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A Conceptual Framework to Analyse Illicit Financial Flows (IFFs)

Ndiimafhi Norah Netshisaulu, Huibrecht Margaretha Van der Poll * and John Andrew Van der Poll

Graduate School of Business Leadership, University of South Africa, Pretoria 0002, South Africa
* Correspondence: vdpolhm@unisa.ac.za

Abstract: This article develops a conceptual framework, based on a comprehensive literature review, to address illicit financial flows (IFFs), characterised by the illegal move of monies or capital across country borders. IFFs compromise transparency through complex transactions and incur harmful effects for both developing and developed economies. Financial opacity creates a conducive environment for IFFs to flourish, as a challenge to good financial practices. Following an interpretive philosophy, an inductive research approach, qualitative methodological choice, cross-sectional time horizon all through data collection through review of scholarly literature, and framework were developed to analyse the said IFFs. Our framework encourages good corporate governance and provides insights, as well as the identification of possible characteristics of IFFs perpetuated in the financial statements of entities, which would discourage entities to engage in IFFs. Specifically, practitioners should be able to identify characteristics of IFFs and use the framework to address these. Within the finance dimension, it is important to study the specific mechanisms regarding how IFFs may damage an entity's reputation, as well as their going concern. In future work, we shall enhance the framework through interviews with auditors, followed by a validation of the enhanced framework through a focus group. The utility of the final framework can be tested through case studies in the industry to analyse IFFs.

Keywords: categories of IFFs; financial reporting problem; financial reporting transparency; illicit financial flows

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1. Introduction

In this work, we examine illicit financial flows (IFFs) perpetuated in the financial statements of entities, with the aim to develop a conceptual framework to enhance transparency and address IFFs. Through these endeavours, we further identify the characteristics and classifications of IFFs, through a comprehensive review of scholarly literature. IFFs lacks mutual agreement on a definition, owing to uncertainties around the IFFs concept (Musselli and Bonanomi 2020). These are, however, generally characterised by the illegal move of monies or capital across country borders (Global Financial Integrity (GFI) (2021); The World Bank 2017). The IFFs challenge in developing countries continues to grow, especially in sub-Saharan Africa (Barasa 2018). Incapacitated tax systems allow for legislation to be avoided or explained, to a certain extent, thus leading to the perpetuation of IFFs, such as transfer mispricing in African countries (Mutio 2020). IFFs also have adverse effects on tax revenue collection, in the form of corruption and governance channelling, such as mobilisation (Thiao 2021). Furthermore, Adeleke (2019) emphasised that inadequate regulatory frameworks fail to curb IFFs.

An improved and context sensitive approach is required, in order to discover the factors and dynamics around the IFFs challenge (Erskine and Eriksson 2018). Lack of financial reporting transparency is related to ethical practices and corporate governance; hence, a loophole for corruption, such as IFFs or earnings management, may arise (Abdullah et al. 2015), while the use of financial opacity continues to create a conducive environment for IFFs (Mwita et al. 2019). Curbing IFFs is hard, since Chowla and Falcao (2016) indicated that IFFs can be as rudimental as not paying any tax on the transfer of money by an individual to an international account to more involved schemes where multi-layered and jurisdictional structures are developed by crime syndicates to cover proprietorship.

International financial reporting standards (IFRS) are applied in entities to process transactions; these transactions report on the financial health of an entity at the end of a financial year through the financial statements (Parrot 2017). We argue in this work that, should financial statements be transparent and devoid of biased information, the process of economic and investment decision-making will be more effective (Mashayekhi and Kalhornia 2016). IFFs essentially breed in opacity, which hinders economic growth through investment deterrents, raised transaction costs, and financial uncertainty (Mwita et al. 2019). Consequently, a need arises to encourage transparency to discourage IFFs enablers, such as financial opacity and secrecy, through the identification and subsequent syntheses of the characteristics of IFFs.

The layout of the article follows. Following the introduction, we present our research questions and objective in Section 1.1. This is followed in Section 1.2 by a presentation of qualitative propositions used in this work. The theoretical lens of the work is given in Section 1.3, followed by the results in Section 2. An important part of the results section is the development of the conceptual framework. Section 3 discusses the content of the framework, followed by the research methodology, in the form of the materials and methods in Section 4. A conclusion to the article is presented in Section 5, followed by a list of references.

1.1. Research Questions and Objective

This research aims to find answers to the following questions:

- What are the characteristics of illicit financial flows (IFFS)? (RQ1)
- What are the categories and drivers of IFFs? (RQ2)
- How may IFFs be addressed? (RQ3)

Our objective is:

- Develop a conceptual framework to assist with the curbing of IFFs. (Obj)

1.2. The Use of Propositions

In this work, we utilise two sets of propositions to develop the conceptual framework in Section 5:

- Content propositions indicate the guiding principles defining the entities (round blocks) in our framework. Content propositions are indicated by PC1, PC2, . . . PC*n*, with *n* representing a natural number.
- General propositions indicate aspects of a more general nature and are indicated by PG1, PG2, . . . PG*m*, with *m* representing a natural number.

1.3. Theoretical Lens of This Work

The theoretical lens and concepts that underpin this research serve as a guide to build the conceptual framework. The practices of normative accounting theory is the formation of value judgment that could establish ethics in accounting (Desalegn 2020), which could suggest a crucial point of departure from the actual practice (Fransesco et al. 2021). In addition, the perspective of normative accounting theory is that it can predict management's decisions, with regard to accounting policies, to maximise their own best interests (Nasution et al. 2020). Furthermore, the normative accounting theory guides policymakers on what should be done, based on theoretical principles (Susanti et al. 2021). Within this research, the possible characteristics of IFFs are identified, which could enhance financial reporting transparency, while discouraging IFFs.

