes fail to consider when planning their audits. It will also provide and serve as a guide which auditors should consider when planning an engagement. This must be considered by both practitioners as well as academics. It is academics' responsibility to assist future auditors in heightening their sense of professional skepticism while conducting their financial statement audits.

REQUIREMENTS OF SAS 99

In understanding the auditor's requirement for the consideration of fraud in a financial statement audit, it is necessary to understand SAS 99. The AICPA, through SAS 99, strengthened the auditing procedures to ensure financial statements are free of any material misstatement caused by fraud. SAS 99 was organized in such a way as to allow for a logical thought process to be undertaken from the initial audit planning until the final reporting stages. One of the major components of SAS 99, in addition to the above, was the fraud triangle (Figure 1). This is to serve as the focal point for all brainstorming sessions conducted during the planning stages of an audit. Each element on the fraud triangle in Figure 1 represents a possible reason why an audit client may commit fraud.



SAS 99 FRAUD TRIANGLE DECONSTRUCTED

The idea behind the fraud triangle and related brainstorming session should be to plan the audit to make sure those potential fraud risks are identified and are examined to ensure that those potential fraud risks are not present and have resulted in a material misstatement on the financial statements. Fraud under SAS 99 is classified into either misappropriation of assets or fraudulent financial reporting. The profession has issued more specific guidance as to what constitutes incentives/pressures, opportunities, and attitudes/rationalization in the appendix to SAS 99 for each of these areas.

Incentives/Pressures

1. As auditors, the profession has understood incentives/pressures to stem from an individual's desire to obtain some sort of economic benefit, very often resulting from the "lure of greed." This can result in someone billing fictitious revenues or delaying the accrual of certain expenses, for

example, so as to obtain a bottom line which is on, or close to, their original budgeted amounts presented to management. If management exhibits a sharp tone that a company's net income (loss) should never be at a variance with the original budget, this now creates pressure for the client's staff to make sure they achieve the "desired" bottom line or face fear of termination. Another possible incentive/pressure can arise if client management has compensation which is connected to the performance of the stock price. Two such examples of this are stock options and stock appreciation rights whereby the compensation of the recipient is tied to the upward performance of the stock price. If this is not a perfect example of incentive/pressure, then what alternatives remain?

2. Sam E. Antar, former Chief Financial Officer of Crazy Eddie, Inc., however, had a different view on the concept of incentives/pressures. His views on the fraud triangle lend themselves for an interesting take as well as an awakening of some of the ideas auditors should be aware of during a brainstorming session. He stated that:

As a society, we too often associate incentive with only an economic incentive to commit crime. You can commit an economic crime and have no economic incentive...Criminals can commit a crime for a whole host of reasons of which money is part of the incentive but not the primary incentive (Antar, 2010).

Antar states that individuals may steal for reasons other than money such as popularity. This is important to note because auditors have taken the approach that someone steals because they are in need of economic financial gain. Therefore, auditors should be accounting for this "popularity factor" in their brainstorming sessions and plan their audits accordingly.

Opportunities

1. The professional literature indicates that opportunities arise as a result of the nature of the client's internal controls. The more lax a client's internal controls, the greater the opportunity for those internal controls to be circumvented and for possible fraud to occur. This does not imply, however, that stronger the internal controls diminish the possibility for fraud completely. It merely makes those committing the fraud work harder. Another opportunity which auditors must take into account is when a current auditor becomes employed in a managerial position at a client. While this is seen as a positive, in that client relations as well as the efficiency of the audit can be greatly improved, this can also represent an opportunity where the person will have the prior audit knowledge and experience which can be used for personal mischievous advantage. Therefore, as part of the brainstorming session, auditors must examine these areas to see what opportunities may exist and how they may cause a material misstatement.
2. Once again, Sam E. Antar offers a different perspective with opportunity, which is cause for concern. He states that:

You [meaning the inexperienced junior auditors who are recent college graduates who go straight out into the field] are the opportunity to allow us to commit the crimes. Your ethics, your gullibility, your lack of skepticism, your humanity, your vanity, your self esteem. We stroke your egos. You on a personal level, give us the opportunity to commit our crimes (Antar, 2010).

