

# Corporate Fraud: An Analysis of Malaysian Securities Commission Enforcement Releases

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**Abstract**—Economic crime (i.e. corporate fraud) has a significant impact on business. This study analyzes the fraud cases reported by the Malaysian Securities Commission. Frauds involving market manipulation and/or illegal share trading are the most common types of fraud reported over the 6 years analyzed. The highest number of frauds reported involved investment and fund holding companies. Alarmingly the results indicate quite a high number of frauds cases are committed by management. The higher number of Chinese perpetrators may be due to fact that they are the dominant group in Malaysian business. The result also shows that more than half of companies involved with fraud are privately held companies in the investment/fund/finance sector. The results of this study highlight general characteristic of perpetrators (person and company) that commit fraud which could help the regulators in their monitoring and enforcement activities. To investors, this would help in analyzing their business investment or portfolio risk.

**Keywords**—Corporate fraud, economic crime, fraud characteristic, perpetrators

## I. INTRODUCTION

RECENT statistics regarding economic crime show that corporate fraud is one of the most problematic issues for businesses around the world. The PricewaterhouseCoopers (PwC) [1] survey highlights cases related to fraud in Malaysia as follows:

- 3% of respondents reported economic crime for the year 2003 and 2004, with 57% related to the misappropriation of assets.
- 70% of the cases are committed by people inside the companies, and of these, 21% were committed by members of the management team.

The number of reported cases of economic crime committed by company employees in Malaysia is higher than that reported for the Asia-Pacific region and for other countries around the world. This statistic supports the statement made

by the PwC Malaysia's dispute analysis and investigations leader, as cited in the PwC press release<sup>1</sup> that senior management were driven by the incentive to maintain an expensive lifestyle and were unaware that they were committing any wrongdoing, and because of their position in the company, they have the opportunity to override the controls system to detect fraud. Managers are supposed to safeguard the assets of the company and to increase shareholder wealth. However, it seems that they are increasing their own wealth at the expense of the shareholders. The PwC [1] survey also highlighted the following issues:

- Companies in Malaysia are more vulnerable to corruption and bribery, and suffered more from corruption and bribery as compared to other countries.
- The perception held by the Malaysian companies that suffered corruption and bribery is that corruption and bribery has no or limited impact on the image of the company.
- Malaysian companies are willing to invest in extended internal controls and risk management. However, only 25% are willing to strengthen the internal audit as compared to 49% around the world.

A later survey by PwC [2] indicates that 48% of Malaysian companies were the victims of economic crime, which is considerably higher than the 23% that was reported in the 2005 PwC survey. However, the 2007 PwC survey reported a decrease in the number of perpetrators among senior and middle management but an increase in the number of perpetrators from other employees. Further, the PwC [3] survey reveals that for the two years prior to the survey, the average loss from fraud per company in Malaysia was US \$173,303. The 2007 PwC survey indicates that corporate fraud would also damage the brand name, staff morale, external business relations, relations with the regulators, and share value. The impact of corporate fraud does not fall on the company and shareholders alone as it will have significant impact on employment, social stability and public as a whole.

The most recent PwC survey, PwC [4], shows that 66 % of Malaysian companies surveyed reported a decline in financial performance, presumably as a result of the economic downturn that had occurred. It was also reported that 82% of the respondents indicated they faced increased pressure to report better financial performance, although there is a risk that this may lead to more fraudulent activity within their

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<sup>1</sup> PricewaterhouseCoopers News Release, Kuala Lumpur, 29 November 2005

companies. Twenty-eight percent of the respondents reported that they have experienced economic crime in the last 12 months before the survey. Even more alarming was that 50% of fraudulent activities are detected by 'accident', suggesting that serendipity rather than management control plays a more significant role in fraud detection. These evidences depict that fraud or similar economic crimes remain as problematic issues in Malaysia. Anwar [5] stated that from the Malaysian Securities Commission (MSC) investigations, many of the losses suffered by PN4 and PN17<sup>2</sup> companies were largely caused by mismanagement, fraud and other unethical practices. PN4 stands for Practice Notes Number 4 and PN17 stands for Practice Notes Number 17 are the regulations issued by Bursa Malaysia Securities in dealing with companies that is facing financial difficulties [6, 7]. This statement highlights that managers were failing to perform their stewardship duties towards the shareholders. Therefore a control mechanism is needed to govern the manager's acts. The collapse of several Malaysian companies is partly due to the ineffectiveness of the regulatory agencies in their legislation enforcement, punishment and protecting minority shareholders [8].