The literature provides evidence that accountants view information on the accrual basis, as useful for making decisions, and crucial decision usefulness indicators that entail the assessment of cash flow, needs of an entity, assistance in managing assets, and liabilities, as well as an entity's resource allocation decisions (Ismail 2022). Georgiou et al.'s (2021) finding contribute to the notion of problematic decision usefulness that emerges to be reliant, rather than synthesised by some agreed ideals, as alluded to in conceptual accounting frameworks. The link of decision usefulness theory into the framework is the relevance of financial information communicated to the stakeholders and transparency in financial reporting. According to agency theory, agents make decisions, which shareholders rely on, and action is taken in the interest of the principal. However, decisions may not always be taken by the agents to the benefit of the principals (Desalegn 2020). This suggests that the focal point is on self-interest with opportunistic practices (Osasere and Ilaboya 2018). Agency theory fits into the framework through IFFs that flourish under weak institutions and poor governance, which can harm stakeholders. The stakeholders neither work at the entity nor know what is happening on a daily basis. The stakeholders appoint independent external auditors (agents), therefore resolving the knowledge gap, mistrust, and misunderstanding.

2. Results

2.1. The Current Conceptual Financial Reporting Framework

The purpose of the present financial reporting framework is to assist the International Accounting Standards Board (IASB), in order to develop and revise the International Financial Reporting Standards (IFRSs), based on consistent concepts. The conceptual financial reporting framework also assists preparers of financial statements to develop consistent accounting policies for areas not covered by standards and assist all parties in understanding and interpreting IFRSs (Osasere and Ilaboya 2018).

2.1.1. A Brief of the Financial Reporting Problem

The decline of the usefulness of financial reporting can contribute to an environment conducive for IFFs, thus leading to misunderstanding and mistrust of financial reports (Hellman et al. 2018). Unless adequately addressed, any flawed financial information negatively affects the quality of the financial reports (Lev 2018). Consequently, IFFs can be enabled by weaknesses in financial reporting.

2.1.2. Conceptualising Illicit Financial Flows (IFFs)

Several countries have committed to significantly reducing IFFs by 2030, in accordance with the Sustainable Development Goal (SDG) target 16.4; however, in the midst, there has not been agreement on the concept and definition of IFFs (Musselli and Bonanomi 2020). The World Bank (2017) and Global Financial Integrity (GFI) (2021) provided a broad definition of IFFs as cross-border financial transfers that are connected with activities that are illegal or when income is gained, moved, or managed illegally. Financial opacity flows are reflected in this definition, which is similar to that defined by Cobham (2018), Asongu and Ssozi (2016), and Hare et al. (2015). IFFs pose a significant challenge, as these operate on a vast scale, making it harder to address. There are various entities and multiple initiatives dedicated to curbing several aspects of IFFs; additionally, comprehensive international cooperation has been seen as a key ingredient in addressing IFFs (Montes 2020).

IFFs are defined as illicit flows emanating from illegal financial transactions (Ortega et al. 2019). IFF practices do not frequently contravene rules and regulations; however, management may make use of obscurity in the rules and regulations to portray their preferences on the financial position of the entity (Makhaiel and Sherer 2018). Reuter (2017) identifies five major sources of illicit finances. In alphabetical order, these include: bribery; corporate profit shifting and currency regulation evasion, involving channels for the movement of the monies, e.g., bulk cash smuggling; criminal enterprise earnings; informal value transfer systems; tax evasion; trade-based money laundering; and using shell corporations. In a similar vein, the United Nations Office on Drugs and Crime (UNODC and UNCTAD 2020) identified one of the characteristics of illicit financial flows as 'theft'-related illegal assets that are domestically laundered and transferred abroad.

Additionally, research on stakeholder mapping and promotion of the Sustainable Development Goals (SDGs) in local management assist to enlighten the connection of networks and stakeholders' responsibilities by pointing out that governance practices and governable representatives are hard to come by and still have a long way to reach diversified practices in the process of decision-making (Catzín-Tamayo et al. 2022).

According to Bohoslavsky (2018) the SDG's specific target to reduce IFFs clarifies that, in order to create an empowering environment for sustainable development, such flows should be limited, yet the target remains broad and vague. As per The World Bank (2017), the following issues were observed:

- IFFs reduce the tax revenue, as well as domestic resources, needed to fund programs for poverty reduction, together with providing the infrastructure for developing economies. Consequently, IFFs are receiving growing attention as an important development challenge.
- IFFs reduce much-needed resources. They also portray symptoms of deeper challenges, for example, reducing poverty and sharing in prosperity. Weak accountability and compromised transparency, coupled with vested interests, are contributing factors.
- Concerted actions and decisive international cooperation are required by both developing economies and developed nations, forming partnerships with civil society and the private sector.
- The World Bank Group can make vital contributions in addressing IFFs, owing to their convening power worldwide and vast technical knowledge. They are furthermore committed to this important task.

According to Pérez and Olivié (2015), the European Union (EU) has access to resources that can assist to curb IFFs by ensuring a more transparent financial system, and further proposals are being discussed, which will likely lead to improved financial transparency within Europe.

Furthermore, UNCTAD (2020) established that an indicator for productive capacity, namely labour productivity, is inversely proportional to increased IFF practices; that is, as IFFs practices increase, domestic productivity decreases, resulting in an undesirable state of affairs. That said, we note that this effect is likely to be relatively low on the African continent, since the continent experiences a relative low productivity growth, in any case. Furthermore, IFFs were discovered to have a negative correlation with poor financial sector regulation. Improving on regulations in the financial sector would likely lead to a growth in productivity. It could also, through a stronger compliance with the Financial Action Task Force (FATF), reduce capital outflow and improve on mechanisms to track financial flows. Hence, improving on prospects for environmental, economic, and social development on the African continent could be achieved by addressing IFFs. Countries in which high levels of IFFs are practiced attract fewer investors for their health and education sectors, and they are more affected by climate changes; hence, the reduced mitigation of these phenomena. However, IFFs negatively impact revenue collection aimed at the allocation of scarce government funds, often earmarked for public services, amongst others, as well as the upliftment of the youth and women.

