Combating Fraud: Is Egypt Ready? Insights from the Literature

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Abstract
The current study aims at evaluating Egypt’s ability to combat internal fraud after the 21st of January revolution in 2011 where the demand for more integrity and transparency increased. The current study critically reviews prior literature into four fraud-related areas in the Egyptian context. This includes the extent of internal fraud risk in Egypt, the efforts of regulators in combating internal fraud, the efforts of external auditors in detecting internal fraud, and fraud research in Egypt. The following databases were used: Emerald, Ebscohost, Science Direct, ElSevier, Web of Science, Jstor, and Academic Search Premier. Google search engine and websites of international professional bodies were also used. The current study is one of few papers that provide knowledge about a context where there is a scarcity of fraud research. The current study also offers recommendations to regulators, audit professionals, and researchers in Egypt in an area that is highly controversial and a concern to various stakeholders. However one of the limitations of the current study is that it provides evidence from prior literature rather than empirical research.

Keywords: Egypt, internal fraud, asset misappropriation, corruption, financial reporting fraud

INTRODUCTION
Fraud is a major cost to society and no country or industry is immune. The Association of Certified Fraud Examiners’2014 Report to the Nation on Occupational Fraud and Abuse (ACFE) showed that the typical organisation loses 5% of revenues each year to fraud. They also added that if applied to the 2013 estimated Gross World Product, this translates to a potential projected global fraud loss of nearly $3.7 trillion.

Combating fraud requires the efforts of regulators, audit professionals, and researchers. The current study thus aims at evaluating Egypt’s ability to combat internal fraud after the 21st of January revolution in 2011 where the demand for more integrity and transparency increased. Egypt was chosen as the context of the current study because of scarcity of research in this area. The current paper focuses only on internal fraud because it is the most common and most costly type of fraud (ACFE, 2014; Wells, 2005; Price WaterHouse Coopers, 2009) and probably occurs more frequently than external fraud (Hassink, et al. 2010).

The rest of the paper is organized as follows. Section II critically reviews prior literature into the above mentioned fraud-related areas in the Egyptian context. Section III is the conclusion and Section IV provides recommendations to regulators, external auditors, and researchers in Egypt on how to combat fraud.

LITERATURE REVIEW
In order to evaluate Egypt’s ability to combat fraud after the 21st of January, 2011 revolution, prior literature into four-related fraud areas were critically reviewed. This includes the risk of internal fraud in Egypt, the efforts of regulators in combating internal fraud, the efforts of external auditors in detecting internal fraud, and fraud research in Egypt. The current study thus provides knowledge about a context where fraud research is scarce and secrecy is the norm. The current study also offers recommendations to regulators, audit professionals, and researchers in Egypt in an area that is highly controversial and a concern to stakeholders.
the Egyptian context. However, evidence from prior studies indicate that there is a high risk of financial reporting fraud in the country due to improper disclosure. For instance, Dahawy et al. (2008) argued that the Egyptian accounting system is characterised by secrecy. They also added that this secrecy preference in the accounting subculture would influence the extent of information disclosed in the accounting reports. Puddephatt (2012) stated that there is a lack of proper government accounting systems. Egypt has the Accountability State Authority, but generally it does not publish its reports - they are sent directly to the president, head of parliament and prime minister who decide what to do with the information. The author added that the Accountability State Authority sometimes fail to get the data they request from government either because the ministry does not want to collaborate or the government does not have the data. The Accountability State Authority (ASA) is an independent organisation attached to the People’s Assembly (Parliament). It helps the People’s Assembly achieve control over state funds, and funds of public entities. The ASA governs the audit of government departments and agencies, public sector enterprises, and companies in which public investment constitutes at least 25 percent of total ownership. The ASA also audits and examines the work and accounts of any other entity assigned to it by the President of the Republic, the People’s Assembly, or the Prime Minister (Wahdan et al, 2005).

A study by Rahman (2002) found that some companies in Egypt avoid full disclosure of information in the published financial statements, ignoring the disclosure requirements set by the applicable accounting standards. He also found that the financial statements of many companies that seem to have related parties do not disclose information on either the existence of related parties or related-party transactions, and companies usually do not disclose information on events after the balance-sheet date. Hassan and Power (2009) argued that although Egypt applies the Egyptian Accounting Standards which is not significantly different from the International Financial Reporting Standards, divergence from full compliance with mandatory disclosure is the norm and voluntary disclosure is limited because of unfamiliarity with IAS, language barriers, tendency towards secrecy in the Egyptian culture, and lack of an effective enforcement policy for companies who do not comply. They also added that in Egypt companies tend to view information as a private asset owned by the firm, hence, the voluntary disclosure of information is rare and compliance with mandatory disclosure is often problematic.
The World Bank conducted a project in 2009 aimed at assessing corporate governance practices in Egypt. The results of the study showed that in practice, non-financial disclosure remains inadequate and public disclosure is generally lacking, especially when it comes to disclosure about conflicts of interest or approving related party transactions.