It is not easy, if not impossible, for the public and general investors to detect fraud in a company. This group has to depend on the regulatory regime to 'control' the activities of the company. Since the MSC has the power to enforce the provisions of the regulatory regime, a study of corporate fraud based on information published by that MSC should provide an insight into the incidence of corporate fraud in Malaysia. Thus, this paper will use information about fraud cases involving companies than have been listed in the Malaysian Securities Commission Enforcement Releases. It is anticipated that this paper will contribute to the literature relating to corporate fraud in Malaysia.

The rest of this paper is organised as follows. The next section explains the significance of the study followed by an overview of the Malaysian Capital Market Legislation and the MSC. This is followed by a discussion on prior studies concerning corporate and management fraud, then the research methodology and discussion on our findings. The final sections conclude the paper and offer suggestions for future research.

## II. SIGNIFICANCE OF THE STUDY

As mentioned above, corporate fraud has a negative impact on the company's brand(s), staff morale, external business relations, relations with regulators, and the value of the company's shares. It can be fairly said that corporate fraud impacts on the company, its shareholders, and society at large by way of employment and social stability. Often the parties that lose the most as a result of fraud are the minority

shareholders and individual investors. The need for a more effective way to regulate, enforce, detect and prevent fraud has increased since one cannot rely upon accidental detection to combat such fraud. The regulators have to be more vigilant and effective in their efforts to fight corporate fraud. The aims of this paper are to review the role of market regulators in Malaysia, in particular the MSC, and to analyse the fraud cases published on the MSC website (the MSC Enforcement Releases).

## III. MALAYSIAN CAPITAL MARKET AND LEGISLATION

The Malaysian capital market is very much concentrated on family-owned businesses. Studies conducted by Lim [9] and Zhuang, Edwards and Capulong [10] indicate that large holdings of common stocks are family owned. Often, the managers are members of the family that owns a large percentage of shares in these companies. Given this relationship, it is reasonable to suggest that the manager would endeavour to increase the value of the company since this ultimately increases the wealth of the family. On the other hand, there is an issue of insider trading, whereby the manager has an intimate knowledge of the business and is in a position to use that information for personal gain before that information becomes publicly available. In cases where the company has performed poorly or is in financial distress, these insiders can sell their shares before the company collapses, thereby avoiding or minimising personal loss whereas the minority shareholders who lack this inside knowledge will not have the same opportunity to avoid such loss. Therefore it is suggested that legislation relating to capital markets and corporate governance should protect the interests of all shareholders, especially minority interests. [11].

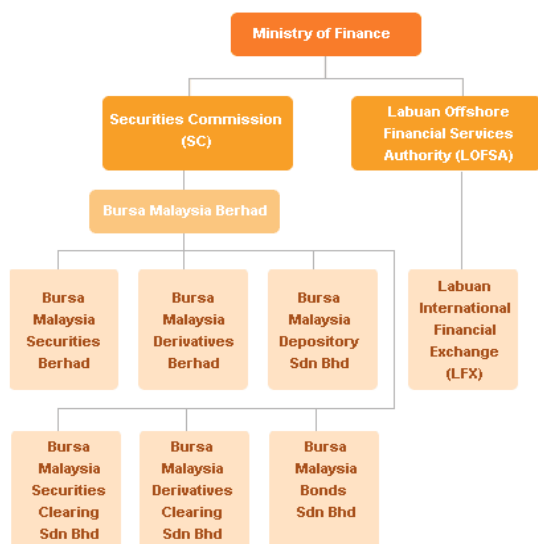
The Malaysian corporate sector has grown rapidly since the 1990s. The total market capitalisation of listed companies on the main and second boards of the Malaysian stock exchange (Bursa Malaysia Berhad) has grown by an average of 40% per year throughout this period [12]. In the same years the number of listed companies has been steadily increasing. It is therefore suggested that a proper regulatory and legislative regime is needed to govern this capital market. Currently, the Malaysian capital market is governed by the following Acts of Parliament:

- Capital Market and Services Act 2007
- Securities Industry (Central Depositories Act) 1991
- Securities Commission Act 1993
- Companies Act 1965
- Offshore Companies Act 1990
- Labuan Offshore Securities Industry Act 1995

Figure 1 shows the regulatory framework of the Malaysian Capital Market. The Ministry of Finance is responsible for controlling the market which is actively represented by the Securities Commission (MSC) and Labuan Offshore Financial

<sup>2</sup> PN4 and PN17 are conditions where companies are facing financial difficulty (i.e. in distress) and did not meet the Bursa Malaysia Listing requirements. These companies are also known as financially distressed companies. Companies listed in the above two practice notes will be suspended from Bursa trading and required to improve their financial situation before the suspension would be lifted.