The above discussions lead to the following regulatory content propositions, with respect to FATF:

Proposition PC1. *IFFs require strong international cooperation and concerted efforts to facilitate the curbing of IFFs.*

Proposition PC2. *The World Bank Group and EU have a critical role to play in combating IFFs and can assist to curb IFFs by ensuring a more transparent financial system.*

2.2. Features/Characteristics of IFFs

The UNODC and UNCTAD (2020) identified the following features/characteristics of IFFs:

- Illicit in origin, transfer, or use. Value created illicitly (criminal activities), transferred illicitly (violation of currency controls), or used illicitly (terrorism financing).
- Exchange of value. This includes when of goods and services are exchanged, as well as financial and non-financial assets (illicit cross-border bartering).
- IFFs measure flow of value over a given time.
- Flows that cross a border (ownership changes between a country resident and non-resident).

The above discussions provide an answer to our first research question, RQ1.

2.3. Categories of IFFs

IFFs can be categorised from different perspectives, which include motives, impacts, sources, actors involved, and channels. The prioritisation of the main activities' classification indicates these, often hidden, activities, which could enable effective identification of IFFs characteristics. The extant literature suggests that IFFs are generally divided into three categories: commercial, criminal, and corruption activities (HLP 2014; Forstater 2016; Gumede and Fadiran 2019). These categories, however, do not reveal the source or origin, neither the intended use of an IFF, making it hard to identify IFFs and embezzlement of funds. The UNODC and UNCTAD (2020) indicate a characteristic of illicit financial flows as corruption-related illegal (from illegal economic activities) assets domestically laundered and transferred abroad.

A comprehensive assessment of these categories is vital, in order to enable the identification of characteristics of IFFs to appreciate the financial reporting transparency challenges involved in attempting to curb IFFs. This article and framework developed in Section 5 are mainly concerned with commercial IFFs, as these affect the financial statements and related decisions.

Commercial IFFs cover tax evasion; tariff, duty, revenue, competition, import/export, and investment or shares offences; and discounts trade regulations, restrictions, or embargoes (UNODC and UNCTAD 2020). According to the HLP (2014), a large component of IFFs occurs through commercial activities, which entails under- and over-invoicing, as well as other practices by multinational corporations (MNCs).

Commercial activities are discussed next.

Commercial Activities

Tax evasion involves hiding profit from the revenue authority, where tax obligations arise and can make up a large component of IFFs (Forstater 2016). MNCs create a gap, in light of the difficulties, to identify the relevant extent of profits of the subsidiaries of the holding corporate group (Picciotto 2018). Furthermore, tax evasion is considered the main reason for cross-border transfers (Collin 2016). Similarly, hidden investments in tax havens' jurisdictions promote destructive tax practices, which may result in the exhaustion of the tax bases of other countries and misreporting of financial flows between countries (Crivelli et al. 2015). Tax jurisdictions face identification challenges, should taxpayers hold assets that are not taxed internationally or MNCs report income in an offshore financial Centre (Collin 2016). Kellenberg and Levinson (2019) identified poor auditing standards, corruption, export/import tariffs, or taxes, as well as the lack of a trade agreements, as risk factors of higher trade gaps. Further, according to the UNODC and UNCTAD (2020), an important characteristic of IFFs is the circumvention of regulations to unlawfully earn profit at home (or abroad) through hidden (offshore) ownerships.

The above discussion leads us to our first driver of an IFFs content proposition:

Proposition PC3. *Tax evasion is often a reason for illegal cross-border transfers.*

Trade-based money laundering (TBML) is likewise a growing problem; licit transactions are used by money launderers to launder illicit money. According to the Financial Action Task Force (2020), when the value of crime proceeds are transferred through trade transactions to cover the origins of the proceeds, thus integrating it into the formal economy, it is called TBML; owing to its nature, TBML is often hard to detect (Marzouk 2022). For instance, viewing the banking sector as simply an arm of law enforcement may not be an effective approach to combat TBML, and it may lead to the establishment of more complicated TBML strategies (Naheem 2020). The burden seems to be on compliance officers to deter and detect emerging strategies, yet the banks are unable to identify the fundamental trade flows in a non-documentary trade. Banks should develop a sounder AML assessment framework, in order to rely less on the traditional customer due diligence and the monitoring of transactions (Naheem 2015).

We arrive at the next driver proposition:

Proposition PC4. *Trade transactions may be used to disguise origins of proceeds from crime.*

Note that Proposition PC4, therefore, calls for the development of a stronger AML assessment framework, as indicated in the controls portion of the framework in Section 5.

Tax avoidance may be a main component of IFFs, where anti-avoidance rules are ineffective (Forstater 2016). As per the extant literature, there is no agreed upon conclusion regarding whether tax avoidance may be included in the definition of IFFs, as it does not contravene law, nor is it identified by misreporting (Kahler et al. 2018). SDG 16.4 identified aggressive tax avoidance as an IFF, while at the same time noting that these, in general, are legal. In this regard, the UNODC and UNCTAD (2020) indicated some of the characteristics of IFFs as lawfully avoiding taxes abroad or legally generated; however, unlawfully avoiding tax assets abroad or violating regulations for cross-border transactions may be the evasion of currency controls, utilisation of monies to fund illegal activities (e.g., terrorism), illegally evading tax on assets abroad, or transferred to fund illegal activities, again including terrorism.

It is noteworthy that the limits between legal and illegal activities may cause confusion. That said, governments are in clear agreement that tax avoidance is classified as an illicit flow (Forstater 2018), thus leading to:

Proposition PC5. *Aggressive tax avoidance is legal; however, it is viewed as an IFF.*

Financial reporting is an essential tool in an entity, which can be used as a benchmark of an entity's financial condition, and it is a result of the accounting process that is taken from the overall transactions in the entity (Rahmawati and Kassim 2020). Young (2013) defined financial reporting irregularities as intentional misstatements or omissions of amounts or disclosures in financial statements. Examples include the manipulation, falsification, or alteration of the accounting records or supporting documents used to prepare financial statements. Lennox et al. (2020) argued that entities with downward adjustments are more likely to be sanctioned by the China Securities Regulatory Commission (CSRC) for the incidence of irregularities in accounting and disclosure thereof in the year prior to the announcement date of mergers and acquisitions. Kausar and Lennox (2017) stated that opinions could be an indication of a lack of accounting conservatism, since ongoing concern opinions are issued by auditors as a warning to investors. Failures in financial reporting can fundamentally distort the monetary position of a business and its financial worth (Roy 2016).

