

Financial Fraud, Audit Failure, and Regulatory Oversight Breakdown: An Empirical Analysis of the Wirecard Scanda

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Abstract. The 2020 Wirecard scandal exposed one of Europe's largest corporate frauds, revealing 1.9 billion euros in fictitious assets and years of inflated revenue created through forged bank letters and sham third party processors. This paper meticulously dissects the deceptive accounting mechanics, EY's decade long failure to challenge management despite mounting red flags, and critical gaps in Germany's fragmented supervisory architecture. By systematically comparing Wirecard with Carillion and FTX, the study uncovers recurring patterns of governance collapse, auditor complacency, and regulatory inertia. Drawing on agency theory and the audit expectation gap lens, it shows how weak whistle blower protections, fee driven auditor dependence, and jurisdictional loopholes magnified the fraud. The paper concludes by outlining a multidimensional reform agenda that includes consolidating regulators, mandating audit rotation, incentivising ethical governance, deploying technique- (such as artificial intelligence) driven real-time monitoring, and enhancing cross-border enforcement to restore market trust and curb systemic risk in global capital markets.

Keywords: Wirecard; accounting fraud; audit failure; regulatory oversight; corporate governance.

1. Introduction

The Wirecard scandal, revealed in 2020, ranked among the biggest corporate scams in European history. The German fintech firm, previously celebrated as the epitome of innovation, had its implosion reveal systematic weaknesses in financial disclosure, external audits, and regulatory control. Wirecard, in fake reports, listed €1.9 billion in phantom assets, deceiving investors, auditors, and regulators for years. Against this background, the paper seeks to unravel the accounting methods that made the deceit possible, analyze why the external auditor could not spot red flags, and consider structural flaws in Germany's regulatory structure [1, 2, 3]. Based on these objectives, the study answers three main research inquiries:

First, what specific accounting mechanisms and governance loopholes allowed Wirecard to conceal its fraudulent activities for more than a decade?

Second, why did external auditors, despite mounting public scrutiny and whistleblower reports, fail to exercise sufficient professional skepticism to uncover the deception?

Third, how did the institutional design of German regulatory bodies contribute to delayed intervention, and what lessons can be drawn for international oversight frameworks in high-growth financial technology sectors?

By articulating these questions, the study not only investigates the mechanics of the Wirecard collapse but also situates it within broader debates about audit independence, regulatory efficiency, and corporate accountability. In answering them, the analysis contributes to the literature on corporate governance and informs policy reforms aimed at preventing similar failures in rapidly growing fintech sectors.

2. Accounting Fraud Mechanisms in the Wirecard Case

2.1. Fabricated Revenues and Forged Bank Account

Core to the scandal at Wirecard was the firm's manipulation of revenue via alleged relationships with third-party payment processors. These third-parties purported to oversee transactions in markets

in which Wirecard had no direct business presence. Many of these companies, however, were fictitious or operated with negligible levels of regulatory oversight. By using this format, Wirecard could publish misleadingly higher levels of transactions as well as revenues, considerably skewing its financial performance [4].

Aside from overstatement of revenues, Wirecard also falsified the holding of more than €1.9 billion, reportedly in trustee accounts in the Philippines. These were purported custodians for revenues from third-party businesses. Nonetheless, later investigations found that the deposits never existed and that the confirmation letters from banks had been faked. The failure of the external auditors to directly confirm these entries allowed this false representation to subsist for years unchecked [5].

2.2. Breakdown of Internal Governance and Oversight

Wirecard's internal governance framework exhibited profound structural weaknesses. There was no effective segregation of duties, as then-CEO Markus Braun exercised unchecked control over financial, strategic, and compliance-related decisions. Such centralization of power hindered the establishment of independent oversight mechanisms. The supervisory board, rather than acting as a safeguard, failed to curb executive dominance. Braun and COO Jan Marsalek thus operated with limited scrutiny or accountability [2].

In addition, the internal audit function lacked both authority and independence. The audit committee did not adequately probe irregularities or demand clarification on questionable financial reports. Standard corporate governance norms were routinely circumvented, allowing executive discretion to override checks and balances [6]. In turn, the financial gains from the fraud reinforced management's centralized control, further eroding oversight.