Although originally dismissing such an unfounded statement, upon further thought, I came to the realization that the inexperienced junior auditors who are only recently graduated from school do

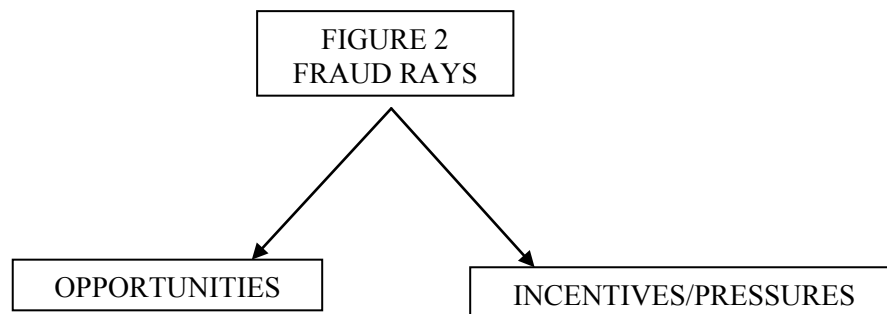
represent a great opportunity for someone committing fraud. How many times do we as senior (or rather more seasoned) auditors leave our new audit staff at a client's office to complete the fieldwork portion of an audit, with nobody there to guide them except the client? Perhaps Mr. Antar has discovered a great opportunity presented in the fraud triangle.

Attitudes/Rationalizations

1. SAS 99 AU Section 316.85 A.3, relating to misappropriation of assets, recognizes that attitudes/rationalizations are most common to those employees with "behavior indicating displeasure or dissatisfaction with the company or its treatment of the employee." They believe that the actions they perform are not really considered fraudulent as they were entitled since management really owed it for all the years of hard work and service. Additionally, attitudes are often such that there is a "disregard for the need for monitoring or reducing risks related to misappropriations of assets" (SAS 99 AU Section 316.85 A.3). Therefore, auditors must attempt to observe the environment and underlying attitudes present at the client. Based on this observation, the audit must be planned and tailored to ensure that any possible material frauds occurring as a result of attitudes/rationalization are examined during the audit.
2. If you are still bewildered by Antar's last statement, you will be confounded at his critique of this last part of the fraud triangle. He states:

In some cases, in most cases, there's really no rationalization for the crimes. Criminals come up with excuses but they know what they're doing and why they're doing it. They don't have to do it in most cases and that's why I disagree with the rationalization concepts (Antar, 2010).

This last point eliminates one side of the fraud triangle. Antar now leaves us with merely two rays extending out into the far reaches of "audit space" (Figure 2). It is interesting to note that Antar takes the position that rationalization can't be used in audit planning.



POTENTIAL WEAKNESSES OF THE FRAUD TRIANGLE

Based on these points, I think the profession can agree that the fraud triangle, while an excellent starting point in addressing the risks of fraud in a financial statement audit, does have some potential weaknesses. The points made by Antar, while at first seem to be far-reaching, really do show some potential weaknesses in the fraud triangle with the two most important being:

1. The fraud triangle used against the auditor in that the auditors themselves become an opportunity.

2. Eliminating the concept of attitudes/rationalization.

This article follows suit with Dorminey et. al (2010) who state that "professionals and academics have offered important insights that have gone beyond the fraud triangle. These extensions have enhanced professionals' ability to prevent, deter, detect, investigate, and remediate fraud (Dorminey et. al, 2010 p. 17). In that article, the authors do present and examine the fact that the fraud triangle does have some inherent limitations. It was created originally for the "accidental fraudster." They also contend that certain components of the fraud triangle do not really capture all the elements of an individual perpetrating a fraud. For example, "with regard to the fraud triangle, all the predator seeks is opportunity. The predator requires no pressure and needs no rationalization" (Dorminey et al, 2010, p.21). This last part sounds very similar to the logic used by Antar when he discusses his views on rationalization. In addition, the fraud triangle "does not provide a good basis for assessing the likelihood of fraud under conditions of collusion. Yet this is one of the central elements of complex frauds and financial crimes" (Dorminey et al, 2010, p.21). Furthermore, the authors make it a point to stress that pressures and rationalizations are generally non-observable which contradicts SAS 99, at least for rationalization.

CONCLUSIONS: WHERE DO WE GO FROM HERE?

The fraud triangle is still a very powerful asset in planning the audit to detect material misstatement and should never be thought of as anything less. However, this article has exhibited that the fraud triangle needs to be used as a starting point in the audit process and not relied on as the only method to be utilized. The viewpoints expressed by Sam Antar as well as Dorminey et al. demonstrate that auditors need to expand their focus and concentration of fraud to many factors beyond that of the specific guidance issued under SAS 99. They must take a broader view in order to make audits more attuned to the sensitive and devious nature that surrounds fraud. Auditors today must be able to overcome the "Sam Antars" of corporate America, which is not an easy task to do given the fact that forensic accounting methods are usually not required courses for most undergraduate accounting degrees. There are also newer models being introduced to supplement the fraud triangle which auditors may find valuable as well (eg. The MICE Model introduced by Kranacher, Riley, and Wells in *Forensic Accounting and Fraud Examination* which describes fraud in terms of Money, Ideology, Coercion, and Ego). Therefore, academics should be using various case studies and exercises in their accounting and audit classes to enhance the students' analytical ability to heighten their awareness of professional skepticism. Practitioners also need to be constantly re-emphasizing this need for heightened awareness and not rely solely on the fraud triangle as the basis for planning and responding to potential fraud risks on the audit engagement.

CASE STUDY METHOD

As noted above, academics should be using the case study method in their accounting and audit classes. These next sections will describe how I employ the case study method for both my graduate and undergraduate auditing classes.

Introducing the Case Study Method in Class

Figures 3 and 4 are assignments given in both my undergraduate (Figure 3) and graduate (Figure 4) auditing classes on the first day and are part of the syllabus. The students form groups of two to three students usually since the class size can range anywhere from 15-25 students. If a student is unable to find a team member, then I will assign that person to a team in need of another member. The concept of groupwork is usually very frustrating for most students as they do not like to have their final grade contingent upon the work of a classmate who may not be able to perform to the level of their academic satisfaction. However, I stress to them working in groups is the core of performing an audit. It is necessary to work, collaborate, argue, and think as a team so that audits can be planned to account for the "Sam Antars." I also advise students to try and solve group situations on their own prior to coming to me.

However, should my intervention be needed, groups are advised to approach me prior to handing in the case study. Once a grade has been assigned, I treat it as a sunk cost and cannot do anything retroactively. Prospectively, the group member who is not performing to the satisfaction of the rest of the group is told that if they are unable to work with the group in an equitable manner, their individual grade would have to be adjusted.

FIGURE 3
UNDERGRADUATE AUDITING CONCEPTS AND ACCOUNTING RESEARCH COURSE

Group Case Study Assignments (15%):

Readings for the course will be a series of 5 cases. The readings for each case will be provided before the scheduled class discussion. Students will be expected to develop a solution strategy for each case and to be prepared to respond to questions, role-play, and/or lead the case discussion. **Three** group written case analyses are also required. Groups will write case analyses for each of the selected cases in the text: [5 points each]

Case 7.8 First Securities Co. of Chicago	Due XXXX
* Case 1.9 ZZZ Best Company, Inc.	Due XXXX
Case 1.8 Crazy Eddie	Due XXXX
Case 1.1 Enron Corp.	Due XXXX

* When groups present a case study, they do not have to submit a formal case study analysis. However, all groups must still have three case study analyses. Therefore, use this case as an alternative assignment to make sure you have three case studies.