With respect to the association with IFFs, we arrive at a proposition, with respect to accounting fraud, which can also be seen as an overarching proposition for accounting fraud categories:

Proposition PC6. *Financial irregularities in the form of, amongst other, falsification of information, misrepresentations, or omissions create more room for IFFs.*

Earnings management (EM) is one of the most widely used techniques by managers to fulfil a number of objectives through manipulating accounting data (Mahjoub and Miloudi 2015). Accounting policies for reporting target earnings can often be manipulated by entities such as EM (Agrawal and Chatterjee 2015). The economy, society, and all other stakeholders of an entity can be significantly influenced through EM (Chatterjee 2020). Wasan and Mulchandani (2020) denoted investment as the driving force to promote economic growth, in turn facilitating the flow of investments (both domestic and foreign). Investors should be protected from accounting scandals that are instantiations of EM by entities. According to Fisher et al. (2019) and Healy and Wahlen (2005), the EM definition has, essentially, two rationales for managers: positive performance representation or contractual outcome influence. Yung and Root (2019) established that policy uncertainty induced EM harms to entities, which implies that low-quality financial reporting impairs entity value. Swai and Mbogela (2016) provided evidence that entity attributes and corporate governance mechanisms have an impact on EM. For instance, when an internal control environment is weak, entities can make use of the opportunity to manipulate their accounting activities, according to Lenard et al. (2016). Consequently, we arrive at:

Proposition PC7. *When earnings management are employed to move funds across the border or to evade tax it might be viewed as IFFs.*

Self-interest earnings management has undesirable effects on all stakeholders, such as employees, shareholders, the community in which an entity operates, and society (Mohmed et al. 2020). Therefore, entities that are concerned about stakeholders act with integrity and trust and are anticipated to provide transparent financial reports (Salewski and Zülch 2013). Furthermore, Paolone and Magazzino (2014) pointed out a positive relationship between the quality of information disclosed by management and quality of financial reporting.

Agency theory asserts that internal control of financial reporting is neglected—likewise for cooperate interests between the agent and principal (Krishnan et al. 2020). Furthermore, ineffective internal control of the financial reporting of an entity influences the quality of financial reporting. Nonetheless, effective internal control of financial reporting considers the need of the entity to disclose all useful information to the users (Foster et al. 2013). Hence, the quality of financial reporting could be enhanced through effective internal control (Abed et al. 2020a; Bardhan et al. 2015). It is, furthermore, noted that corporate governance is stated as the best way to control unethical practices of creative accounting (Tassadaq and Malik 2015).

The preceding sections identified a number of factors that lead to IFFs, and the following section addresses further IFF drivers, with respect to taxes, natural resources, institutional capabilities, political (in)stability, and regulatory quality.

2.4. The Drivers of IFFs

The drivers of IFFs, namely high tax rates, natural resources, low institutional capabilities, political stability, and regulatory quality, are discussed next.

A major determining factor of IFFs is the tax burden leading to tax evasion of individuals and other entities, suggesting that entities seek out favourable fiscal environments for their funds (Signé et al. 2020) and leading to:

Proposition PC8. *High tax rates are viewed as a major driver of IFFs.*

Note how the above proposition supplements PROPOSITION PC3, regarding tax evasion, above. In fact, the framework developed in Section 5 indicates tax evasion as a subcategory of higher taxes.

The availability of natural resources in developing countries is often a significant driver of IFFs. Likewise, developed countries have experienced significant growth from minerals and energy in areas that are attractive, require large investments, and generate substantial profits (Reuter 2017), thus leading to:

Proposition PC9. *Resource-rich countries are often prone to IFFs.*

IFFs are likely experienced most often by countries with incapacitated institutions. Governments with weak institutional abilities, characterised by a weak ability to observe, regulate, and tax capital, in general (United Nations Interregional Crime and Justice Research Institute (UNICRI) (2018)), may be prone to IFFs, thus leading to:

Proposition PC10. *Low institutional capabilities create a conducive environment for IFFs.*

Note how the above proposition for developing economies may be viewed as the dual of PROPOSITION PC9, with respect to a developed economy.

At the centre of good governance is political stability, as it strengthens trust of economic actors in the national economic and financial system. Inability to do so generates substantial risks, and the extant literature reveals that MNCs react to such political risks by engaging in IFF practices (Reuter 2017), thus leading to:

Proposition PC11. *Political instability leads to IFFs.*

PROPOSITION PC11 may be particularly relevant for developing economies that may suffer from politically unstable governments.

The weaknesses in regulatory frameworks may encourage businesses to evade taxes; nonetheless, weak institutional quality generates losses for entities, of which, businesses seek to counter through IFFs. The foregoing propositions PC10 and PC11 may be relevant here, with respect to weak and evolving regulatory frameworks.

2.5. Impact of IFFs

IFFs hinder resources that could be utilised for economic development (Geda and Yimer 2016; Ndikumana et al. 2014), thus suggesting that the curbing of IFFs could free resources and lead to a higher availability of more resources. Similarly, Cobham (2018) contended that countries with high IFFs are likely to reveal high inequalities, poor public services, weak governance, low growth, and noticeably poor prospects for the progressive realisation of human rights. As alluded to before, such conditions may be prevalent in developing economies, thus leading to a *general* observation:

Proposition PG1. *IFFs hinder state resources, revenues, in particular, and weaken governance.*

The above discussions provide an answer to our RQ2.

2.6. Curbing IFFs

A framework that can be used as a tool to curb IFFs may disrupt illicit finances and discourage entities to take part in IFF activities. According to Hughes and Fisher (2015), five steps towards adding immediate value to the financial statements of an entity without significant investments, time, or resources are: adding financial reporting to the strategy of the entity, directing their focus to materiality, refining the formatting and presentation, condensing the interim reporting, and looking ahead positively.

