Researchers look at who's to blame for financial fraud

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When companies deceive shareholders about earnings or commit other kinds of accounting fraud, the legal fireworks can be spectacular. Even if the companies don't collapse, as in the notorious Enron case, some executives are sent to jail, fired, or otherwise punished.

But what happens to executives who weren't implicated in the fraud? That's a question a team of researchers examined over a period of years, including the University of Delaware's Amanda Convery, assistant professor of accounting in the Lerner College of Business and Economics. The point of their study, they write, was to discover "how does the labor market react to individuals with a questionable past?"

The idea started over a lunch conversation among the authors: In particular, they wanted to know what kind of fallout chief financial officers face, even if they weren't held legally responsible.

These executives, in theory, should have had a good handle on their company's finances.

"They're signing off on the financial statements," Convery said, that "these numbers are trustworthy and …. To the best of their knowledge, there are systems in place to prevent and detect the fraud. And so even if they're not associated at all, at a minimum it suggests things happened on their watch."

The research paper was published in the journal *Contemporary Accounting Research*, and it examined how these executives fared on the job market, both in keeping their original jobs or landing new ones.

The researchers delved into news reports and SEC investigations between 2005 and 2014, after legislation took effect that clarified and added to CFOs' responsibilities.

A natural assumption might be that most CFOs are implicated in fraud cases, given their positions, but the authors discovered that in about a third of the cases they looked at, these executives weren't implicated.

They did still pay a cost, though, with higher turnover in their jobs and, once news broke publicly about the fraud, decreasing ability to find new ones. The job turnover was especially high for CFOs who were on the job before the fraud began.

While the authors can't determine whether the CFOs were actually innocent or had evaded justice, Convery did note that sometimes the reputational hit isn't fair. In some cases, the CFOs actually exposed the fraud.

Also, companies can be really complicated, she said. "Many of these are multinational companies, they're large operations. And so to think that your career could be hinging on something that you may or may not have any direct control over, that was something that we were just always curious about."

Not everyone faced a ruined career. Some of these executives, Convery and her fellow researchers found, did end up with new jobs at publicly traded companies, which "suggests that the labor market really does look at all aspects of the individual."

To ensure that their analysis was fair, the researchers compared the fates of the CFOs who weren't convicted of fraud to the careers of CFOs at companies of similar size, performance and industries.

One surprise in the research was that before the fraud scandals became public knowledge, non-implicated CFOs were actually much more likely than their struggling counterparts to land a new job—perhaps, the authors suggest, because they were able to take advantage of the knowledge that they might need a new job soon. But of course, once word got out, this advantage evaporated.

The findings indicate that companies should take a buyer beware approach when hiring, Convery proposes, looking at the full circumstances of why a job candidate is leaving the old position. At the same time, "Just that someone is associated with this [company] shouldn't be a scarlet letter."

There's also been criticism of how long it takes to carry out these investigations, Convery said, but the study shows that the labor market needs this information.

"We find evidence that even if this revelation happens years later … it still has an impact," she said.

More information: Eric R. Condie et al, Fraud Firms' Non-Implicated CFOs : An Investigation of Reputational Contagion and Subsequent Employment Outcomes*, *Contemporary Accounting Research* (2022). DOI: 10.1111/1911-3846.12817

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