Services Authority (LOFSA)<sup>3</sup>. The Securities Commission governs the Malaysian stock exchange (Bursa Malaysia Berhad, formerly known as the Kuala Lumpur Stock Exchange or KLSE), as well as being responsible for the enforcement of the capital market rules and regulations. Labuan Offshore Financial Services Authority is responsible for governing the Labuan International Financial Exchange only.



Source: Bursa Malaysia, 2009

Fig.1 The regulatory framework of Malaysian Capital Market

The two main agencies that regulate the Malaysian capital market are therefore the MSC and Bursa Malaysia Berhad. The MSC is a self-funding statutory body with investigative and enforcement powers that has an important role to play with respect to corporate fraud, since it has the power to prosecute companies for committing fraudulent acts. This authority will be explained in more detail in the next section, but briefly, the MSC administers the following Acts:

- *Securities Commission Act 1993*;
- *Capital Markets and Services Act 2007*; and
- *Securities Industry (Central Depositories) Act 1991*.

Bursa Malaysia is the main Malaysian stock exchange organization. It was established in 1973 to provide a central market place for Malaysian listed companies to transact business in shares, bonds and various other securities. This

<sup>3</sup> Labuan is an island strategically located in the Asia-Pacific region, off the coast of East Malaysia. It is administered by the Federal Government of Malaysia. Labuan Offshore Financial Services is an integrated International Business & Financial Centre (IBFC), offering a wide range of offshore financial product and services to customers worldwide including banking and investment banking, insurance, captives, trust business, fund management, investment holding, company management and Islamic Financing. Labuan, Malaysia, was designated as an offshore international financial centre in 1990. As part of its development, an offshore financial exchange, Labuan International Financial Exchange (LIFX), was launched on 23 November 2000.

self regulated organization governs the conduct of its members. Bursa Malaysia has its own listing and disclosure standards that must be followed by listed companies [13]. Bursa Malaysia, in its effort to ensure that listed companies maintain these standards and abide by their regulations, established Practice Notes for distressed companies (i.e. companies in financial distress). This is to monitor the companies and maintain the quality of market place. Apart from the MSC and Bursa Malaysia, the following regulatory bodies have responsibilities relating to company and business activities in Malaysia. Each has their own duty to ensure the smoothness of the market as well the protection of the interests of shareholders, irrespective of whether they are majority interest or minority interests. The bodies that are responsible for regulating and governing the capital market and company disclosure and reporting requirements are:

- Bank Negara Malaysia (the Malaysian Central Bank) – responsible for governing the banking and finance industries.
- Company Commission of Malaysia (CCM) – responsible for the management and enforcement of the Companies Act 1965 (Act 125), Business Registration Act (Act 197), Companies Trust Act (Act 100), and any other subsidiary law under any of the above mentioned acts such as the Companies Regulations 1966 and Business Registration 1957. The Company Commission of Malaysia works with other regulatory bodies and authorities such as the Insolvency Department of Malaysia, Bank Negara Malaysia, Securities Commission of Malaysia and related government agencies, to ensure that good corporate governance is practiced by the market players.
- Malaysian Accounting Standard Board (MASB) - an independent technical body responsible for setting the Malaysian accounting standards. Its primary objectives are the setting of accounting standards and conceptual framework.
- Malaysia Royal Police (Commercial Crime Department) - the main function of this department is to investigate, catch and prosecute white collar criminals who commit fraud or corruption, including commercial falsification and cyber crime. The Commercial Crime Department consists of units such as the anti-laundering unit, forensic accounting unit, financial investigation unit, corporate investigation unit, multimedia and cyber investigation unit, and other units for forgery including credit card forgery. This Department and the Malaysian Securities Commission both play an effective role in combating fraud.

#### IV. MALAYSIAN SECURITIES COMMISSION

The Malaysian Securities Commission (MSC) was established on first of March 1993 under the *Securities Commission Act 1993*. It is a self-funding statutory body with investigative and enforcement powers that reports to the

Minister of Finance. It is required to table its accounts annually in Parliament. According to the MSC (2009) website the Commission's regulatory functions include:

- Supervising exchanges, clearing houses and central depositories;
- Registering authority for prospectuses of corporations other than unlisted recreational clubs;
- Approving authority for corporate bond issues;
- Regulating all matters relating to securities and futures contracts;
- Regulating the take-over and mergers of companies
- Regulating all matters relating to unit trust schemes;
- Licensing and supervising all licensed persons;
- Encouraging self-regulation; and
- Ensuring proper conduct of market institutions and licensed persons.