Fu et al. (2015) found that audit quality is impacted by meeting the minimum transparency disclosure requirements through different approaches of governance, whereas Adiputra et al. (2018) found a significant positive effect on the transparency and quality of financial reporting through the audit opinion and political environment. Transparency International (2017) developed a questionnaire aimed at appraising the progress of some countries in combatting corruption, addressing IFFs, and improving transparency and access to information. Similarly, Lord et al. (2019) found that an advantageous tactic to eliminate IFFs, though it provides its own challenges, will be to focus on expert intermediaries and ways through which the beneficiaries of assets and their flows can be highlighted. In line with this assessment, Ostrowska (2018) argued that transparency measures had to be improved, as the financial crisis of 2018 showed that the current transparency standards were unsuccessful.

The discussions in this section lead to our next proposition, which may also be viewed as an overarching proposition (refer to the subgrouping 'Regulatory quality' in the "Drivers if IFFs" entity of the framework):

Proposition PC12. *Simplified financial reports, auditing, and transparency in financial statements may assist in addressing IFFs.*

Buijze (2013) defined transparency as a situation when all stakeholders received all the information needed to understand the current state of affairs and how it will influence their decisions. Literature on transparency confirmed the importance of intensified transparency for various reasons. Firstly, transparency on corporate governance processes enable good financial performance and informed decision-making for the entity. Secondly, stakeholders who received the required information are, likewise, able to make informed decisions (Ostrowska 2018). There have been numerous benefits realised for entities to have transparency in their financial reporting. Roychowdhury et al. (2019) found that a rise in financial reporting transparency is linked to an observed rise in investment, which, in turn, might promote a rise in transparency, thus leading to a reduction in adverse selection costs, leading to a reduction in the cost of capital; hence, the entity's investment opportunities are increased. Zhong (2018) argued that innovative efforts are boosted when the concerns of managers' careers are reduced and monitored, all because of financial reporting that became more transparent.

According to Beyer et al. (2010), financial reporting transparency mainly arose as important for the following two reasons: (1) information asymmetries between management and possible capital providers are reduced through financial reporting and the valuation role where profit potential of the entity is evaluated; and (2) capital providers can monitor the capital usage through the information provided in the financial reports, thereby serving a stewardship role (Bassemir and Novotny-farkas 2018; Beyer et al. 2010).

The analysis indicates an adverse association between price-fixing agreement engagement and financial reporting opacity; this reinforces that managers curtail financial reporting opacity to promote information communication amongst users, delay the period of price fixing agreements, and enlighten financial opacity or the dark side of financial information transparency regarding consumer interest in commodity markets (Diantini et al. 2022). The higher the pressure from regulatory standards, the higher the incentive for financial institutions to engage in financial irregularities or issue off balance sheet wealth management products and run the risks of drive-up action (Huang et al. 2022).

Any lack of oversight to prevent and detect accounting fraud or illicit activities in financial reporting could adversely affect the quality of reporting (Abed et al. 2020b). The basis of normative accounting theory works with events in the future, such as what should occur in particular circumstances. The identification of the possible characteristics of IFFs perpetuated in the financial statements could enhance financial reporting transparency, while discouraging IFFs.

The application of agency theory showed that transparency and disclosure contribute to a greater quality of financial reporting, by way of justification of asymmetrical information, which resulted from the perception rectification of investors in the financial market (Abed et al. 2022). With respect to the agency theory link, financial statements provide information for users to make informed decisions, as a mechanism for management responsibility (agent) to the stakeholders (principal) of an entity (Alayemi and Abdul-Lateef 2017).

Salehi et al.'s (2022) finding show an adverse and significant link between board independence, independence of an audit committee, stability of a management team, the remuneration of the board of directors, and the transparency of financial reporting. Financial reporting transparency enhances users' confidence to rely on financial reports to make informed decisions (Omotoso et al. 2022). The application of the theory of decision usefulness guides the accounting information provided to users.

The above discussions on transparency lead to two propositions regarding the benefit of correct financial reporting. Since these are rather broad, with respect to financial reporting, we make them content propositions under reporting benefits, rather than drivers or controls.

Proposition PC13. *Improving on financial reporting transparency may assist in addressing the challenge of IFFs.*

Proposition PC14. *Financial reporting transparency can provide stakeholders with useful information to make informed decisions and combat IFFs.*

2.7. Regulatory Environment

The role of a regulatory environment, which consists of accounting principles and standards, the international accounting standard on income taxes, King IV, and the Auditing Professions Act, are discussed next.

2.7.1. Accounting Principles and Standards

Accounting standards accepted in developed countries are employed for the preparation and presentation of financial statements and reports; these standards equalise global accounting practices' practical significance. They, furthermore, ensure that stock exchange business outside the national borders are simplified, thus enabling market and economic growth nationally and internationally (Anicic et al. 2017).

The international public sector accounting standards (IPSASs) were developed to harmonise public sector accounting at a global level, in order to minimise differences in countries' generally accepted accounting principles (GAAP) and generate comparable financial information across national boundaries (Schmidthuber et al. 2020; Brusca and Martínez 2016; Pontoppidan and Brusca 2016). If adhered to, in conjunction with IFRIS and the IPSASs, these rules aim to address IFFs, thus leading to:

Proposition PC15. *Compliance with IFRS, the IPSASs and GAAP will assist in curbing IFFs.*

2.7.2. International Accounting Standards on Income Taxes (IAS 12)

Income taxes (IAS 12) deal with the accounting for all taxes. These include all domestic and foreign taxes, based on taxable profits, including taxes reported in the consolidated financial statements. Even though there are financial reporting accounting standards in place, there may be no specific attention paid to a robust accounting standard, in order to discourage IFFs perpetuated in the financial statements, which will encourage adequate financial reports, thus leading to:

Proposition PC16. *Accounting principles and standards ought to be put in place to address IFFs.*

2.7.3. King IV Corporate Governance Sections on Fraud and Corruption

King IV views corporate governance as a component of governing body leadership that is ethical and effective. The entity's citizenship considerations include sustainable establishment, human rights, influence on communities, managing of tasks by the entity manages, distribution of output, compliance with legislation, community, and environmentally duty, and prevention, discovery, and reaction to illegal activities, according to KING IV (Institute of Directors Southern Africa 2016).

