Impact of the Corporate Governance on the Financial Statement Fraud: A Study Focused on Companies in Tanzania

Ally Faraj Abri, Dhamayanthi Arumugam, Suresh Balasingam

***Abstract:** In the previous couple of years, the attention of the public has been increasing rapidly towards big corporations and their disclosures of accounting frauds and false reporting as well as high amounts of compensations given to the executives and mismanagement leading to bankruptcy faced by the large corporations. The accounting frauds and poor corporate governance system have been reported in many countries including Tanzania, USA, and Canada etc. The scandals committed by large companies in Tanzania was brought to public attention when it began around 2005 which led to loss of millions of dollars. These scandals were such as External payment arrears known as EPA and the scandal of Escrow. Corporate governance system has a major impact on the financial statements and accounting fraud in the company. Good corporate governance means that the financial statements reported to the public will be free from errors and accounting frauds will be minimized. The general objective of this research is to analyze the impacts of corporate governance system on the financial statement frauds particularly with companies in Tanzania. The design and approach of this study is chosen as a quantitative research which incorporates primary data. The primary data of this research will includes questionnaires given to stakeholders of companies in Tanzania. The results indicate that Audit committee effectiveness, tone at the top level management, Independence of BOD and Audit committee, policies and ethical guidance and corporate culture has a direct impact on the financial statement fraud. Future researchers may also include other areas of corporate governance in which they can include other variables such as Board meeting and board size should be included in relating to how it affects the overall quality of financial reports and the financial statementfraud.*

***Keywords:** Corporate governance, financial statement fraud, Tanzania*

I. INTRODUCTION

In the previous couple of years, the attention of the public has been increasing rapidly towards big corporations and their disclosures of accounting frauds and false reporting as well as high amounts of compensations given to the executives and mismanagement leading to bankruptcy faced by the large corporations. The fraud in financial statements or accounting fraud has been in existence from a longtime ago which public and private companies commit the accounting fraud. The public companies commit accounting fraud for various reasons such as manipulation of the financial performance of the company to the public i.e. investors and private companies as well manipulates its financial reporting to deceive its lenders such as banks.

Financial reporting fraud also exist to manipulate government authorities regarding the company's income tax. (Crawford and Weirich,2011). The accounting frauds and poor corporate governance system have been reported in many countries including Tanzania, USA, and Canada etc. these countries are considered to be an example of having effective and efficiency accounting structures, corporate governance systems and high capital market. The scandals committed by large companies in Tanzania was brought to public attention when it began around 2005 which led to loss of millions of dollars. These scandals were such as External payment arrears known as EPA and the scandal of Escrow.

Furthermore, looking into the other side of USA, the country started facing scandals when large corporations such as Enron and Lehman Brothers were facing bankruptcy and demised. The failure of corporate governance system was increasing significantly causing more large companies to be affected. These companies that failed in USA caused loss of billions of dollars to the shareholders and directing towardsbankruptcy.Since these scandals have been increasingly arising in the US, the quality and the efficiency of corporate governance system in the country is at stake. According Edwards (2013), some of the fraud scandals was caused due to the bubble burst of the market in the year 2000, however, the increasing of misreporting and misconduct by large corporation caused corporate governance system to get weaker and poor in the country.

Table 1: Cases by Country in Africa

Country	Number of cases
Angola	3
Botswana	1
Cameroon	1
Central African Republic	1
Chad	3
Congo, Democratic Republic of the Congo	3
Cote d'Ivoire	5
Tanzania	5
Uganda	11

Source: ACFE report (2018)

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From the above table, the association of certified fraud examiners (ACFE) has released the overall global study on the occupational fraud and the abuse in which it includes financial statement fraud, asset misappropriation and corruption for the year 2018. In accordance to the report, the number of major fraudulent cases in Tanzania for the year 2018 was 5 cases in which it illustrates that there is an increase of occupational fraud in which the fraud was committed by an individual to the company in which he/she is working for.Therefore this research is focusing towards analyzing the Impact of the corporate governance on the financial statement fraud: A study focused on companies in Tanzania.

Problem statement

Currently, corporate governance system has a major impact on the financial statements and accounting fraud in the company. Good corporate governance means that the financial statements reported to the public will be free from errors and accounting frauds will be minimized.According to Romano (2012), the board independence is one of the factors which can be used as a mechanism in order to detect fraud in the financial statements. This means that the company should establish an independence board in order to detect any accounting fraud. If the board will be independent, there will be high chances of detecting any financial statement fraud within the company. According to the author, most of the companies that commit fraud is because they have a lower number of directors which are independent making it vulnerable for committing accountingfraud.Furthermore, Lokanan (2014) has stated that senior managers in the company have a high access and probability in committing accounting fraud. The author states that a company with internal control which is weak and poor corporate culture will lead to accounting fraud since the supervision is poor.