2.3. Neglect of Red Flags and External Warnings

Numerous early indicators of fraud were overlooked. Starting as early as 2016, concerns were raised by short sellers and investigative journalists—particularly by the Financial Times—highlighting discrepancies in Wirecard's disclosures and inconsistencies in its business practices. Reports frequently questioned the legitimacy of certain acquisitions and the nature of its client portfolio [7].

Rather than responding with transparency, the company adopted an aggressive legal strategy aimed at silencing dissent. Whistleblowers were marginalized, and internal concerns were systematically ignored. In a further display of regulatory failure, BaFin—Germany's financial regulator—chose to investigate journalists and short-sellers, rather than probe the allegations against Wirecard itself [4]. This approach discouraged accountability and fostered an environment in which misconduct could thrive unchallenged [7].

3. External Audit Failures and Unethical Practices

Earlier parts have shown how Wirecard used tricks and how weak controls let them continue. The next step is to look at the role of the outside auditor. This part looks at EY, who checked Wirecard's accounts for about ten years. It points out moments when they did not question enough and when basic audit checks failed to find big mistakes.

3.1. EY's Role in the Wirecard Case

Ernst & Young (EY) was the external auditor of Wirecard for over ten years, delivering unqualified audit reports every year. Despite various indicators of financial manipulation, EY never implemented basic verification procedures, for example, confirming bank balances by directly checking with independent institutions [8].

More prominently, EY accepted third-party confirmations from management at Wirecard and never questioned them as fake. In the years preceding the implosion, auditors never effectively

checked the validity of Wirecard’s third-party acquiring relationships, nor checked if there were any cash flows corresponding to revenues the firm purportedly earned [9]. By not performing substantive testing, this directly breached standards requiring independent verification of material balances [8].

3.2. Lack of Professional Skepticism and Ethical Responsibility

Beyond these technical omissions, the audit team’s broader mindset and ethical stance were also called into question.

The team demonstrated a fundamental lack of professional scepticism, which is a core tenet of the International Standards on Auditing (ISA 200 and ISA 240). Rather than maintaining an objective stance, EY appeared to rely heavily on management’s representations. Whistleblower reports and investigative journalism were dismissed or ignored, and the auditors failed to react appropriately to the growing body of evidence suggesting fraud [10].

This failure reflects technical negligence and a deeper ethical issue in audit practice. The audit teams did not respond with due care to public concerns, seemingly prioritising client retention over their duty to the public interest [11]. Such ethical blindness, where auditors overlook misconduct due to cognitive biases or client pressure, was a critical factor in the collapse [10].

3.3. Comparative Case Analysis: The Collapse of British Company Carillion

The Wirecard case is not isolated. In the UK, Carillion plc collapsed in 2018 after years of accounting manipulation. Audited by KPMG, Carillion overstated its assets and continued to operate under a flawed “going concern” assumption despite growing financial distress [12].

Parliamentary inquiries concluded that the Big Four audit firms, including KPMG, had failed in their role as independent watchdogs. Like EY, KPMG did not adequately challenge management’s assumptions and consistently failed to recognize signs of corporate distress. The Carillion case exposed the broader problem of audit market concentration and the systemic complacency within the audit profession [13].

3.4. Insights from Case Comparisons

Both Wirecard and Carillion demonstrate a concerning pattern: audit firms being excessively reliant on their clients, leading to compromised independence. The lack of mandatory auditor rotation, weak enforcement of professional standards, and audit fee dependence contribute to a culture of “perfunctory auditing” [12].

Reforms are urgently needed. Regulators and professional bodies must strengthen ethical training, enforce stricter quality controls, and consider restructuring the audit market to mitigate conflicts of interest [14]. Mandatory auditor rotation, if implemented alongside cooling-off periods and joint-audit mechanisms, may mitigate risks arising from prolonged client dependence, though evidence on its fraud-prevention efficacy remains inconclusive [3].

4. Regulatory Oversight Failure and Governance Mechanism Collapse

While the preceding discussion underscores the audit profession’s shortcomings, it also raises a broader question: why did regulators—tasked with safeguarding market integrity—fail to intervene? This section turns to the structural deficiencies in Germany’s oversight framework.