The information with respect to King IV leads us to a regulatory proposition:

Proposition PC17. *Entities ought to adhere to rules and regulations including guidelines on corporate governance principles as per King IV to address IFFs.*

The above proposition may also be viewed as a control proposition; however, for the sake of cohesion, we opted to make it a content proposition to fit in with the IFRIS, IPAS, and so forth regulatory guidelines.

2.7.4. Auditing Professions Act (APA) on Reportable Irregularities

The Auditing Professions Act (APA) (2005) defines a reportable irregularity in Section 1 as an "unlawful act or omission committed by any person responsible for the management of an entity". An unlawful act or omission is deemed to be an act which:

- May likely result in material financial loss to an entity having partners, members, shareholders, creditor, or investors (stakeholders) associated with the entity; or
- Is fraudulent; or
- Amounts to theft; or
- Represents a material breach of any fiduciary duty (defined as a legal duty to act solely in another party's interests). Such duty may be owned to the entity or its partners, members, shareholders, creditors, or investors (stakeholders) under any law applying to the entity, or conduct, or management thereof.

Naturally, auditors have a major role to report on financial irregularities to improve the quality, trustworthiness, and accuracy of the financial reports; consequently, we arrive at:

Proposition PC18. *Reliable auditing services are vital for stakeholders and to address IFFs.*

2.8. Other Initiatives Aimed at Curbing IFFs

Further initiatives that can address the challenges incurred by IFFs are discussed next.

2.8.1. The Financial Action Task Force

In 1998, an independent and inter-governmental body was established to develop and promote policies aimed at protecting global financial systems against terrorist financing, money laundering, and financing weapons of mass destruction. This body is called the called the Financial Action Task Force (FATF).

2.8.2. Global Financial Integrity (GFI)

The GFI, established in 2005, aims to address the challenges caused by trade mis-invoicing, transnational crime, kleptocracy, and tax evasion. The GFI seeks to create a safer and more equitable world, through collaborating with partners to improve the transparency of global financial systems and promote trade integrity.

2.8.3. Sustainable Development Goals Related to IFFs 16.4

In 2015, all United Nations Member States adopted the 2030 Agenda for Sustainable Development. This agenda offers a common blueprint for peace and prosperity for humanity and the planet, including current and future generations. Specifically, Goal 16 is aimed at promoting peaceful, inclusive, and peaceful societies to facilitate sustainable development, providing justice for all, and building effective, accountable, and inclusive institutions at all levels.

We arrive at our last content proposition and a general proposition:

Proposition PC19. *Effective controls ought to be put in place to facilitate the curbing of IFFs.*

Proposition PG2. *Through the GFI, Sustainable Development Goal 16.4.1, related to IFFs, may facilitate the curbing of IFFs.*

Our propositions are summarised in Table 1.

Table 1. Summary of propositions.

Proposition Number	Description
	Content Propositions
PROPOSITION PC1	IFFs require strong international cooperation and concerted efforts to facilitate the curbing of IFFs.
PROPOSITION PC2	The World Bank Group and EU have a critical role to play in combating IFFs and can assist to curb IFFs by ensuring a more transparent financial system.
PROPOSITION PC3	Tax evasion is often a reason for illegal cross-border transfers.
PROPOSITION PC4	Trade transactions may be used to disguise origins of proceeds from crime.
PROPOSITION PC5	Aggressive tax avoidance is legal; however, it is viewed as an IFF.
PROPOSITION PC6	Financial irregularities in the form of, amongst others, falsification of information, misrepresentations, or omissions create more room for IFFs.
PROPOSITION PC7	When earnings management are employed to move funds across the border or evade tax, it might be viewed as IFFs.
PROPOSITION PC8	High tax rates are viewed as a major driver of IFFs.
PROPOSITION PC9	Resource-rich countries are often prone to IFFs.
PROPOSITION PC10	Low institutional capabilities create a conducive environment for IFFs.
PROPOSITION PC11	Political instability leads to IFFs.
PROPOSITION PC12	Simplified financial reports, auditing, and transparency in financial statements may assist in addressing IFFs.
PROPOSITION PC13	Improving on financial reporting transparency may assist in addressing the challenge of IFFs
PROPOSITION PC14	Financial reporting transparency can provide stakeholders with useful information to make informed decisions and combat IFFs.
PROPOSITION PC15	Compliance with IFRS, the IPSASs and GAAP will assist in curbing IFFs.
PROPOSITION PC16	Accounting principles and standards ought to be put in place to curb IFFs.
PROPOSITION PC17	Entities ought to adhere to rules and regulations, including guidelines on corporate governance principles, as per King IV, to address IFFs.
PROPOSITION PC18	Auditing services are vital for stakeholders and to address IFFs.
PROPOSITION PC19	Effective controls ought to be put in place to facilitate the curb of IFFs.
	General Propositions
PROPOSITION PG1	IFFs hinder state resources, revenues, in particular, and weaken governance.
PROPOSITION PG2	Through the GFI, Sustainable Development Goal 16.4.1, as related to IFFs, may facilitate the curbing of IFFs.

2.9. Critical Reflection of Methods and Tools for Identifying and Managing Illict Financial Flows

A comprehensive assessment of IFFs categories as embodied by the preceding discussions and the Table 1 propositions are important to enable the identification of the characteristics of IFFs to appreciate the financial reporting transparency challenges involved in attempting to address these.