The MSC ultimate responsibility is to protect investors. Apart from discharging its regulatory functions, the Commission is also obliged by statute to encourage and promote the development of the securities and futures markets in Malaysia. It has direct responsibility to supervise and monitor the activities of market institutions and regulate all persons licensed under the Capital Markets and Services Act 2007. The MSC enforcement and legislation is divided into four sections:

- Criminal Prosecution
- Civil Actions
- Administrative Actions
- Cases Compounded

Criminal prosecution and civil actions will be those cases that the MSC bring forward to court while the administrative actions will be the warning, revamp or licence been revoked by the MSC. Cases compounded are those cases with less serious offences where the MSC will offer certain amount of compounds (penalties in monetary terms) and warning letter. The MSC will make public announcements on all cases been investigated through a press release and enforcement release listings. This study uses the MSC Enforcement Releases as primary source of data. Analysis of the cases, its natures, penalties and outcomes from the year 2002 to 2007 therefore extract the following results. The penalties resulting from criminal prosecutions varied from fines of RM 30,000 to RM 3 million and jail sentences that varied from one day to five years. However, it should be noted that many of the cases reported are still subject to court proceedings or are under appeal. For civil actions, outcomes varied from the imposition of a restraining order, restoring defendant assets to restitution depending on the severity and type of offences committed. The penalties for administrative actions range from a warning letter, the revocation of a licence, a public reprimand, and the

'correction' and reissue of affected financial statements. For compounded cases from 2002 to 2007 the amount of compound varies from RM 10,000 to RM 1 million.

The MSC plays the most important role in dealing with corporate fraud. It has the investigative and enforcement powers over publicly traded companies irrespective of whether or not they are listed by Bursa Malaysia. The MSC also has the power to charge a company with criminal fraud. This study will explain the role of MSC and analyze the data on corporate fraud published in its Enforcement Release section.

## V. BUSINESS RISK AND FRAUD

The ultimate goal of an investor is to receive a return on their investment that is appropriate for the level of risk associated with that investment. It is generally accepted that there is a positive correlation between risk and return. It is therefore vital that investors and shareholders are provided with information that helps them assess the risks associated with any particular business. This is no easy task since risk is a function of many factors, including those that relate to the socio-economic environment within which the business operates. However, it has been suggested that risk can be categorised in three ways [14]:

- Inherent Industry Risk – Inherent risk is the risk that is impossible to manage or transfer away for a particular industry. There are two types of fraud associated with inherent industry risk, namely management fraud and employee fraud, both of which could occur in any type of business. The risk of management fraud is influenced by a few key characteristics such as financial structure, the company's secrecy policy, and volume of transactions, access to credit, where there are new and complex products, and where the market is subject to changing conditions. The risk of employee fraud is greater when authority to deal with large transactions is given to lower level management without the existence of proper controls.
- Environmental Risk – This risk relates to the organization or business structure, the social and cultural environment, performance evaluation, financial condition and managerial structure and quality.
- Business Risk – The risk associated with the market and customer.

Financial statements are one of the important sources of information used by shareholders, investors and other stakeholders in assessing company's performance. Financial statements should be free from bias, material errors, or misstatements. Misstatement is a result of fraud or unintentional errors of a material nature. Auditing Standards SAS No. 54, AICPA 1988 (SAS No. 82), AICPA 1997 define fraudulent financial reporting as "fraudulent acts that cause material misstatement of financial statement". Therefore, fraud can be classified into 1) Misstatements arising from

fraudulent financial reporting and 2) the misappropriation of assets. Nonetheless, KPMG [15] has a broader view that breaks financial fraud into five categories:

- Fraudulent Financial Statement reporting – most fraudulent financial reporting schemes involve earnings management, arising from improper revenue recognition and overstatement of assets or understatement of liabilities.
- Misappropriation of assets – this category involves external and internal schemes such as embezzlement, payroll fraud, external theft, procurement fraud, royalty fraud and counterfeiting.
- Expenditures and liabilities (avoided or incurred) for improper purposes – this category refers to commercial and public bribery, tax fraud, wages abuse, falsifying compliance data provided by regulators, as well as other improper payment schemes,
- Fraudulently obtained revenue and assets– such as over billing customers, deceptive sales practices, accelerated revenue or bogus revenue.
- Other misconduct – such as conflicts of interest, insider trading, discrimination, theft of competitor trade secrets, antitrust practices and environmental violations.

## VI. PRIOR STUDIES

This section reviews past research studies in corporate fraud. This section will start with a brief discussion on fraud motivation, the element of fraud and causes that triggers fraud to happen. It is then followed by a brief review on agency cost and management fraud.