All assignments must be submitted on the assigned due date. **Late assignments will not be accepted under any circumstances. In addition, students will not be given the opportunity to revise or resubmit these assignments so be sure to proof your paper carefully.** The format which groups need to submit in order to obtain full credit for the assignment is as follows:

1. Papers should be typed and submitted on 8 ½ x 11 paper, single-sided, with 12 point Times New Roman font. Papers must be a **minimum** of three full pages. **Format will count towards the grade, so be sure to proof your paper at least once!**
2. **Plagiarism – Under no circumstances may a student use an author’s words without proper citation. To do so is considered plagiarism and will result in an automatic failure for the paper being submitted. If you wish to use an exact phrase from the casebook or any outside reference, please use proper citation when doing so.**
3. **Academic Integrity:**

The faculty and administration of XXXX support an environment free from cheating and plagiarism. Each student is responsible for being aware of what constitutes cheating and plagiarism and for avoiding both. The complete text of the Academic Integrity Policy and the College procedure for implementing that policy can be found at this site: [XXXX](#). If a faculty member suspects a violation of academic integrity and, upon investigation, confirms that violation, or if the student admits the violation, the faculty member **MUST** report the violation. The College policy on academic integrity applies at all times. A copy of the policy is available at: XXXX

4. General Methodology

- a. “Problem” or “Opportunity” Statement (aka. the Critical Issue). Provide a single statement of the critical issue present in the case. If several issues are apparent, identify them in priority order. Generally, several problems are all symptoms of one overriding problem. Try to abstract up to the overriding problem after the symptoms are known.
 - i. i.e. “The critical issue is...”
- b. Critical Factors. **List** (using bullet points) the key factors that give **evidence** that there is a problem or opportunity condition. Identify them in priority order. Explain why they are relevant.
 - i. Critical Factor #1
 - ii. Critical Factor #2
 - iii. Critical Factor #3
 - iv. Etc.
- c. At the end of the case, there are several questions provided by the author. Copy the questions down (single-spaced) and provide your answers to those questions (double-spaced). Answers must be clear and grammatically accurate.

FIGURE 4 GRADUATE AUDITING CONCEPTS: ADVANCED TOPICS ON ASSURANCE SERVICES

Group Case Study Assignments: [15%]

Readings for the course will be a series of several cases. The readings for each case will be provided before the scheduled class discussion. Students will be expected to develop a solution strategy for each case and to be prepared to respond to questions, role-play, and/or lead the case discussion. Three written case analyses are also required. Groups of students will write case analyses for each of the selected cases: [5 points each]

The Enron Collapse	Due XXXX
Callmate Telips (A) Choice of Accounting Policy	Due XXXX
Accounting Fraud at WorldCom	Due XXXX
* Sara Campbell Ltd. (A&B)	Due XXXX

* To be used as an alternative assignment for those groups who present a case that has a related case study assignment due. In cases where a group makes an oral presentation, they will not be required to hand in a formal written case study assignment. Instead, they will do this case in order to meet the required three case study submissions.

All assignments must be submitted on the assigned due date. **Late assignments will not be accepted under any circumstances. In addition, students will not be given the opportunity to revise or resubmit these assignments so be sure to proof your paper carefully.** The format which students need to submit in order to obtain full credit for the assignment is as follows:

1. Papers should be typed and submitted on 8 ½ x 11 paper, single-sided, with 12 point Times New Roman font. Papers must be a **minimum** of three full pages. **Format will count towards the grade, so be sure to proof your paper at least once!**
2. **Plagiarism – Under no circumstances may a student use an author’s words without proper citation. To do so is considered plagiarism and will result in an automatic failure for the paper being submitted. If you wish to use an exact phrase from the casebook or any outside reference, please use proper citation when doing so.**
3. General Case Study Methodology – A guideline for case study analysis follows. You should be aware that this is essentially the same as the traditional systematic approach to problem-solving. Mastery of this approach will serve you well in any problem solving situation in your professional career.
 - a. “Problem” or “Opportunity” Statement (aka. the Critical Issue). Provide a single statement of the critical issue present in the case. If several issues are apparent, identify them in priority order. Generally, several problems are all symptoms of one overriding problem. Try to abstract up to the overriding problem after the symptoms are known.
 - i. i.e. “The critical issue is...”
 - b. Critical Factors. **List** (using bullet points) the key factors that give **evidence** that there is a problem or opportunity condition. Identify them in priority order. Explain why they are relevant.
 - i. Critical Factor #1
 - ii. Critical Factor #2
 - iii. Critical Factor #3
 - c. Alternative Solutions. Provide a list of possible solutions to fix the various problems found in the case. Explain the advantages and disadvantages of each.
 - d. Recommended Solution and Implementation. Which alternative solution is best? Why? Prepare an action plan of how this solution could be implemented successfully.

Case Study Method for a Graduate Auditing Course

The case study method needs to be tailored to the specific level of course being taught. I use an abbreviated version in my undergraduate course while using the full version in my graduate course. The full case study methodology is:

- a. “Problem” or “Opportunity” Statement (aka. the Critical Issue). Provide a single statement of the critical issue present in the case. If several issues are apparent, identify them in priority order. Generally, several problems are all symptoms of one overriding problem. Try to abstract up to the overriding problem after the symptoms are known.
- b. Critical Factors. **List** (using bullet points) the key factors that give **evidence** that there is a problem or opportunity condition. Identify them in priority order. Explain why they are relevant.
- c. Alternative Solutions. Provide a list of possible solutions to fix the various problems found in the case. Explain the advantages and disadvantages of each.
- d. Recommended Solution and Implementation. Which alternative solution is best? Why? Prepare an action plan of how this solution could be implemented successfully.

I would recommend this approach for a graduate level auditing course. The reason being that the level of analysis in a graduate level course would be conducive to the outline above. Cases for this level of course come from a custom text, which I created with the assistance of Wiley Custom Services, and has cases from Harvard Business School, Institute for Management Development, and Richard Ivey School of Business (to name a few with the majority coming from Harvard Business School). The cases are designed to present a set of facts about a company (sometimes a real company and sometimes not) and an accounting/auditing issue which is facing management. The case will often present the positions taken by management and the auditors. After a series of further facts and sometimes financial analysis, the case ends with no solution or epilogue. This is the point where groups now need to determine the critical issue, factors, and possible solutions to the problem. In a graduate level course, it is important to note that there may be more than one way to interpret a case and, as a result, there may be more than one critical issue. Groups will need to ensure that they are able to support their critical issue with factors.

Case Study Method for an Undergraduate Auditing Course

The undergraduate auditing course has a separate casebook, which is not custom. This casebook does not have any Harvard Business School, Institute for Management Development, and Richard Ivey School of Business cases as that would be too high a level of analysis for an undergraduate student. The casebook uses shorter length cases which also present real world cases as well as some other educational cases. The cases present the same information as would the graduate cases with the major difference being that the undergraduate casebook always has the epilogue/solution. This is why, in lieu of "Alternative Solutions" and "Recommend Solution and Implementation," my undergraduate audit classes are given the following:

- a. At the end of the case, there are several questions provided by the author. Copy the questions down (single-spaced) and provide your answers to those questions (double-spaced). Answers must be clear and grammatically accurate.