Dahawy and Conover (2007) found that companies disclosed 61% of the required level of disclosure by the Egyptian Financial Supervisory Authority and IASs and that companies were selective in their choice of what to comply with and what not to. Examples of the disclosure of the items that companies failed to comply with were policies related to consolidation, leasing, and treatment of intangible assets, policies and values of commitments for capital expenditures, market values of investments, disclosure of liabilities to members of the board and the effects of transactions with related parties. Samaha and Abdallah (2012) explored disclosure of electronic versions of financial statements in Egypt. Results indicated that Egyptian listed firms are still in the early stages to disclose electronic versions of its print-based financial statements and very limited voluntary financial, corporate governance and investor-related information is available online, which are displayed using the very static basic Internet technologies. Samaha et al. (2012) investigated the extent of corporate governance voluntary disclosure and the impact of a comprehensive set of corporate governance attributes (board composition, CEO duality, director ownership, and the existence of audit committee) on the extent of corporate governance voluntary disclosure in Egypt. They measured the degree of disclosure by examining annual reports and websites of the most active 100 Egyptian companies on the Egyptian Stock Exchange as measured by the EGX 100 index at the financial year ends on 2009. Findings of their study revealed that the levels of corporate governance disclosure are minimal. However, disclosure was found high for items that are mandatory (41 items out of 53) under the Egyptian Accounting Standards (EASs) because of EGX listings’ requirements. The findings also showed that the extent of corporate disclosure is lower for companies with duality in position and higher ownership concentration, and increases with the proportion of independent directors on the board and firm size.

There are also few evidence that management in Egypt are overstating revenues. For instance, Dey et al. (2008) found support that management in Egypt are motivated to overstate revenues through using income-increasing accounting techniques to increase their bonuses and pay less tax, but they found little evidence that management will manipulate revenues to avoid debt covenants. Kamel and Elbanna (2010) found that management manipulates earnings in Egypt to enhance the chances of obtaining a bank loan, the desire to sustain last year’s profit performance, report profits, and achieve high-share valuation.

However, the above studies are just an indication that the risk of financial reporting fraud might be high in the Egyptian context. This indicates there is a need for empirical research to explore the nature of financial reporting fraud in the Egyptian context. This should include the frequency of financial reporting fraud in Egypt, the types of financial reporting fraud that are common in Egypt, how they are committed, whether any was detected, how it was detected, and by whom.

**Corruption in Egypt**

The number of reported corruption related crimes as of 2007 were 287 cases and they were all detected but only 24 cases were referred to the court. Number of reported fraud cases as of 2006 was 9,930 and 12,570 in 2007 (Middle East and North Africa Financial Action Task Force, 2009). However, there are no updated reports about the current reported fraud or corruption cases in Egypt.

Egypt is confronted with both grand and petty corruption which is a major obstacle to business operations and growth, as mentioned by the European Commission in its 2009 report about anti-corruption efforts in Egypt. The Corruption Perceptions Index ranks countries based on how corrupt their public sector is perceived to be. A country’s score indicates the perceived level of public sector corruption on a scale of 0 - 100, where 0 means that a country is perceived as highly corrupt and 100 means it is perceived as very clean. Egypt’s CPI score was 37 which indicates that the country is suffering from a relatively high level of corruption.

In a survey conducted by Transparency International ‘Global Corruption Barometer’ in 2013, 30-39% of the study respondents in Egypt reported they have paid bribes in the past year. Corruption occurs in every sector but according to the Global Corruption Barometer survey, corruption is more common in the police and media sectors in Egypt. Evidence from the 2014 Report to the Nation on Occupational Fraud and Abuse issued by the Association of Certified Fraud Examiners showed that corruption cases in countries in Africa including Egypt accounted for 50% of the total fraud cases in their study. This shows how serious the issue of corruption is in the Egyptian context.
The Efforts of Regulators in Combating Internal Fraud in Egypt

There are anti-corruption and anti-money laundering institutions in Egypt like: The Administrative Control Authority (ACA), which was set up in 1964, and is responsible for monitoring the soundness of administrative performance and safeguarding integrity among public employees. The ACA investigates around 400 - 450 cases annually, of which 65% are related to bribery, public funds misappropriations and transgression thereon. There is also the Egyptian Coalition for Transparency and Anti-Corruption (NGO). A Committee on Transparency and Integrity was also set up under the Ministry of State for Administrative Development, with the aim of meeting international anti-corruption guidelines and implementing the United Nations Convention against Corruption. Criminal law in Egypt Article 112 and 113 of the penal code criminalise corruption and bribery. Criminal law in Egypt Article 112-119 criminalise fraud (Middle East and North Africa Financial Action Task Force, 2009).