4.1. Indicators of Regulatory Inaction in the Wirecard Scandal

German financial watchdog BaFin failed to respond adequately, despite repeated signs of misconduct. One of its major oversights was treating Wirecard as a tech firm instead of a financial service provider, which exempted the company from more stringent banking oversight such as anti-money laundering monitoring and capital regulation [15]. This misclassification enabled Wirecard to escape appropriate financial scrutiny [16].

BaFin did not want to look into Wirecard, and instead it went after the people who tried to speak out. This helped the fraud stay hidden for a longer time. Stronger checks at the time might not have uncovered the fake papers, yet the regulator's inaction granted Wirecard additional latitude to continue its deception. Such passivity illustrates the danger posed when market guardians intimidate the very voices that seek to expose the truth [17].

Additionally, the institutional framework for reviewing corporate disclosures was seriously flawed. The Financial Reporting Enforcement Panel (FREP), a private body assigned to assess financial reporting compliance, failed to demand deeper transparency or rigorously investigate inconsistencies in Wirecard's financials [1].

4.2. Case Comparison: FTX Collapse and U.S. Regulatory Gaps

A comparable regulatory breakdown occurred in the collapse of FTX, a cryptocurrency exchange led by Sam Bankman-Fried. When the firm declared bankruptcy in 2022, it emerged that billions in customer assets had been misused to fund proprietary trading and other affiliated ventures.

In the U.S., regulatory confusion between the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) contributed to a weak oversight environment. FTX operated largely outside the established regulatory framework, with no functioning governance structure and an almost non-existent board [18].

Just like Wirecard, FTX benefited from unchecked growth, media praise, and political capital. This masked the firm's internal failures, allowing risks to accumulate beneath the surface [18].

4.3. Shared Regulatory Weaknesses in Both Cases

Systemic flaws in the oversight of high-growth, high-tech sectors are illustrated by Wirecard and FTX. Regulators' inaction and leniency have enabled misconduct to continue for years [15, 16, 18]. Secondly, the mechanisms for protecting whistleblowers were structurally weak. Warnings were ignored and retaliation was common. The absence of meaningful financial incentives discouraged early disclosure, burying critical signals [7, 17]. Thirdly, regulatory frameworks lagged behind financial innovation. Wirecard took advantage of the gaps in the rules between banking and technology classifications, while FTX took advantage of the uncertainty in the law between the SEC and the CFTC, leaving both firms without any regulations to stop them [18]. Fourthly, both firms were shielded from rigorous scrutiny by a powerful "halo effect". Deep investigation was discouraged and a culture of deference towards these "tech disruptors" was fostered by media hype, political donations and high market valuations [5]. Collectively, these weaknesses show that there are fundamental problems in supervising fintech and cryptocurrency markets. This highlights the urgent need for oversight mechanisms that can adapt to technology, are aware of it, and are coordinated globally [18].

4.4. Reform Recommendations for Regulatory Bodies

4.4.1 Regulatory architecture: clarifying mandates and closing oversight gaps

The Wirecard scandal revealed the structural risks of fragmented supervisory responsibilities and unclear legal mandates, which enabled high-growth fintech firms to exploit oversight blind spots. A vivid illustration was BaFin's misclassification of Wirecard as a technology company rather than a financial institution, thereby shielding it from the stricter scrutiny typically applied to banks [17]. This ambiguity created a regulatory vacuum, delaying the detection of fraudulent practices and allowing the company to expand unchecked for years. Such institutional fragmentation undermines the accountability of regulators and fosters systemic vulnerabilities.

To resolve deficiencies, a unified financial oversight authority is crucial. This model would reduce regulatory arbitrage and close loopholes that allow firms to shift risk exposure between categories of supervision. Sector-specific supervisory boards should be mandated for emerging fintech niches. These boards would provide specialised expertise, ensuring regulators keep pace with innovations.

Another necessary measure is the introduction of statutory "fit-and-proper" tests for senior management.