These questions are provided by the author of the casebook. It gives the undergraduate students more focus in reading and analyzing the cases. Also, being that these cases are more straightforward, there is always only one critical issue, which makes grading a little easier for the instructor since all groups should arrive at the same conclusion. On a graduate level, the use of answering questions at the end of a case, in my own professional opinion, inhibit their "creative juices" from flowing. This is why I recommend that graduate students come up with suggested solutions, choose the best one, and how that solution should be implemented.

Grading

The case study assignments constitute 15% of the overall final grade, with 5 points going to each of the 3 case studies. I assign points as follows:

A	5 points
B	4 points
C	3 points
D	2 points
F	0 points

The grading varies based on whether the course is undergraduate or graduate. In order for a group in the undergraduate audit course to score the maximum grade ("A"), they need to provide the correct critical issue, the supporting factors (along with any technical references), and detailed answers to the questions. Most times, in the casebook used, the questions require the group to give opinions on the issues presented in the case. This can be quite subjective to grade so I tell groups to give as much of their opinion as possible and avoid using simple one to two sentence answers. Students who tend to support these opinions with proper professional arguments and technical references will score higher. In addition, case studies are expected to conform to a well written executive summary using bullets to support ideas as well as standard English grammar and punctuation. Since sometimes undergraduates may not have had

extensive preparation writing courses up to the level of this course, I may be lenient somewhat. However, I do stress to them that writing skills are important in today's professional environment.

The graduate course is also graded using the same five point scale as noted above. In order for them to earn the A, the case study must give a critical issue supported by proper critical factors. As noted above, the case studies used in a graduate level course come from advanced sources and, as such, may have more than one critical issue. Therefore, as long as the group can present their critical issue with enough supporting factors, it will not hinder the ultimate grade. In addition, groups at this level need to also provide alternative solutions and implementation for the one solution they feel will best solve the critical issue. The solutions and implementation must be feasible and realistic in order to receive credit. For example, groups that simply write that "the law must be changed to stop companies from committing fraud," while indeed noble needs much more elaboration and details. How should the law be changed, what elements are currently lacking or can be expanded, and how can the accounting profession contribute to this solution? In addition, similar to the undergraduate case studies, the level of writing is expected to conform to a well written executive summary using bullets to support ideas as well as standard English grammar and punctuation. Oftentimes, papers will get a B as the case study was written poorly although all the other requirements were perfectly satisfied.

Assessment of Case Study Method Approach as a Tool to Strengthen Future Auditors

In either course, the assessment is similar. The groups tend to work together to try and come up with the critical issue and supporting factors. They are able to discuss and even argue amongst themselves and the rest of the groups if they have differing critical issues. It is rewarding as an instructor to see this because it shows the development of thinking and critical analysis, the skills which Antar accuses junior auditors of being lax. This is the first step in addressing the serious problem which the auditing profession faces in that junior audit staff are vulnerable to the many "Sam Antars." Antar's statement that junior auditor "give us the opportunity to commit our crimes" (Antar, 2010) may now face some challenges if academics assign students the case study method. By assigning these cases, academics can not only reinforce the subject matter contained within the textbooks, but can further develop the skills involved with research and critical analysis, which is something present on all financial statement audit engagements. Perhaps now we can send the next generation of auditors into the field with some more tools to defend against the Sam Antars of the corporate world!

REFERENCES

American Institute of Certified Public Accountants. *AICPA Professional Standards Volume 1*. New York, New York: 2008.

Dorminey, J., Fleming, A., Kranacher, M., and Riley Jr., R. (2010). "Beyond the Fraud Triangle: Enhancing the Deterrence of Economic Crimes." *The CPA Journal*, 80, no. 7: 17-23.

"GuestPost: Fraud Girl Interviews Famous Financial Felon Sam Antar." (2010, May 9). *Simoleon Sense*, <http://www.simoleonsense.com/guestpost-fraud-girl-interviews-convicted-financial-felon-sam-antar.html>

Wall Street [Motion picture]. Directed by Oliver Stone. (1987 United States: 20th Century Fox.)