There is also the Anti-Money Laundry (AML) law in Egypt that criminalises money laundering. The Egyptian system is structured to ensure that legal entities are not used for unlawful purposes and legal provisions on the establishment, registration and monitoring of non-governmental organizations are strictly enforced. However, there is a lack of overall effectiveness of the AML system due to low money laundering investigations and prosecutions arising out of profit generating crimes (Middle East and North Africa Financial Action Task Force, 2009).

In spite of the authorities’ strong efforts, however, domestic and international perceptions of corruption in Egypt are slow to change and remain high (Transparency International, 2013). According to the index developed by the Egyptian Cabinet’s Information and Decision Support Centre in 2009 to measure the degree of citizens’ perception in public institutions, corruption is perceived to be higher in urban areas (69.2 points), compared to rural areas (62.9 points) (Middle East and North Africa Financial Action Task Force, 2009).

In Egypt, several mechanisms were adopted in the last decade, which aims to increase levels of transparency and confidence in the content of financial reporting, such as the compliance with the International Financial Reporting Standards, the code of corporate governance, and the creation of the Egyptian Financial Supervisory Authority (EFSA) which is responsible for supervising and regulating non-banking financial markets and instruments, including the Capital Market, the Exchange, and all activities related to Insurance Services, Mortgage Finance, Financial Leasing, Factoring and Securitization(www.efsa.gov.eg). However, in spite of all these mechanisms, the ability of companies to manipulate financial reports through the earnings management still exists (Metawee, 2013). There also is no professional body in Egypt dedicated to anti-fraud education apart from the anti-corruption professional bodies such as the Administrative Control Authority in Egypt. We have also noticed that regulators efforts in Egypt are directed towards combating corruption while less attention is given to asset misappropriation and financial reporting fraud.

The Role of External Auditors in Detecting Fraud in Egypt

External auditors in Egypt are required to follow the Egyptian Standards on Auditing (ESA) which is just a translation of the International Standard on Auditing (Trade and Development Board, 2008). External auditors are generally not responsible for fraud detection, however the International Standard on Auditing (ISA) No.240: the Responsibility of Auditors Relating to Fraud in an Audit of Financial Statements requires external auditors to assess and respond to the risk of fraud arising from asset misappropriation and financial reporting fraud.

Reviewing prior literatureshowed no evidence into the use and impact of ISA 240 in either the Egyptian context or elsewhere. There is also no empirical evidence that shows the degree of compliance of audit firms in Egypt with the requirements of ISA 240. However, prior research showed that in practice, the International Standards on Auditing in general are either not fully complied with or inconsistently complied with among audit firms in Egypt. For instance, the degree of compliance with applicable auditing standards varies among large and small firms. Although large auditing firms generally have greater capability to provide quality services, compliance with the standards is not always ensured (Rahman, 2002; Ministry of Foreign Trade, 2003). Wahdan et al (2005) in their study on auditing in Egypt have concluded that there is compliance gap between auditing requirements and actual practices in Egypt. Their results also revealed that noncompliance with auditing standards in Egypt was mainly caused by the lack of experience and expertise in the profession, the lack of accounting and auditing education, and the lack of competitiveness of the profession in terms of salaries and incentives.

Samaha and Hegazy (2012) explored whether external auditors in Egypt follow the requirements of ISA No. 520 related to analytical procedures. The results of the
study showed relatively low use of analytical procedures by Egyptian auditors with wide variations in its use by Big 4 and other audit firms, and that auditors from Big 4 firms are found to use analytical procedures to a greater extent compared to auditors from non-Big 4 audit firms. Findings also revealed that ISA 520 was not that effective in stimulating significant change for the use of analytical procedures in Egypt audit engagements. The researchers explained the reason behind that could be due to lack of adequate training and awareness of auditing standards, less qualified auditors and more reliance on experienced ones, insufficient materials about auditing standards taught at various universities and finally inability of some auditors to read and interpret ISA on its original English language.