Beasley, Carcello and Hermanson [16] indicate that fraud is committed in more than one way and revenues and misstatement are the common techniques used. Squires [17] states that economic crime and fraud does not show a clear or obvious signal and therefore forensic accountants have to look beyond all the figures to see the reality. There are three elements that are common to all fraudulent acts; a perceived pressure, a perceived opportunity, and ability to rationalize the fraud as acceptable and consistent with one's personal ethics [see 1, 14, 18]. The motivation to commit fraud is due to pressure, such as financial needs, frustration with work, or the challenge to 'beat the system'. The opportunity to commit fraud is enhanced when the internal control system is weak or absent. The final element is the ability of the (potential) perpetrator to rationalise their behaviour as acceptable.

According to the PwC (2007) survey, there are two types of 'causes' that could trigger fraud, namely, individual causes and corporate causes. Individual causes are the perpetrator's personal reasons for committing fraud encompassing the incentive to commit a fraudulent act and the ability to rationalise their actions to themselves. Corporate causes are the organizational reasons that allowed fraud to occur. The survey lists the following reasons why fraudulent acts had been committed:

- i. Individual causes – Financial incentives (greed), low temptation threshold, lack of awareness of wrongdoing, expensive lifestyle, denial to financial consequences, career disappointment and potential redundancy.
- ii. Corporate causes – Low commitment to brand, insufficient controls within the organisation, the use of authority to override existing controls, high level of staff anonymity, high target for company performance, and lack of clarity concerning corporate ethics.

According to agency theory, unconstrained management will act in a manner that benefits themselves at the expense of the owners, although this agency problem can be addressed by monitoring and control activities [19]. Jensen and Meckling [20], Rozeff [21] and Crutchley, Jensen, Jahera and Raymond [22] indicate that dividend payment reduces the agency problem as it reduces the discretionary funds available to managers. Rozeff (1982) states that in firms where insiders hold a lower fraction of the equity and/or a greater number of stockholders own the outside equity, the dividend payout would be higher as dividend payments are part of the firm's monitoring strategy that could reduce the agency cost. In order to control agency cost from inefficiencies, managers will make financial policy tradeoffs (Crutchley et al. 1999).

Nonetheless, shareholders have to incur these agency costs in order to reduce the agency problems. Allowing managers excessive levels of freedom enables them to act in their own interest, increases the likelihood that fraudulent acts might be committed. According to Zahra, Priem and Rasheed [23], fraudulent acts are deliberate acts of management (at any level) that are designed to deceive, con, swindle or cheat stakeholders. Managerial fraud would refer to any such actions taken by top management, that is, senior management who have the authority to make decisions on behalf of the company. Some decisions made by the managers did not take into consideration the sustainability of the company in the future; it is made based on the benefit that the managers would receive. For example, during the economic boom, managers decided to commit the companies into large debts to finance many projects. This resulted in company's performance being at the top. However, when the economic started to decline, the company will face the problem of paying up debts, thus moved into a difficult situation.

Brief, Dukerich, Brown and Brett [24] conducted a study on chief financial officers and the pressure to shift expenses between periods for income smoothing and found out that 87% of the respondents are willing to do so. Barnes [25] states that senior managers and directors will take all possible action to improve company's performance as a defence against a potential merger or takeover as their livelihoods are at stake. The same conclusions were made from the studies conducted by Jensen [26] and Franks and Mayer [27]. Williamson [28] argues that the motivations for managers principally include salary, security prestige and power which may be seen through expense account, luxurious office, company cars, the number of assistants, professional excellence and others. A study conducted by McKenna [29] and Brief et al. [24] shows the same conclusion that managers are willing to smooth

income or misrepresent accounting information when under pressure. The collapse of many multinational companies such as Enron, WorldCom, and others, resulted from fraudulent acts being committed by management in order to report good corporate performance even though the reality was the opposite.

## VII. RESEARCH METHODOLOGY

This study analyzes the Malaysian Securities Commission Enforcement Releases for period 2002 to 2007. The data related to company or persons being charged and investigated for commercial fraud is obtained from the MSC website under the enforcement section. Analysis of data is carried out on the four sections of enforcement release documents namely the criminal prosecution, civil actions, administrative actions, and cases compounded. Descriptive statistics for each section are prepared, as follows:

- Number of cases in section for 2002 to 2007 – this analysis is based on the number of cases reported in each category (criminal prosecution, civil action, administrative action and cases compounded)
- The nature or type of offences – for this analysis, the offences nature for each of the cases reported will be categorized in the accounting and auditing natures (AA) or other (O) natures such as breach of client trust, unlicensed trading or share price manipulation.
- The perpetrators – this analysis is on the characteristic of perpetrators that is the person/people that commit the fraud. The two characteristic analyzed are the ethnicity and whether they belong to management groups or employee/non-employee group.
- A general characteristic of fraudulent company – the general characteristic that is analyzed is the type of the company and in what industry does each of the company trade in.

