



## A SYSTEMIC VIEW OF FRAUD EXPLAINING ITS STRATEGIES, ANATOMY AND PROCESS

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Auditors do not and cannot represent the difference underlying audit risk and fraud (Deleuze, G., *Difference and Repetition*, Patton, P. (trans.) (New York: Columbia University Press, 1994).), which may explain why the auditing literature's reductionist, holistic and historical-event approaches to audit risk and fraud do not curb the increasing number of fraud cases occurring today. The concern for this ineffectiveness has reached such a high level that the U S Congress and society at large now question the entire independent auditing process (Fogarty, T. J., Heian, J. B. & Knutson, D., "The Rationality of Doing 'Nothing': Auditors' Responses to Legal Liability in an Institutionalized Environment", *Critical Perspectives on Accounting*, Vol. 2, 1991, pp. 201–226.).

This paper explains the Deleuzian difference in order to develop a systemic description of fraud. The historical-event of fraud presumes that a fraud event occurs within a system. Without understanding the system's nature and components (anatomy), environment and structures (CES), and the mechanism that explains their causative and probabilistic interactions, fraud may not be deterred or detected on time. The system of fraud developed in this paper is an open one since fraud can never be totally eliminated from society given the endless greed and chaos that rule every-day life. (Deleuze, G. and Guattari, F., *The Logic of Sense*, Mark Lester with Charles Stivale (trans.), Constantin, V. Boundas (ed.) (New York: Columbia University Press, 1990).) and (Deleuze, G., *Anti-Oedipus*, R. Hurley, M. Seem and H. R. Lane (trans.), (Minneapolis: University of Minnesota Press, 1983); Deleuze, G. and Guattari, F., *A Thousand Plateaus*, B. Massumi (trans.), (Minneapolis: University of Minnesota Press, 1987).) refer to such an open system as pragmatic, rhizomatic schizoanalytic and nomadologic. Ironically, this pragmatic (open) system of fraud is the auditing profession's *raison d'être*: without it, there would be no need for the attest function, as we now know it. Therefore, such conclusions as "auditors should prevent fraud" and "auditing standards should be designed to eliminate fraud" form contradictions currently littering the auditing literature.

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While the auditing profession has increased its responsibility to detect financial-statement fraud, it assumes “full responsibility” for such detection only as a by-product of applying auditing standards. However, applying such standards has not actually curbed fraud, leading the US Congress and society at large to question whether the entire independent auditing is needed (Fogarty *et al.*, 1991). Zeune (2000) notes that fraud costs our economy \$400 billion a year. A consensus has emerged demanding drastic action to increase auditors’ accountability and society’s confidence in the auditing profession.

When the government and society demand auditors to detect and prevent fraud, in effect, they ask where fraud comes from, where it resides, how it grows and repeats over the years. While these questions address the process of fraud,<sup>1</sup> the auditing literature has paid inadequate attention to this process; rather, the emphasis of traditional auditing has been on audit risk, assessed through a narrow lens, which Bell *et al.* (1997, pp. 2–3) describe as disaggregative, bottom-up and reductionist (one that emphasizes account balances and classes of transactions). They recommend assessing audit risk through a broader lens that they describe as aggregative, top-down and holistic (one that direct auditor’s attention to the client’s business and its connections and interactions with its environment).<sup>2</sup> However, we argue that traditional auditing (reductionist) and holistic approaches, applied individually or collectively, would not contribute much towards fraud detection and deterrence, for the following reasons:

1. The primary concern of these approaches is audit risk, not fraud. Fraud detection and deterrence are management’s responsibility. As the Treadway Commission asserts, “[t]he responsibility for reliable reporting resides first and foremost at the corporate level. . . . Thus, reducing the risk of fraudulent financial reporting must start with the reporting entity”.
2. Audit risk is assessed by viewing fraud as a historical event.
3. These approaches do not conceptualize fraud as difference; instead, they focus on the coordinates of the binary opposition in fraud: The *given* state (—) the *should-be* state. For example, in a fraud case involving cash theft, the amount stolen is determined from ⟨reported cash balance (\$300) (—) should-be cash balance (\$400)⟩. Focusing on these two balances does not address directly the theft process. Typically, auditors prefer to quantify the materiality judgment (McKee and Eilifsen, 2000, p. 55).
4. These approaches to audit risk assessment are methodological rather than explanatory. Methodologically, most auditing standards and guidelines are descriptive and hermeneutic (interpretive). Conversely, explanation deals with determination, causative and probabilistic, i.e. with mechanism (Bunge, 1996, pp. 137–142). The essence of audit risk and fraud events is difference that is either caused or chance-effected. Therefore, understanding the mechanism of fraud is essential to plan a program of fraud detection and deterrence.

The auditing literature also addresses fraud as a predicate and as a conceptual fraud rather than as a concept of fraud. As a predicate, fraud is removed from

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