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Behavioural Intention for Fraudulent Reporting Behaviour Using Cognitive Theory

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Abstract

Fraudulent financial reporting is a serious social problem that has spread worldwide. The consequences of it can be detrimental to many stakeholders. Thus, fraudulent financial reporting has to be prevented and combated. Fraudulent financial reporting involves human deviant behaviour. Thus, to prevent it from occurring, the root causes that relate to deviant human behaviour have to be identified. This paper tries to explain how the social behavioural theory, in particular the theory of reasoned action can be used to explain for fraudulent financial reporting behaviour.

Keywords: Theory of Reasoned Action, Fraudulent Financial Reporting

1. Introduction

Financial fraud is increasing world wide (Albrecht & Albrecht, 2002) and has also spread to Malaysia. Several Malaysian corporations were charged and alleged of fraudulent financial reporting by the Malaysian Securities Commission. For example recently, Transmile Group Berhad was under probe for cooking the book. The consequences of fraud can be disastrous if fail to detect and deal with adequately (Barsky *et al*., 2003; Hemraj, 2004). Some of the consequences are bankrupt to businesses (Spathis *et al*. 2002), such as in the case of Enron; costly litigation or prosecution process (Holtfreter, 2005); increasing the concern on the roles of auditors in general, regulators, and analysts in financial reporting (Geriesh, 2003); has resulted in the demise of a reputable big five audit firm, Arthur

Andersen; and perpetrators may face criminal prosecution. Fraud may take in three broad forms: asset misappropriation; corruption; and fraudulent financial reporting (Lavery *et. al.*, 2000). Thus, fraud in this article is referred to as financial reporting fraud (FRF) or fraudulent financial reporting (FFR). FFR is also known as management fraud since it involves senior management's intentional misrepresentation of financial statements (Silverstone & Sheetz, 2004). AI 240 International Standards on Auditing (ISA) on "Fraud and Error" defines fraud in relation to financial statements as "an intentional act by one or more individuals among management, employees, or third parties, which results in a misrepresentation of financial statements". Fraud may comprise manipulation, falsification or alteration of records or documents; misappropriation of assets, suppression or omission of the effects of transactions from records or documents; recording of transactions without substance; and misapplication of accounting policies (MIA, 2001).

FRF must be combated (Root, 1998) since it is increasing each year (Albrecht & Albrecht, 2002). Thus, there should be a study carried out to probe at root level the incidence of FRF. The theory of reasoned action (TRA), which draws from a social psychology theory, serves as a useful theoretical framework for researchers who wish to explore the factors that influence the behavioural intention for FFR (Buchan, 2005).

Therefore this article focuses on how the behavioural factors: attitude toward the behaviour and subjective norm drawn from the theory of reasoned action can be used to explain the financial reporting fraud behaviour.

2. Theory of Reasoned Action

The theory of reasoned action (TRA) is fundamentally based on cognitive belief system (Fishbein & Ajzen, 1975). The theory is useful in examining behaviours since it is able to examine the cognitive self-regulation, which is one aspect of behavioural dispositions (Ajzen, 1991). Moreover, it is able to explain, understand, predict as well as influence virtually any human behaviour in applied settings and is not restricted to specific behaviour domain (Ajzen & Fishbein, 1980). The theory is able to probe at root level, to identify the potential factors that might influence the individual's behavioural intention to report fraudulent financial statements. The TRA, as shown in Figure 1, is developed by Fishbein and Ajzen (1975). With regard to FFR, the theory postulates that FFR behaviour can be determined by individual's behavioural intention to report fraudulently, which in turn can be determined by attitude toward behaviour to report fraudulently and subjective norm. The attitude toward behaviour and subjective norm are the main constructs in the TRA.

The attitude toward behaviour to report fraudulent financial statements is a function of salient behavioural beliefs, while the subjective norm is a function of salient normative beliefs. These beliefs are the basic foundation level of the TRA and they determine the behavioural intention (Ajzen & Fishbein, 1980). These beliefs reflect the underlying cognitive structure (Armitage & Conner, 2001) of an individual. Thus, studying these beliefs will enable us to understand in depth the FFR behaviour and be able to identify the most influential beliefs that determine behavioural intention to report fraudulent financial statements.