## VIII. ANALYSIS OF FINDINGS

This section discusses the results of analysis on the MSC Enforcement Releases from 2002 to 2007. Investigation into company misconduct or mismanagement is initiated from public or employee (whistleblowers) 'complaints' and/or from any observed irregularities in company activities that were detected by the MSC as a result of their monitoring activities. The results of descriptive analysis are presented here in four sections of number of fraud cases, nature of offences, the perpetrators/fraudsters, and general characteristic of fraudulent companies.

### A. Number of Fraud Cases

Table 1 shows the number of cases published in MSC Enforcement Releases from 2002 to 2007. It should be noted that this table does not report the number of persons or entities charged for each case. The highest number of cases for criminal prosecutions is fifteen which was reported in 2002

and the lowest was four cases in 2004. Except for 2004, criminal prosecution cases were the highest type of enforcement action taken. Civil action cases are the lowest for all the years analyzed, with zero reported cases for 2002 to 2004.

TABLE 1 NUMBER OF CASES IN EACH CLASS OF ENFORCEMENT

Enforcement	2002	2003	2004	2005	2006	2007
Criminal prosecutions	15	13	4	8	6	8
Civil Actions	-	-	-	1	1	4
Administrative Actions	9	4	2	4	1	2
Cases Compounded	7	6	7	6	4	3
Total	31	23	13	19	12	17

Administrative action cases are the second lowest number reported for the six years of study. The highest were nine cases reported in 2002 and four in 2003 and 2005 and one cases in 2006 and two cases in 2004 and 2007. The number of compounded cases reported ranged from six to seven in 2002, 2003, 2004 and 2005. The number decrease to 4 cases in 2006 and down to three cases in 2007. Overall, 2002 shows the highest number of reported cases and 2004 shows the lowest. There is a decreasing trend from 2002 to 2004 and an increasing trend from 2005 to 2007. Two possible reasons for the decreasing trend are more effective internal controls within companies and effectiveness in enforcement by the regulators. One possible reason for the increasing number of cases after 2004 is the ability of the perpetrators to override the control systems.

The fluctuation of the number of cases spread throughout the six years is shown clearly by the line chart in Figure 2.

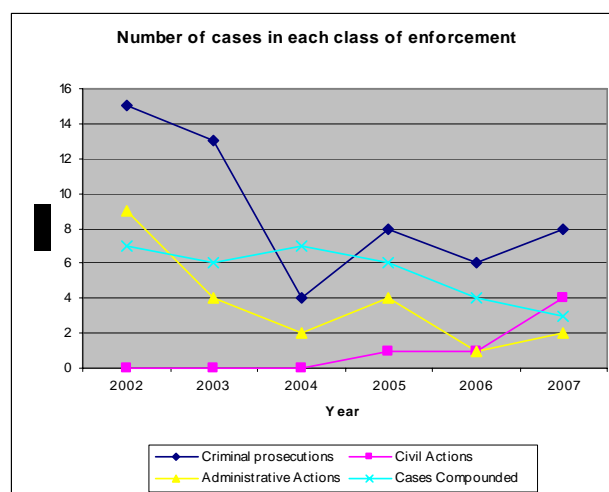


Fig. 2 Number of cases in each class of enforcement

The PwC (2007) survey indicates that 48% of companies surveyed were subjected to fraud for 2005 and 2006. Since 100 Malaysian public listed companies responded to this

survey, it follows that 48 of these companies were the subject of fraudulent acts during this period. However, for the same period of time, the MSC reported only 31 companies from a population of all public and private companies in Malaysia. This apparent difference suggests that many cases of fraud are either not detected or not reported to the MSC. Since perpetrators always attempt to cover-up their fraudulent acts, detection is not easy and this may be one reason why it is difficult to determine the actual number of fraud cases. Another reason may be that the company is reluctant to report fraud for fear that the company's image may be tarnished. Irrespective of the reason, this discrepancy should be of concern to the relevant authorities who, perhaps, need to be more active in monitoring and enforcement.

### B. Nature of Offences

Table 2 illustrates the nature of offences from 2002 to 2007, divided into two categories of accounting and auditing related offences and other offences. The accounting and auditing related offences are those that violate the accounting and auditing requirements in terms of reporting and disclosure such as providing or furnishing misleading financial statement which contains material omission and incorrect figure (assets and revenue were inflated or deflated). Other offences are the offences committed that are not related to accounting and auditing requirement violation such as unlicensed trading, unlicensed investment advice, criminal breach of trust, unauthorized trading of shares, manipulation of share price and unauthorized and unlicensed fund collection.

