accountingTODAY FOR THE WebCPA

July 17, 2013

Executives' Off-the-Job Behavior Indicate Fraud

By Michael Cohn

The "off-the-job" behavior of corporate executives, including legal infractions and ownership of luxury goods, could influence the likelihood of future financial misstatements and outright fraud.

The 2011 study, "Executives' 'Off-the-Job' Behavior, Corporate Culture and Financial Reporting Risk," by Georgetown McDonough professor Robert Davidson, University of Minnesota professor Aiyesha Dey and University of Chicago professor Abbie Smith, finds the probability of fraud is higher by approximately 120 percent among firms run by CEOs with a legal record than in firms run by CEOs with a clean record.

In addition, firms run by frugal CEOs have fewer unintentional reporting errors, a stronger governance of the work environment and a decrease in fraud risk during the CEO's tenure, according to the study.

While they find that CEOs and CFOs with a legal record are more likely to perpetrate fraud, in contrast, they do not find a relation between executives' frugality and the propensity to perpetrate fraud.

"However, as predicted, we find that unfrugal CEOs oversee a relatively loose control environment characterized by relatively high and increasing probabilities of other insiders perpetrating fraud and unintentional material reporting errors during their tenure," they wrote.

"Further, cultural changes associated with an increase in fraud risk are more likely during unfrugal (vs. frugal) CEOs' reigns, including the appointment of an unfrugal CFO, an increase in executives' equity-based incentives to misreport, and a decline in measures of board monitoring intensity."

Accounting Today
Georgetown University's McDonough School of Business
July 17, 2013

(http://www.accountingtoday.com/debits_credits/Executives-Off-the-Job-Behavior-Indicate-Fraud-67451-1.html)