Philip law (2011) has also added factors such as the effectiveness of audit committee and internal audit, the tone/power at the top level management, policies of the company and ethical guidelines will lead to a lower commitment of financial fraud. These factors positively affect the frauds in the organization and will minimize the overall financial statement frauds. Also, other authors have stated that companies with auditors, professional accountants and board of directors are good mechanism for a company to have an effective corporate governance (Alleyme, Marshall, Broome,2014).

Moreover, Crawford and Weirich (2011) have analyzed and came up with ways on how companies can use the corporate counsel in order to reduce frauds from financial and other misreporting. Crawford came up with more than ten tips regarding the corporate counsel and how the company can minimize its financial statement misreporting. This tips include how company can control its earnings when it exceeds the cash flow and reconciliations and reviewing the financial statements in regards to the accountsreceivable.

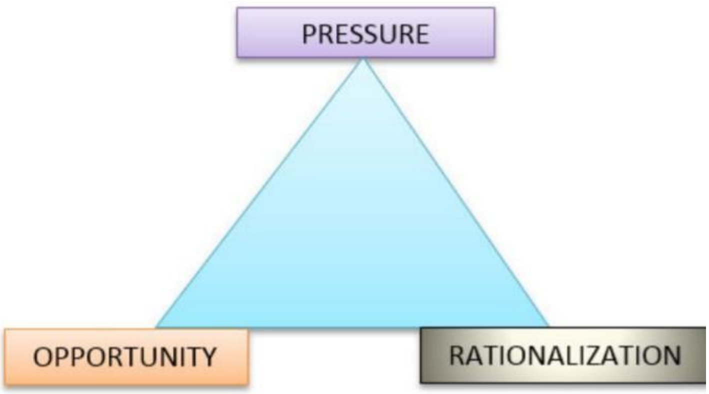
According to Agyei-Mensah (2017), the author has found a unique results stating that companies that are located in countries with least corruption such as Botswana discloses transparent information than companies located in most corrupt countries such as Ghana. This means there is a significant relationship between transparency level of the company and country.Lastly but not least, another factor leading to financial statement misstatement is to increase/inflate company’s earnings. The authors states that there is less independent between the committee and the top level management. Also, authors states that companies with high amount of debts have high probability of committing financial misstatement. (Nahar Abdullah, Zalina Mohamad Yusof and Naimi Mohamad Nor, 2010). Therefore, with the analyzed gaps above, this study is focused towards analyzing the impacts of corporate governance system on the financial statement frauds for companies in Tanzania.

Research Objective

- ❖ To analyze how board independence have an influence on the reporting of financial statements and how financial misstatementoccurs.
- ❖ To identify how the tone at the top level management influences on the accounting/financial statementsfraud
- ❖ To identify whether the effectiveness of audit committee will lead to a lower financial statementfrauds.
- ❖ To identify how corporate culture affects the effectiveness of corporate governance and accountingfraud.
- ❖ To describe how policies and ethical guidelines in the company has an effect on the financial statement frauds in theorganization.

Theories

Exhibit 1
Fraud Triangle



Source: Abdullahi and Mansor(2015)

The **pressure** factor was raised because individuals may commit fraud and violate trust if they feel that they are facing financial difficulties and are not financially stable. **Opportunity** is another factor in the fraud triangle. Opportunity simply means the ability and chance in committing fraud. Lastly on **rationalization** factor, an individual e.g. employee will come up with a justified reason that led in committing fraudulent activity. For example, this occurs mostly when companies are taking too long to release salaries to the employees, therefore, an employee might commit fraud since the salary payment was late (Abdullahi And Mansor, 2015),