According to table 2, in 2007 the number of accounting and auditing offences were higher than other offences, and from previous years. Although each offence will have an impact on the business, it is suggested that accounting and auditing offences are likely to have the greater impact since these will affect all stakeholders and public trust. Investors and external users of the financial statements rely upon audited accounting information, so the impact of these types of offence is likely to be damaging to these groups. In comparison other offences, such as unlicensed trading of shares, unlicensed fund collection and unlicensed investment advisor, would be less damaging.

O – Other offences

### C. The Perpetrators/fraudsters

Table 3 represents the data on the groups of perpetrators. This study divides the perpetrators into two groups; the management team and others. Management team are those perpetrators from the middle and senior manager's level such as the chief executive officer, chief financial officer including company's board of directors. Others are perpetrators that did not belong to the management team criteria such as general employees and outsiders (not company's employee).

TABLE 3: FRAUD COMMITTED BY GROUPS OF PERPETRATORS FROM 2002 TO 2007

Group	2002	2003	2004	2005	2006	2007
Management team	7	13	7	9	6	8
Others	24	10	6	10	6	9
Total	31	23	13	19	12	17

Table 3 shows that fraud committed by members of the management team is higher in 2003, 2005 and 2007, than in 2002, 2004 and 2006, but that the number fluctuated over the period of the study. In 2002, 7 out of 31 cases are perpetrated by management and increased to 13 cases in 2003. However 2004 and 2006 show a decrease in number of fraud cases perpetrated by management team. 2007 does not shows significant decrease in the number of perpetrators from management team. On average for the six years analyzed, the perpetrator from management team is more than 8 cases per year.

Fraud committed by management is difficult to detect. Management have the authority and the opportunity to cover fraud and not report it (PwC, 2007). However companies are more open in reporting fraud committed by outsiders. The fact that fraud is committed by an insider conveys the perception that the company has failed to detect and/or deter the fraudulent activity, and this will have a negative impact on the corporate image.

TABLE II NATURE OF OFFENCES – 2002-2007

Offences/Year	2002		2003		2004		2005		2006		2007	
	AA	O	AA	O	AA	O	AA	O	AA	O	AA	O
Criminal Actions	4	11	3	9	2	2	2	6	3	3	5	3
Civil Actions	-	-	-	-	-	-	1	-	-	1	2	2
Administrative Actions	1	8	1	4	-	2	1	3	-	1	2	2
Cases Compounded	4	3	4	2	3	4	1	5	3	1	1	2
Total	9	22	8	15	5	8	5	14	6	6	10	7

Legend: AA – Accounting and Auditing related offences

However, this does not happen when the company reports fraud by an outsider since this proclaims 'success'. Therefore, the regulators, shareholders and other stakeholders have to closely monitor company performance and managers' activities to ensure a proper conduct and regulations are appropriately followed.

Table 4 shows the results of fraud committed according to the ethnic of the perpetrators from 2002 to 2007. For this part of analysis the number of perpetrators is based on the number of people/person involved in each of the cases therefore the number of perpetrators will not be same with the number of cases reported as one cases may involved more than one person. Malaysia is a multiracial country and the three main ethnic groups are Malay, Chinese and Indian. Other group in this analysis is the foreigners (not a Malaysian citizen). The results of the analysis are shown separately in table 4. In 2002 the number of Malay perpetrators is the highest followed by Chinese with only one Indian. During 2003 to 2007 however, most frauds were committed by Chinese. This may be due to the fact that in Malaysia, Chinese people are more involved in business (as owners or managers) and Chinese people appear to have greater interest in businesses as compared to the Malays and Indians. Of the 176 perpetrators over the six years (a total from 2002 to 2007), 7 are foreigners (i.e. not a Malaysian citizen).

TABLE IV ETHNICITY OF PERPETRATORS 2002-2007

Ethnicity	2002	2003	2004	2005	2006	2007	Total
Malay	25	9	2	6	4	5	51
Chinese	23	18	12	19	17	26	115
Indian	1	2	-	-	-	-	3
Others	-	2	2	2	1	-	7
Total	49	31	16	27	22	31	176

#### *D. General Characteristics of Fraudulent Companies*

The general characteristics of fraudulent companies from 2002 to 2007 are being presented in table five.

TABLE V INDUSTRY AND TYPE OF FRAUDULENT COMPANIES

Industry/Sector	Public		Private	Other/ Foreign	Total
	Listed	Not Listed			
Manufacturing/Industrial product	7	1	-	-	8
Construction & Engineering	3	-	-	-	3
Investment Holding/ Fund	1	4	42	3	50
Technology/ Telecommunication	2	2	-	-	4
Property development	3	-	-	-	3
Plantation	1	-	-	-	1
Consumer product	3	2	-	-	5
Trading & Services	4	2	2	-	8
PN4/ PN17	3	-	-	-	3
Others (accounting firm, valuer)	-	-	-	3	3
Total	27	11	44	6	88

The general characteristics are being determined by analyzing industry/sector and type of the fraudulent companies. The industry or sector of each company is determined by the core or nature of company's business activities. For the six years analysis the industry/sector is divided into 10 groups as shown in table five. For this analysis, once again the number of companies involved may differ from the number of cases recorded this is due to there are a few cases where the perpetrators is a person that does not represent any companies or commit any crime for a company.