The feasibility of such reforms is supported by empirical evidence. Singapore's Monetary Authority (MAS) integrated fintech oversight pilot reduced compliance review times by 27%, demonstrating that a consolidated supervisory framework can improve both efficiency and effectiveness. A phased approach is advisable: short-term efforts should focus on drafting cross-sector jurisdictional amendments, followed by the establishment of supervisory boards and the implementation of fit-and-proper registries within three years, and finally, a long-term evaluation of regulatory performance over five years.

4.4.2 Institutional tools: strengthening whistleblower protection and auditor independence

A second key vulnerability lies in the weakness of whistleblower protections and the erosion of auditor independence. In both the Wirecard and FTX cases, insiders and external auditors failed to act effectively on early warning signs due to inadequate legal protections for whistleblowers and entrenched, long-term auditor-client relationships [3, 7]. Without credible channels for internal reporting and without independent audit scrutiny, opportunities for early detection of fraud are severely reduced. This combination of silence and capture allows accounting irregularities to persist undetected until catastrophic collapse.

Solving this challenge demands a two-pronged approach. First, whistleblower protection legislation patterned after the U.S. Dodd-Frank Act, blending powerful anti-retaliation elements with financial rewards for reporting impropriety, must be implemented by regulators. These incentives would embolden staff to speak up without the risk of career ruin. Second, statutory firm rotation at audit must be compelled, especially for higher-risk activities like fintech, with a seven-year maximum tenure. It would mitigate the deep-rooted coziness between auditors and clients and stimulate new thinking. Further, for systemically significant firms crossing a specific threshold in terms of market capitalisation, regulators must set up independent audit review panels as a second level of review that mitigates the possibility of collusion or complacency.

Experience from the European Union shows that these kinds of reforms really do make a difference. For example, when mandatory auditor rotation was introduced in 2016, the average quality of audits across listed companies went up by about 15%. In other words, auditors became more independent and more willing to question what they saw. To make sure these changes actually work, it helps to roll them out step by step. In the short run, governments could start by giving employees financial rewards and legal protection when they report wrongdoing, and by setting clear limits on how long an auditor can stay with the same client. Once those rules are in place, the next step would be to test independent review panels in a few industries to see how well they function. Over time, regulators should keep an eye on how often fraud happens and whether the quality of audits continues to improve. Big audit firms will almost certainly push back against rotation, but that resistance can be softened. For instance, during the transition period they could receive temporary subsidies, or firms that follow the rules could be given priority when bidding for government contracts.

4.4.3 Market incentives: aligning corporate behaviour with public interest

Another structural weakness exposed by the Wirecard case is the lack of meaningful economic incentives for firms to engage in ethical governance. In practice, many companies are encouraged to pursue short-term gains through risky or opaque practices, undermining both investor confidence and market stability [5]. The absence of effective incentive alignment creates an environment where executives are rewarded for aggressive expansion or financial manipulation, while the costs of misconduct are borne by shareholders, creditors, and the public.

Introducing mechanisms to align corporate behaviour with the public interest. Linking executive compensation with long-term performance over short-term gains. Providing tax incentives for companies meeting transparency standards, rewarding disclosure over compliance. Imposing proportionate fines for misreporting scaled to market capitalisation, ensuring penalties deter

misinformation. Such reforms reshape the cost-benefit calculus of corporate governance and incentivise sustainable business practices.

Evidence from the United Kingdom indicates that incentive alignment can improve outcomes. The Senior Managers Regime, introduced in 2016, reduced regulatory breaches by 22% among covered firms, showing that personal accountability improves compliance. Implementation should be incremental. Digitising reporting and reducing manual compliance costs can mitigate industry resistance to additional disclosure obligations, raising overall transparency.

4.4.4 Technological support: leveraging real-time data and AI for supervision

The rapid evolution of fintech and blockchain-based business models has revealed the inadequacy of traditional manual supervision systems. These conventional methods are too slow and resource-intensive to detect complex, fast-moving fraud schemes, creating systemic vulnerabilities in the oversight of digital financial services [18]. Wirecard's case shows that if regulators don't have the right technology to monitor transactions in real time, it's possible for fraudulent activities to go undetected for years.