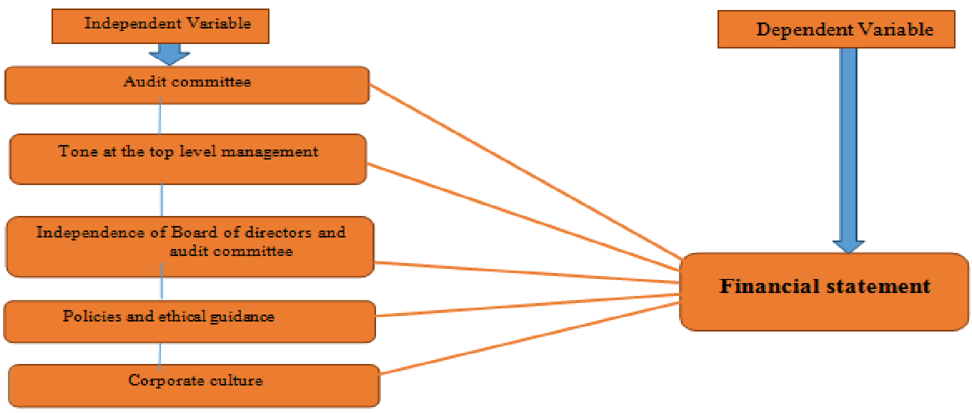
AgencyTheory

Agency theory is one of the oldest theory in which it is widely used to examine and evaluate the corporate governance system. The main idea in the agency theory is when there is conflicts of interests between agents and principals. In this, the agents are considered to be the managers and are responsible for the management of the company's operations while principals are the shareholders or owners of the company as shown in the **exhibit 2**. This means that the conflicts between the agent and the principal arises when the agent will conduct and take actions that are not aligned to the principal's best interest. Furthermore, the agency theory is based on the conflict that arises between the managers and shareholders in which the quality and performance of the managers (agents) is not aligned as well as not verified by the shareholders (principals). This will lead to an agent/mangers to act on his own interest and self-behavior that affects the interest of the shareholders/principals. The theory of agency is important and critical for the company's corporate governance since the agents or top managers in the company are having better and more information of the company's operations than the shareholders/owners (Panda and Leepsa,2017).

EXHIBIT 2
Agency Theory
(Source: Kaplan, 2012)

Agency theory is one of the oldest theory in which it is widely used to examine and evaluate the corporate governance system. The main idea in the agency theory is when there is conflicts of interests between agents and principals. In this, the agents are considered to be the managers and are responsible for the management of the company's operations while principals are the shareholders or owners of the company as shown in the **exhibit 2**. This means that the conflicts between the agent and the principal arises when the agent will conduct and take actions that are not aligned to the principal's best interest (Panda and Leepsa,2017).

Research Framework



Research Methodology

The design and approach/method of this study is chosen as a quantitative research which incorporates primary data. The primary data of this research will includes questionnaires given to stakeholders of companies in Tanzania. The questionnaires will be distributed in different forms such as through Emails and based on 68 respondents such as employees, senior managers and other related parties of companies in Tanzania. This research will analyze and evaluate the relationship between these two variables through linear regression analysis.Using the ANOVA tool, it will test the level of significance between the variables based on the 5% level of significance, the hypothesis will be proved. This research will utilize regression model and analysis in which it will statistically test in order to examine the hypothesis in this research.

$$FSF = a + a1\ ACE + a2\ TONE + a3\ INDBRD + a4\ POL\&ETH + a5\ CC$$

Where:
FSF = Financial statement fraud
a=Alpha
ACE = Audit committee effectiveness TONE = Tone at the top levelmanagement
INDBRD = Independence of Board of directors and audit committee POL&ETH = Policies and ethical guidance
CC = Corporate culture

TABLE 2
REGRESSION MODEL SUMMARY

Mode l	R	**R Square**	Adjusted R Square	Std. Error of the Estimate
1	.784[a]	**.614**	.587	2.06141

Source: Primary data

As shown in the above table 2, it illustrates the overall tests conducted based on linear regression model in which the table was produced through SPSS software. The regression model summary is an important part of analyzing the data obtained from the respondents. In accordance to Burns and Burns 2008, **the R square** is an important element in the regression model summary in which it helps the researcher to measure the overall strength and stability of linear association in which it is between various independent variables and the overall dependent variable. From the results obtained in the above table, the results shows that there is relationship between financial statement frauds with the five variables sets in which the value of **R Square** was at **.614.** The results of obtained of the R Square shows that 61.4% which is the variation of financial statement fraud is explained and related with the set of 5 independent variables (Audit committee effectiveness, Tone at the top level management, Independence of BOD and AC, Policies and ethical guidance as well as the corporate culture). The remaining 38.8% is described and explained by other various determinants of financial statement frauds. This provides insight to do further research in this study in order to obtain the other various determinants in the financial statementfrauds.

TABLE 3
ANOVA RESULTS

Model		Sumof Squares	Df	Mean Square	**F**	**Sig.**
1	Regression	473.528	5	94.706	**22.287**	**.000[b]**
	Residual	297.459	70	4.249		
	Total	770.987	75			

a. Dependent Variable:DVFSF
b. Predictors: (Constant), IV5, IV1, IV2, IV3,IV4

In accordance to Burns and Burns (2008), the overall analysis of F test is the foundation of the multiple regression model and analysis. The f test is used to analyze and provide insights to the researcher in regards to whether the regression model is significant. Moreover, the overall judgement of the significance level is that the p value (Sig.) should be lower than 0.05 in order to show and illustrate the overall model is statistically significant and adequate.