Prior research also showed that there are governance issues in Egypt that might affect audit quality. For instance, Wahdan et al (2005) explored the status of the auditing profession in Egypt, and study data was collected using two questionnaires distributed to 13 auditors with PhDs and 19 practitioners. Auditors in their study stated that laws do not include rules that state auditors rights and obligations, there is no strong independent professional organisation to guarantee auditors rights with the auditees, there are no standardised measures for audit quality, and there is no separation between the auditing service and other services provided to the auditees by the auditors.

In 2009, the World Bank assessed the application of Corporate Governance in Egypt as part of the World Bank and International Monetary Fund (IMF) programme on Reports on the Observance of Standards and Codes (ROSC). The findings revealed that auditor independence is addressed in the legal and regulatory framework, however, not consistently complied with in practice. Moreover, auditors often remain with their clients for extensive periods, often exceeding ten years, which may influence auditor independence. Boards are not required or encouraged to ensure for the integrity of the financial reporting process. In addition, key policies on risk management, internal control and audit processes, and succession planning are often absent. Anis (2014) found many challenges that might affect the application of mandatory auditor rotation in Egypt such as the significant gap between the audit quality of big auditing firms and that of other auditing firms; the lack of a wide pool of qualified auditors to choose from when changing auditors; the significant variation in audit fees between big auditing firms and other auditing firms in Egypt; and that almost no lawsuits have ever been brought against audit firms in the past. Thus, the auditor liability structure and the strength of law enforcement may affect the auditors’ incentives to maintain audit quality. Results from the ACFE in its 2014 Report to the Nation on Occupational Fraud and Abuse showed that no fraud cases were detected by external auditors in the Middle East and North Africa including Egypt, while 33.3% of the fraud cases were detected by internal auditors.

The above indicates that the challenges faced by external auditors in Egypt raises concerns about their ability to discharge their responsibility for fraud as required by ISA 240. The lack of evidence in this area also indicates a need for empirical research that could add to our knowledge of the Egyptian context and to what extent Egyptian auditors are successful in detecting fraud.

**Fraud Research in Egypt**

Reviewing prior literature showed a huge gap in the literature when it comes to fraud research in Egypt. For instance, only two studies were found into financial reporting fraud in Egypt. Hegazy and Kassem (2010) conducted a study to explore external auditors’ perceptions of the importance of red flags in detecting financial statements fraud and the effect of demographic factors on auditors’ perception. Their findings revealed that external auditors in Egypt perceived red flags as an important tool in detecting financial statement fraud. However, they did not also explore if external auditors in Egypt actually use red flags to assess risks of financial statement fraud and how they actually respond to these risks. Kamel and Elbanna (2010) conducted a study to assess respondents’ perceptions of the quality of reported earnings in Egypt. The respondents included external auditors, accounting and auditing academics, and financial managers. Their results revealed that one of the main incentives for manipulating earnings in Egypt is to enhance the chances of obtaining a bank loan, the desire to sustain last year’s profit performance, report profits, and achieve high-share valuation. However, although their paper holds important implications about the quality of earnings in Egypt, it was not clear whether the management’s motives arise from earnings management or financial reporting fraud. They did not also mention the implications of their results for external auditors, however they only provided general recommendations or actions required for improving the quality of information. Besides, they did not specify the techniques used by management to manipulate earnings as was intended by their study.

Kassem (2014) explored Egyptian auditors’ perceptions of the most effective red flags in detecting asset misappropriation, and how would they respond to each risk. Findings revealed that external auditors perceived
analytical procedures as the most effective tool to assess risks of asset misappropriation. Findings also indicates that external auditors still need guidance on how to respond to risks of asset misappropriation.

The above shows there is a need for fraud research in Egypt to raise fraud awareness and to help find effective fraud detection and prevention techniques.