These limitations must be overcome by regulators if advanced technological tools are to be embraced. Artificial intelligence and machine learning algorithms should be used for transaction monitoring to detect anomalies and flag suspicious patterns on a large scale. Furthermore, the requirement for real-time audit disclosures could be imposed through the use of secure data pipelines. This would guarantee that vital financial data is accessible to regulators in a timely manner. Cross-agency analytics and the integration of supervisory data across jurisdictions must be enabled by the introduction of standardised fintech reporting formats. These reforms would empower regulators to identify misconduct early and respond proactively.

Australia's financial intelligence unit, AUSTRAC, has demonstrated the advantages of this approach. During its pilot phase, its AI-driven monitoring programme identified 31% more suspicious transactions than traditional methods. A phased rollout is advisable: regulators should first develop standardised data reporting protocols, then implement AI systems in pilot agencies within three years, and ultimately create cross-border data sharing frameworks in the longer term. Anticipated concerns regarding data privacy can be mitigated through end-to-end encryption and strong legislative safeguards that balance the need for oversight with the protection of individual rights.

4.4.5 International coordination: closing jurisdictional loopholes

Finally, one of the most persistent vulnerabilities lies in the global nature of financial fraud, which exploits gaps between national jurisdictions. Cross-border payment structures, offshore shell entities, and regulatory arbitrage allow fraudulent firms to evade enforcement, making purely national responses ineffective [7]. The Wirecard case, where subsidiaries in multiple jurisdictions shielded the true state of operations, exemplifies how fragmented international oversight can be exploited for years without meaningful accountability.

To really fix this problem, regulators need to work more closely with each other across countries. One way is to expand existing legal agreements so that requests for fintech-related data are also covered. That way, regulators can actually get the key information they need from abroad. Another step could be setting up a permanent cross-border team that focuses on high-risk industries, making it easier to run joint investigations and enforcement actions. And if countries can agree on the same minimum disclosure rules for listed fintech companies, then firms won't be able to take advantage of the differences between national standards.

The value of international coordination is evidenced by the International Organization of Securities Commissions (IOSCO), whose Multilateral Memorandum of Understanding facilitated a 19% increase in cross-border enforcement actions between 2016 and 2020. Implementation should begin with short-term negotiations on fintech-specific MLATs, followed by the launch of cross-border task forces in the medium term, and long-term tracking of jurisdictional arbitrage cases as a measure of effectiveness. While sovereignty concerns from national regulators are a likely obstacle, phased

harmonisation and shared-benefit frameworks can mitigate resistance by emphasising collective gains in financial stability and investor protection.

5. Conclusion

The Wirecard scandal serves as a stark reminder of the severe consequences that corporate fraud, audit negligence, and regulatory inaction can have. By inflating revenues, exploiting weaknesses in internal governance, and engaging in deliberate fraud, Wirecard exploited loopholes in financial reporting and regulatory systems. External auditors, particularly EY, failed to maintain the necessary professional skepticism, while regulatory bodies like BaFin misjudged the situation and even went so far as to protect the company to some extent. Compared to other failed cases like Carillion and FTX, Wirecard once again exposed recurring vulnerabilities in corporate accountability mechanisms and highlighted the urgency of reform. To rebuild trust and prevent similar crises from recurring, it must elevate professional ethical standards, strengthen regulatory coordination, and ensure financial transparency. Especially in rapidly evolving fields like fintech, the Wirecard incident serves as a cautionary case study from which lessons must be learned.

This study also has certain limitations and biases. First, it primarily relies on public documents, court records, and investigative reports, and did not obtain internal confidential materials or direct testimony from management. Therefore, there may be issues in revealing the intentions of senior management or potential collusion, and it can only interpret the content from an objective perspective. Second, the use of secondary sources may lead to selective reporting and bias, affecting the objectivity of the conclusions. Third, the study focuses solely on the Wirecard case, and the generalizability of its conclusions may be limited in other industries or under different regulatory environments.

Future research could adopt a mixed-methods approach, integrating whistleblower testimony, forensic data analysis and cross-border comparative studies, to validate and expand upon existing research findings. Longitudinal studies could also track the implementation process and real-world impact of governance reforms following a scandal, identifying their intended and unintended consequences. Extending the scope to multiple case studies would further enable scholars to identify cross-case patterns and enhance the practicality of policy recommendations.

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