From the above table 3, the output from the above Anova table indicates the significance level of the F statistics in which the overall value of the Sig. was below 5% with the value of **.000** in which it is illustrated as **0.00 < 0.005.**

In elaboration, this means the overall regression model used in this study is significant enough to explain relationship of the variables. From the obtained results in the above table 5.1 and 5.2, the above model is significant and adequate since it is supported by the value of **R Square** at **.614** together with the results of F statistic which is 22.287 with the overall significance level of .000 which is less than p value of 0.05.This shows that the overall five variables of the alternative hypothesis (Ha) are accepted in which it indicates that there is a direct relationship of all the five independent variables (IV) to the dependent variable (DV).

II. CONCLUSION

From the objectives in regards to this study, the objectives and aim of this study was to study and analyze various variables in corporate governance in order to determine and analyze how corporate governance system has an impact on the company's financial statement fraud. The selected variables of corporate governance system was studied and analyzed in order to allow the targeted audience i.e. companies to understand how the variables of corporate governance affects the quality of financial reports and include further recommendations and conclusion based on the variables selected in this study. The variables of corporate governance selected in this study consisted of 5 variables which are audit committee effectiveness, tone at the top level management, independence of BOD and AC, policies and ethical guidance and lastly the corporate culture. All the 5 independent variables selected in this study was to analyze how it affects the dependent variable which is financial statement fraud. The results obtained in this research was mainly from the primary data through questionnaires in which the participation of respondents was high and met the expectations of the researcher.From the research conducted, the researcher has met all the objectives and concluded that the 5 independent variables of corporate governance system selected in this study has a direct impact on the financial statement fraud.

RECOMMENDATION

In regards to the findings and results obtained in this research, Audit committee effectiveness has a direct impact on the financial statement fraud. An audit committee of any company is a crucial and important element in the structure and governance system of a company. The effectiveness of audit committee will improve the overall quality and integrity of financial statements prepared since it does not only deal with the financial controls but also other activities which are important to ensure the financial statements prepared presents a true and fair view of the company. The effectiveness of audit committee in a company is judged based on specific areas such as the reporting relationship between BOD and audit committee, relationship between senior management and audit committee and the overall training, experience and skills of the audit committee members to ensure that they have a suitable knowledge in finance and accounting and thus ensure the quality of financial reports. Therefore, it is recommended for companies which has audit committee sector to consider such specific areas when measuring the effectiveness of audit committee.

Tone at the top level management has a direct impact on the financial statement fraud as supported by the findings of this study. It is recommended for the individuals at the top level management such as senior managers and CEO in creating an ethical atmosphere in the company in which it will have an impact on the employees. Ethical atmosphere created by the top management should be of integrity and ethics in which it will ensure the employees of the company are upholding the same values as witnessed by the top management. The top management should not ignore the overall ethics and just focusing on the lower level management since it will lead to employees to become vulnerable in committing fraudulent activities such as fraudulent financial reporting due to the feelings embedded in the employees that the company is not focusing on the ethical conduct and it's not considered to be a priority in the company.

Moreover, the independence of BOD and AC is crucial in ensuring the financial reports are prepared with complete honesty and integrity. It is important for companies in creating a proper oversight process of company's activities by ensuring there is independence of BOD and AC and thus tackle and reduce the risks of financial statement fraud. It is recommended that an active AC should provide oversight and acts as an obstruction to the employees and the overall management in taking part of any fraudulent activities including any misstatements of reports from the monthly reports prepared from the low level management up to the final financial statements prepared by the top level management.

As for policies and ethical guidance, the studies showed that proper implementation of policies and the overall code of conduct is crucial for the quality of financial statements prepared. It is recommended for the companies in Tanzania to improve and revisits its policies and code of conduct and keep up to date with the current global policies to ensure the management of the company is fully aware of fraudulent policies and the consequences if they partake in any of the fraudulent activity. It is recommended for companies in Tanzania to join and subscribeto organizations of anti-fraud such as ACFE (Association of Certified Fraud Examiners) in which such organization provides adequate policies and trainings to the management of the company in regards to fraud detection and prevention and thus reduce and mitigate risks of financial statement fraud.

Moreover, corporate culture plays a major role in the overall corporate governance system in the company and the circumstance of financial statement fraud. It is recommended for companies in Tanzania to improve its corporate culture by strengthening the culture of ethics and ensure all the individuals in the company are embedding the culture of ethics throughout the company's activities. Companies must ensure that all the employees are well addressed of the ethical culture to improve the integrity of the employees when executing daily tasks and thus improve the quality of the financial statements. Moreover, another recommendation for companies in improving its corporate culture is through benefits and monetary rewards. This will improve the overall corporate culture since taking the measures of rewarding employees will boost the employees' and managers' motivation to work with integrity for the company and thus tackle and reduce risks of fraudulent activities and fraudulent financial statements.

Benefits and monetary rewards is an effective measure to undertake since one of the main reasons for fraudulent financial reporting is the greediness from low level employees up to top level mangers through personal interests in which they seek to gain advantage and interests in the expense of thecompany.

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