The literature hints that unethical behaviours by management in entities encourage poor governance and a lack of quality financial reporting, which suggest that ethical behaviour by management encourages accounting transparency (Tassadaq and Malik 2015). Similarly, the literature shows there is a low degree of adoption of ethical professional standards on financial reporting practices in developing economies, owing to accountants' self-centredness and greed, while also not necessarily hindering the infringement of ethical codes of conduct (Ezeagba and Abiahu 2018). An entity engaging in fraud or scandals activity, owing to the agency problem, displays an unprofessional attitude, thus making itself guilty of unethical behaviour (Tassadaq and Malik 2015). In addition, there is a direct relationship between information asymmetry and the degree of creative accounting practices, which suggest that improved quality in financial reports of an entity leads to a decrease in information asymmetry (Long et al. 2020). Furthermore, Sekgoka et al. (2022) argued that the suggested associated measures could identify inconsistencies' connection in the cross-border financial flows, which allow law enforcement agencies and regulatory authorities to identify possible illicit financial transactions and criminal activities. Our framework, which follows below, takes cognisance of these important aspects.

Madrueño and Silberberger (2022) argued that IFFs are a subproduct of ineffective multilateral regulatory frameworks and global policies that have reduced nation states of incentives to collaborate in areas such as IFFs, international cooperation on tax, and global corporate governance. This research addressed manipulative actions and identified possible characteristics of IFFs to enhance transparency and curb IFFs. There are embedded in the framework.

The preceding discussions answer our RQ3.

2.10. The Conceptual Framework

Following the observations from the literature, and further to the recommendations in our propositions, we arrived at our conceptual framework, depicted below.

3. Discussion and Validation

Our framework gives at a conceptual level cognizance of characteristics, categories, impacts, benefits, and the role of financial reporting. At the more detailed level, propositions have been identified to define aspects of regulation, drivers, and controls of IFFs. As indicated, the drivers of IFFs are numerous; chief among these are the aspects of tax (high tax, followed by tax evasions), earning management aspects, and further financial irregularities. Some controls aimed at curbing IFFs include strong governance, policies, tax reforms, regulatory bodies, and assessment frameworks. It is clear that the human element plays a major role—ethical aspects and honesty to combat corruption, bribery, and the like may be hard to address. The arrows indicate the flow of information in the framework. The characteristics of IFFs feed into all of categories, regulations, and drivers of IFFs. We believe the drivers feed back into the categories, as well as the impact of IFFs. Drivers and controls through agency theory have a two-way influence and information feed. Impacts and controls, likewise, influence decision usefulness, as indicated.

The framework serves as a guideline and control measure that can be utilised by entities to identify characteristics of IFFs. The operational activities of the entities remain the responsibility of management who are likely to increase their own wealth through engagements with IFFs. It is clear that the drivers of IFFs are widespread, and a comprehensive attack on these through the preliminary set of controls identified is much needed. Specifically, there is a need for entities to comply with the regulatory requirements, such as accounting principles and standards, APA on reportable irregularities, FATF, GFI, SDGs related to IFFs 16.4.1, and King IV guidelines.

The Figure 1 framework meets our objective (Obj) stated in Section 1.1.

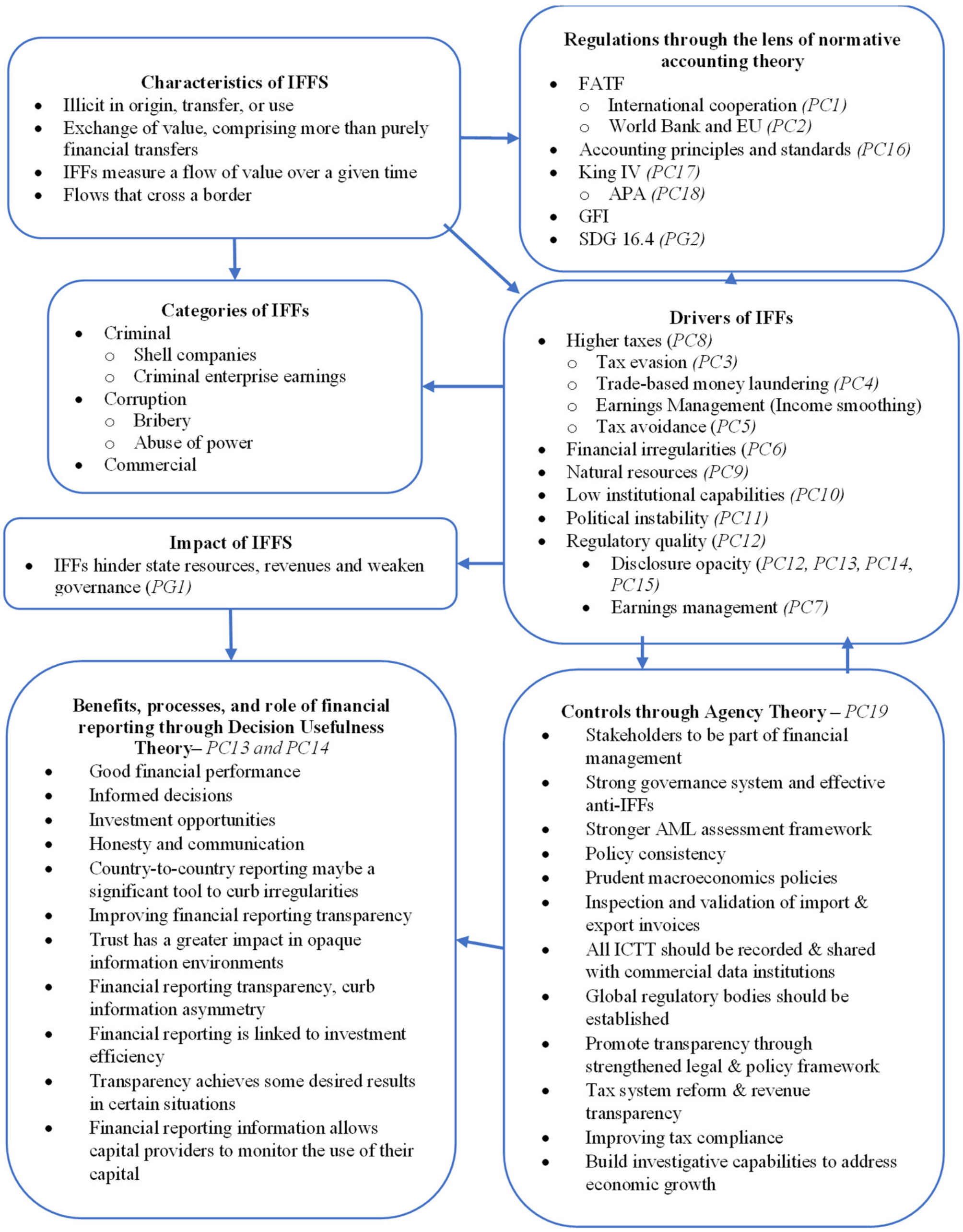

Figure 1. Conceptual framework to analyse IFFs.