As mentioned above, the main constructs of the theory are the attitude toward behaviour and the subjective norm. These are now explained in the ensuing sections.

2.1 Attitude toward behaviour

The attitude toward behaviour is one of the determinants of the behavioural intention. In the TRA, attitude refers to the attitude toward behaviour which is the positive or negative evaluation of performing or not performing the behaviour of interest (Ajzen, 2002; 2005). The individual's evaluation about the outcome of performing the behaviour of interest depends on his or her beliefs known as behavioural beliefs. These are salient or accessible beliefs that are acquired through learning, experience, and socialisation with others.

In relation to FFR, based on the theory (Ajzen, 1988), when the individual believes that reporting fraudulent financial statements will lead to positive outcomes, he or she will evaluate it positively and will have favourable attitudes toward reporting fraudulent financial statements. Thus, the individual is most likely to intend report fraudulent financial statements. On the other hand, when the individual believes that the evaluation will lead to negative outcomes, he or she will evaluate it negatively and will have unfavourable attitudes toward reporting fraudulent financial statements. However, there are instances where or possibilities that, the acquired beliefs might not be complete. This might caused the individual into believing that reporting fraudulent financial statements would lead to positive outcomes and hence favour the performance of FFR. Thus, fraud perpetrators must have evaluated the outcomes of reporting fraudulent financial statements positively before engaging in fraudulent reporting behaviour.

Further, according to the theory, the positive or negative evaluation of the possible outcomes of performing the behaviour of interest can change very quickly when certain events occur or when new information becomes available, which render changes to the individual's beliefs. Thus, to change the individual's behavioural beliefs is by providing him or her with new, pertinent and persuasive information. For instance the individual has to be taught and always be reminded about the consequences of the wrong doing and that the effect will not only be on the other stakeholders but it could also affect him severely.

2.2 Subjective norm

The next important construct in the TRA is the subjective norm, that is an individual's perception of social influence or pressure to perform or not to perform the behaviour of interest (Ajzen, 1988; Beck & Ajzen, 1991), the likelihood that the important referent others approve or not approve the performance of the behaviour of interest (Ajzen & Madden, 1986; King & Dennis, 2003). In relation to fraudulent reporting behaviour, an individual who perceived that the important referents approve the fraudulent reporting behaviour, will hold a positive normative belief, and will most likely perform that behaviour. On the other hand, if he or she perceived that the important others disapprove, he or she will hold a negative normative belief, and thus, will most unlikely perform the behaviour. Normative beliefs underlie the subjective norm. Important referent others include parents, spouse, close friends, co-workers, tax accountant and physicians (Ajzen, 1988). Changes in normative beliefs may cause changes to the individual's perception on social influence or pressure. Thus, to change individual's perception on social influence or pressure is to change his or her normative beliefs. Similar to above, this is perhaps can be done by giving courses about the serious consequences of the fraudulent financial reporting to the important referents and inform them that the repercussion of it will not only affect the company or other stakeholders but might also cause loss of jobs to them and to the individual whom he has high influence.

3. Behavioural intention

As shown in Figure 1, behavioural intention to report fraudulent financial statements can be determined from the attitude toward behaviour and subjective norm, and it can also predict behaviour for FFR. Behavioural intention refers to individual's subjective probability that he or she will perform a given behaviour (Fishbein & Ajzen, 1975). Behavioural intention motivates the performance of behaviour (Beck & Ajzen, 1991) since it is the effort an individual planning to exert, the persistence, and the willingness to try to perform the behaviour (Beck & Ajzen, 1991). It is a behavioural disposition (Ajzen, 1988) that will be transformed into reporting fraudulent financial statements when an individual put effort, persist and willing to perform the behaviour at appropriate time and opportunity (Ajzen, 1988).

4. Limitations of TRA

Although the TRA is useful in examining the behavioural intention, however it has some limitations. The TRA is applicable only to behaviour which is voluntary, where an individual may decide to perform or not the behaviour at will (Ajzen & Fishbein, 1980; Ajzen & Madden, 1986). The theory did not take into account situations where an individual has no complete or volitional control (Ajzen, 1991). However, most behaviours are not voluntary (Ajzen, 1988) even everyday activities are not under volitional control of an individual (Ajzen & Madden, 1986). Thus, the TRA model was found insufficient in explaining behaviours that are not volitional. To overcome this, Ajzen (1991) has introduced the perceived behavioural control into the model to account for behaviours that are not under complete control. Further, besides including the perceived behavioural control, the model is opened for inclusion of other predictors if they are able to improve the prediction of or be able to explain a significant variance in the behavioural intention and behaviour after the main predictors are controlled (Ajzen, 1991).