CONCLUSION
Fraud by all means is a concern for stakeholders. Combating fraud requires the effort of regulators, governance bodies, audit professionals, and researchers. The current study thus aims at evaluating Egypt’s ability to combat internal fraud after the 21st of January revolution in 2011 where the demand for more integrity and transparency increased. The focus of the current study was on internal fraud because it is the most common and costly type of fraud. To achieve this aim, the current study critically reviewed four fraud-related areas in the Egyptian context. This includes the extent of internal fraud risk, the efforts of regulators in combating internal fraud, the efforts of external auditors in detecting internal fraud, and fraud research in Egypt. Findings of the current study revealed that it is unlikely that fraud cases are publicised in Egypt due to the secrecy culture. There is also a lack of proper government accounting systems where the Accountability State Authority in Egypt does not publish its reports, however, they are sent directly to the president, head of parliament and prime minister who decide what to do with the information. It was very difficult to find evidence in prior literature of published financial reporting fraud cases or asset misappropriation cases in Egypt. However, there was evidence that Egypt might be facing high risk of financial reporting fraud due to improper disclosure and tendency to overstate revenues in the financial statements. Findings also revealed that Egypt is confronted with both grand and pretty corruption which is a major obstacle to business operations and growth. There are anti-corruption and anti-money laundry institutions in Egypt like: The Administrative Control Authority (ACA), which is responsible for monitoring the soundness of administrative performance and safeguarding integrity among public employees. In addition, several mechanisms were adopted in the last decade, which aims to increase levels of transparency and confidence in the content of financial reporting, such as compliance with the International Financial Reporting Standards, the code of corporate governance, and the creation of the Egyptian Financial Supervisory Authority. However, in spite of the authorities’ strong efforts, domestic and international perceptions of corruption in Egypt are slow to change and remain high. Besides, prior literature showed evidence that the ability of companies to manipulate financial reports through the earnings management still exists. There is also no professional body in Egypt dedicated to anti-fraud education apart from the ACA in anti-corruption efforts. We have also noticed that regulators efforts in Egypt are more directed towards combating corruption while less attention is given to asset misappropriation and financial reporting fraud.

There are concerns regarding the ability of external auditors in Egypt to discharge their responsibility for fraud as required by ISA 240. That is because of some governance issues in Egypt that might have an impact on audit quality. This includes lack of rules that state auditors’ rights and obligations, no strong independent professional organisation to guarantee auditors rights with the auditees, no standardised measures for audit quality, and issues regarding auditors’ independence. No evidence was found in prior literature about the degree of compliance of audit firms in Egypt with the requirements of ISA 240. However, evidence from prior research showed that in practice, the International Standards on Auditing are either not fully complied with or inconsistently complied with among audit firms in Egypt. Prior research explained that non-compliance with the international standards could be due to lack of experience and expertise in the profession, the lack of accounting and auditing education, and the lack of competitiveness of the profession in terms of salaries and incentives.

Reviewing fraud research in the Egyptian context showed a huge gap in this area. The role of research should not be undermined. Fraud research is needed not just to raise fraud awareness but also to find more effective fraud detection and prevention techniques. Like any other paper, the current paper has also limitations. One of which comes from the fact that the current paper provides evidence from prior literature rather than empirical research. However, the current study is one of few papers that provide knowledge about a context where there is a scarcity of fraud research. The current study also offers recommendations to regulators, audit professionals, and researchers in Egypt in an area that is highly controversial and is a concern to various stakeholders.

RECOMMENDATIONS
The current study recommends the following. More attention should be given to fraud education and training. Fraud education should be part of the curriculum at all Egyptian Universities to raise fraud awareness. Audit firms need to offer more anti-fraud education and training to external auditors at all levels.
This might increase the likelihood of fraud detection. External auditors also need to be aware that although they are not directly responsible for fraud detection, they still need to have good knowledge of the nature and types of fraud so as to properly assess and respond to fraud risks as required by ISA 240.

In the meantime, fraud education will not be effective with the lack of effective laws and legal system that prohibits all types of internal fraud and not just corruption. Increasing the penalty for committing fraud might also reduce the opportunity to commit fraud. The establishment of a professional body to combat fraud is also quite important.

Egypt should exert more effort to enhance both financial and non-financial disclosure. Both fraud cases and alleged fraud cases need to be reported to the public to raise fraud awareness. Lessons learned from previous fraud cases could be invaluable in designing effective mechanisms in fighting fraud today.

More attention should be given to fraud research in the country. Fraud research is needed not just to raise fraud awareness but also to fight fraud. New research ideas are needed to identify current weaknesses in governance mechanisms, and to design effective fraud detection and prevention techniques. Future studies should explore the nature of internal fraud in Egypt. This includes how common each type of internal fraud is, how each is committed, whether any fraud cases were detected before, how fraud was detected, and by whom. Future studies also need to explore the impact and use of ISA 240 not only in the Egyptian context but also in other contexts because of lack of evidence in this particular area. The role of external auditors in detecting fraud in the Egyptian context is still ambiguous so research in this area is needed to explore the challenges facing external auditors in discharging their responsibility for fraud as required by ISA 240, as well as exploring their efforts in detecting fraud in the Egyptian context.

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