4. Materials and Methods

The research reported on in this article, essentially, follows the six-layer research onion of Saunders et al. (2019), as depicted in Figure 2.

At the outermost layer (layer 1), our research philosophy is a mix between critical realism and interpretivism. The critical realism part establishes a link between what is observable in the financial statements and how IFFs manifest, as well as the underlying reasons for these. Our philosophy is also interpretivist since we are interpreting qualitative literature text, diagrams, tables, and so forth.

The second layer describes our approach to theory development; here, we have a large inductive component in that a conceptual framework has been developed, followed by a deductive component, in the form of a discussion and evaluation in Section 3. Our methodological choice is qualitative, in that we comprehensively analysed qualitative literature in Section 2. Our research strategy is survey-based, owing to the literature review (survey). Future work in this area will involve a survey among stakeholders in industry, upon which, a second phase survey will be added, possibly augmented with case studies in one or entities.

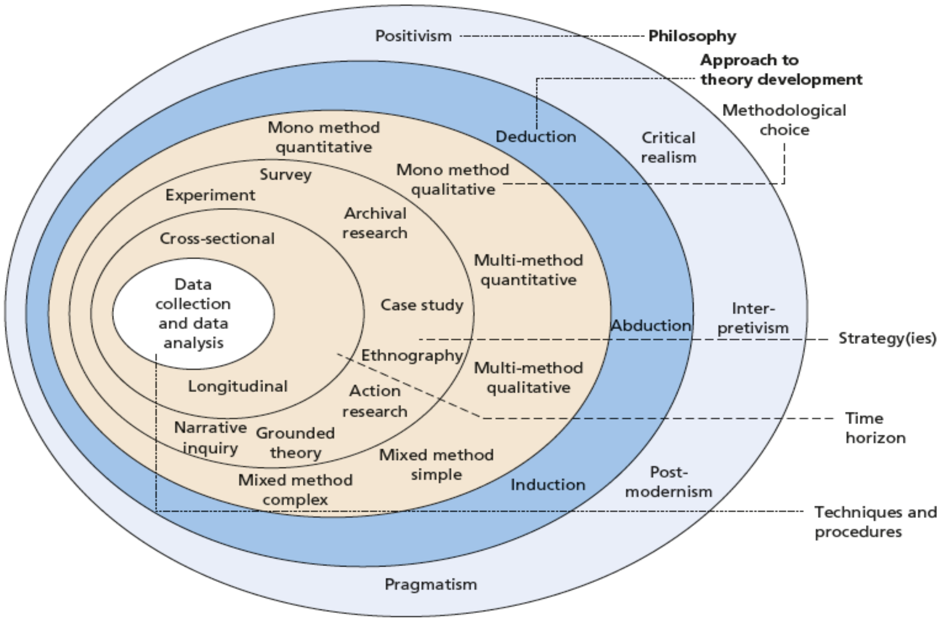

Figure 2. Saunders et al.'s (2019) research onion (the research onion diagram is ©2018 Mark Saunders, Philip Lewis, and Adrian Thornhill and reproduced in this article with their written permission).

Further towards the inner layers of the onion, our time horizon is cross sectional, since our research is conducted during a specific point in time. Our data collection and analyses are at this point through a literature review. Further data collection will be through industry surveys—interviews and focus groups to validate and enhance the framework in Figure 1.

5. Conclusions

This study reviewed the literature on the current conceptual financial reporting framework (which was updated by the IASB in 2018) used by entities and perhaps other financial reporting frameworks used globally. Even though the reality that the extant literature covers issues around financial reporting, useful financial information is often poorly presented and lacks clarity regarding how to communicate relevant information effectively, thus leading to irregularities in financial reporting, following the manifestation of IFFs.

We synthesised that IFFs can be channelled in the form of three different categories, namely commercial, corruption, and criminal activities. Consequently, the need for a framework to address the effects of IFFs was motivated in this article on the strength of their effects in numerous accounting and other financial aspects. In adherence to this call, a framework, in the form of Figure 1, to analyse IFFs was synthesised from the literature review, and sets of propositions were synthesised from the literature.

Previous research often concentrated on the correlation between financial reporting and investment effectiveness and stopped short of exploring a strategy to provide valuable financial information users truly need. Our research contributes to the existing body of knowledge along several dimensions. First, it developed a framework to analyse IFFs; secondly, we identified the characteristics and types of IFFs that might lead to transparency in financial reporting. We hope that awareness may be created on issues to curb IFFs in financial reporting. Furthermore, this research addresses the problem of disclosure in financial accounting to facilitate deterrence of IFFs by entities.

The review and development of recommendations for financial reporting transparency may assist regulators and standards setters to issue more robust transparency standards to discourage IFFs. The framework may, therefore, encourages good corporate governance, provides insights, and discourages entities to engage in IFFs.

Future work in this area may be pursued in the enhancement and validation of the framework. Therefore, in a way, this may serve as a current limitation of the work presented above. The Figure 1 framework is conceptual and will first be enhanced through sets of qualitative interviews among practitioners, followed by a validation of the enhanced framework through a focus group in the industry. We anticipate this sequential survey to establish the utility of the framework and further validate the information flows, as indicated by the arrows in the framework.

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