The type of company is determined by the registration of company under Company Act 1965 whether it is a public, public listed or private company. Any company that is registered under the Companies Act 1965 and has criteria defined under Companies Act 1965 Para 15 (1) as in Appendix 1 will falls under the private company. A public company is a company other than a private company. Public listed companies are companies whose shares are listed (traded) on Bursa Malaysia, whereas 'other' public companies are not. Table 5 present the summary of the analysis of 10 industry types of fraudulent companies.

Table 5 shows the attributes of the companies listed in the Enforcement Release for various charges of fraud and misconduct. The analysis shows the majority of companies charged with frauds are private companies that are 44 out of 88 companies. Private companies are not subject to mandatory requirements for corporate governance and are under less scrutiny by the public and regulators. Consequently, their internal management control could be weak that fraudulent activities could easily been committed. Three of the public listed companies charged with fraud are listed as PN4/PN17 companies, which indicate that they are in financial distress.

The PwC (2009) economic crime survey indicates that companies facing financial difficulty with higher performance pressure are vulnerable to fraud. The highest proportion of offenders, 50 companies out of a total of 88 companies reported, came from the Investment holdings/fund management/ finance sector or industry.



Most of the investment/fund/finance company committed fraud in dealing with client monies, initial public offerings, manipulation of share price and unauthorized dealing in securities. These types of fraudulent activities will diminish the public trust in the capital market investment which will affect the economic development. Three companies being charged with fraud are foreign investment companies and one is an accounting firm and two are valuer companies. From the total offenders, 38 (27+11) of the companies are public companies from which public listed companies are more than half of it. It is quite a high number (27) of public listed companies involved in fraud and the impact could be very damaging to the minority interest group and individual investors due to the concentrated family-owned businesses in Malaysia.

#### IX. CONCLUSION AND REMARKS

This study reveals the number of corporate frauds reported from 2002 to 2007 which are categorised by nature of fraud, perpetrators (management and others), ethnicity, industry and type of the companies. The high percentage of fraud committed by management shows that fraud is a serious threat to businesses specifically to the investors in Malaysia. The Malaysian Chinese community is the lead player in Malaysian business which could contribute to the results that they illustrate a higher number of perpetrators of fraudulent acts. Private companies constitute the majority offenders for the six years with the investment/fund/finance sector presenting a higher number of fraud cases. This could be due to the fact that the private companies are subject to less scrutiny by the public and regulators or the enforcement agencies. Private companies are not subject to the mandatory requirement to have corporate governance which could be another reason for the high number of private company involved with fraudulent activities. As public companies are more exposed to public scrutiny and subject to greater regulation, the incidence of reported fraud was quite low. It is suggested that private companies should be effectively monitored since they constitute more than half of the total number of fraud cases that were reported.

However, since a vast majority of fraud cases are detected accidentally or through whistleblower, then it is reasonable to conclude that there must be more cases of fraud that are not being detected and/or reported to the authorities or regulators. It is therefore very important for the regulators to be increasingly vigilant in their detection activities and to have effective regulations in order to protect the interest of the shareholders and other stakeholders. Companies have to be more open to reporting acts of fraud and to take corrective action/s. The limitation of this study is its descriptive nature, relies upon the information published in the Malaysian Securities Enforcement Releases. Future research could be carried out in analyzing the nature of offences and the penalties to understand the punishment system and its impact on the fraudulent activities. A study on the time taken in dealing with each fraud cases could also be carried in understanding the effectiveness of fraud enforcement in Malaysia.

#### APPENDIX

##### 1. The criteria of private companies defined under Companies Act 1965 Para 15 (1)

A company having a share capital may be incorporated as a private company if its memorandum or articles -

- (a) restricts the right to transfer its shares;
- (b) Limits to not more than fifty the number of its members (counting joint holders of shares as one person and not counting any person in the employment of the company or of its subsidiary or any person who while previously 58 Laws of Malaysia **ACT 125** in the employment of the company or of its subsidiary was and thereafter has continued to be a member of the company);
- (c) Prohibits any invitation to the public to subscribe for any shares in or debentures of the company; and
- (d) Prohibits any invitation to the public to deposit money with the company for fixed periods or payable at call, whether bearing or not bearing interest.

[30]

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