Besides this, there are other fundamental problems with the TRA. It relates to determining behaviour from behavioural intention. Since this article only relates to using TRA in determining behavioural intention, the problems that relate to predicting behaviour from behavioural intention will only be briefly mentioned. For accurate prediction, certain conditions have to be met (Ajzen, 1991). According to Ajzen, generally, there must be correspondence among the factors included in the model. They must agree on action, target, context and time in order to predict a specific behaviour of interest. Ajzen strongly insist that the behavioural intention measures must be consistent with, and assessed in relation to the behaviour of interest, the behavioural intention measure must be in specific context and similar to the specific context in which the actual behaviour is to occur. In other words, the measures of the behavioural intention have to be specific to the behaviour that is to be performed or not to be performed. The second condition is the stability of the behavioural intention at the time it is assessed and the performance of the behaviour of interest as intervening events might render the original measures of behavioural intention to change and that they were no longer accurately predict actual behaviour of interest. This means that the time gap between the intention to the perform the behaviour and the actual performance of the behaviour is not long enough to render changes in intention. If this happens, then intention will not be able to predict behaviour of interest.

5. Conclusion

The TRA, which is derived from cognitive theory, provides a promising theoretical framework to researchers who wish to understand more how deviant behaviour occurs especially in relation to fraudulent financial reporting. At the basic foundation level, the theory is based on behavioural beliefs and normative beliefs. Thus, by examining these beliefs, which are entrenched in cognitive of the individual, one can understand how these beliefs influence the behavioural intention to report fraudulent financial statements and hence influence the behaviour of fraudulent financial reporting. Once the beliefs that have caused the individuals to have behavioural intention to engage in fraudulent financial

reporting have been identified and the relative weights or importance of the behavioural beliefs and normative beliefs have been determined, strategies can be developed to change these beliefs into negative attitude toward fraudulent financial reporting or negative normative beliefs. Changing these beliefs about the behaviour will lead to subsequent changes in the behaviour (Heath & Gifford, 2002) of reporting fraudulently. In developing the strategy, the beliefs that influence the greatest will have to be given more attention. For instance certain individual is highly being influence by his attitude toward behaviour than by the subjective norm in engaging in fraudulent financial reporting behaviour. Thus, to change the behaviour, more focus should be addressed to change from his positive attitude toward behaviour of fraudulent reporting thinking. Once he has developed negative belief about the behaviour then most probably he will not engage in fraudulent financial reporting behaviour. Likewise, if an individual is more influence by his subjective norm rather than by his attitude toward behaviour, then to address the matter, more focus should be given to his important referent. It is important that the important referent who is the role model to the individual should view the bad effect of fraudulent financial reporting behaviour. Thus, the individual too would view the bad effect of engaging in such behaviour.

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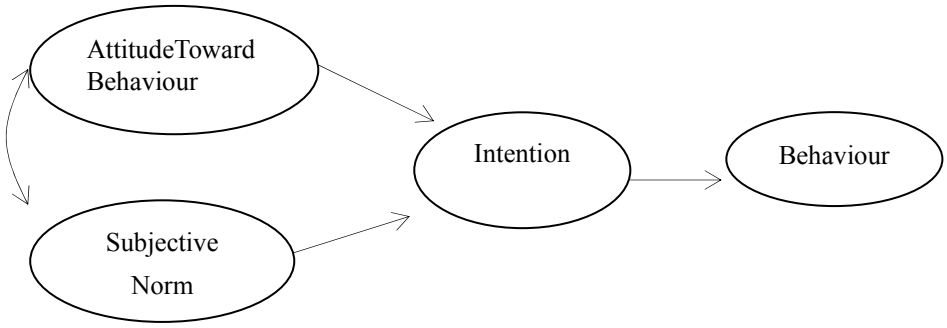

Figure 1. The Theory of Reasoned Action (Ajzen, 1988)