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CHAPTER 5 CORPORATE CULTURE AND FRAUD

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ABSTRACT
This chapter examines the academic and empirical evidence on fraud firms and the tone at the top management culture that contribute to corporate misconduct. The chapter focuses on fraud in the form of fraudulent financial reporting. Corporate culture is defined as the values, beliefs and norms shared by a particular group in the context of a business organization. Prior research into fraud firms shows a variety of ways that corporate financial reporting fraud is measured, Further, there are many different proxies that researchers use to measure the tone at the top, by attributing the corporate culture to the risk-taking attributes and characteristics of senior executives. The chapter's goal is to provide a synthesis of the empirical evidence linking corporate culture to corporate wrongdoing.

INTRODUCTION

As the end of the second decade of the twenty-first century draws near, trust in public and private institutions has eroded. Multiple incidents of financial reporting scandals coupled with the financial crisis of 2007-2008, also called the global financial crisis, and has resulted in a deterioration of investor trust in the very institutions charged with protecting their wealth. This situation occurred in multiple layers and extended beyond the executive and boards of corporates to the regulation of gatekeeping professions such as ratings agencies and auditors. Not only did these organizations gamble away investor funds, in many cases they undertook calculated moves to defraud.

Dealing with the risk of fraud today is becoming increasing complex and challenging. The emergence of digital data and global markets with complex legal requirements has only added to the intricate task of protecting against fraud. The global accounting firm PwC's Global Economic Crime and Fraud (PwC 2018) survey finds that while almost half of global organizations have experienced fraud, many of the remaining organizations are likely to become victims of undetected fraud. Fraud can manifest in several ways including consumer fraud, cybercrime, identity theft and money laundering. For the purposes of this chapter, *fraud* is defined as financial statement fraud, which is the intentional manipulation of financial statements intended to mislead. This type of fraud cannot exist in a vacuum because it requires several agents in a firm to commit the fraud and many more to allow it to occur. As such, this chapter considers how an organization's corporate culture affects the prevalence of financial statement fraud.

Viewing financial statement fraud through an ethical lens focuses on the environment that allows fraud to occur. Corporate governance and control mechanisms within a firm are powerless to uncover financial fraud if the culture of the firm allows it. The combination of a toxic corporate culture and fraud lead from the top results in a substantial decline in investor trust.

As such, there is no shortage of high-profile examples.

- In 2015, the top management at Toshiba deliberately overstated operating profits by 1.9 billion over a seven-year period. An investigation into the scandal revealed a corporate culture where staff felt they could not go against their superiors: "When top management presented 'challenges', division presidents, line managers and employees below them continually carried out inappropriate accounting practices to meet targets in line with the wishes of their superiors" (Reuters 2015, p. 1).
- Lehmann Brothers' toxic culture and predatory behavior was as much to blame for their 2008 collapse as the sub-prime products that crashed with them. Described as both

financial and morally bankrupt, reports of the company reveal multiple layers of corruption (Wolff 2011).

- In 2003, the telecommunications giant, Worldcom, became one of the largest accounting frauds in U.S. history. Although the blame for the downfall is primarily attributable to the chief executive officer (CEO) who pursued a path of growth through aggressive acquisitions, he was also the source of the culture that allowed the fraud to occur. Reports into the collapse reveal a culture of secrecy and lack of scrutiny that saw staff hiding financial data from both the board and the auditors (Securities and Exchange Commission 2003).

Corporate scandals fueled by toxic or dysfunctional corporate board result in corporate misconduct that causes external and wide-scale harm. Such broader deliberate misconduct, even though it involves deceptive reporting, may not strictly be included as misappropriation or financial reporting fraud. Examples such as consumer fraud, as perpetrated by Volkswagen and Wells Fargo (Schrieberg 2016), and environmental scandals such as large-scale oil spills by petroleum companies such as BP come to mind (Van Rooij and Fine 2018). For example, for about a decade, executives at Volkswagen made the operational decision to sell motor vehicles as allegedly emissions compliant, but which in fact contained hidden software to override such controls. According to estimates, Volkswagen sold more than 11 million misrepresented vehicles with the software adjustment remaining undisclosed to consumers and regulators.

This chapter explores how and whether the corporate environment facilitates fraud by examining some key questions: What is fraud? What is culture? Is culture governance or something else? Recent research suggests that culture is measured or observed by characteristics of the top management team. How has the academic research examined corporate culture and fraud? The chapter has the following organization. The next section explores the definition of fraud, particularly financial statement fraud, and how it is measured in academic research. The following section discusses the concepts of organizational culture and

environment, showing the academic evidence that seeks to measure “tone at the top.” Finally, the chapter concludes with some closing ideas and questions.

WHAT IS FRAUD?

Other chapters in this book provide insights and definitions of fraud. For the purpose of answering the questions posed in this chapter, a brief overview is provided to justify the focus on financial reporting fraud.

Fraud Defined

Fraud in the accounting and finance research context is usefully defined as “an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage” (ISA240.11). Fraud is categorized as either financial statement fraud or misappropriation of the company’s assets or cash. Researchers find various ways to identify and observe instances of financial statement fraud. It is much more difficult to conduct research into misappropriation type fraud (Tan, Chapple, and Walsh 2015).

There are several reasons why fraud is difficult to research:

- The breadth of the types of conduct.
- Fraud is difficult for firms to detect.
- Fraud is generally collusive and covert in nature (Bishop, Hermanson, and Riley 2017).
- Fraud involves multiple facets of perpetration. That is, the fraud may be conducted by insiders such as managers and employees, by parties affiliated with the company such as suppliers and customers, or by random outsiders, such as in the case of cyber fraud.
- A lack of data providing reputable reported instances exists. Some researchers rely on firms’ self-reported misappropriation fraud, with the obvious inherent limitations with self-reporting (Chapple, Ferguson, and Kang 2009; Tan et al. 2015).

- Fraud is difficult to measure. Many studies such as Beasley (1996) use a binary variable that measures a fraud firm with the value of one and a non-fraud firm with the value of zero. Less often, researchers are able to access more detailed information about misappropriation fraud and use a continuous variable such as the dollar value of the fraud (Chapple et al. 2009).

Global accounting firms, regulators and industry bodies provide useful surveys, reports and databases into incidences of fraud. Some notable examples of fraud data include:

- KPMG (2016), Global Profiles of the Fraudster;
- PwC (2018), Global Economic Crime and Fraud Survey; and
- Association of Certified Fraud Examiners (ACFE), 2018, Report to the Nations: Global Study of Occupational Fraud and Abuse.
- Federal Securities Regulation database, which provides a central repository for resources to ensure empirical research in federal securities regulation (Khana, Kim, and Lu 2015).
- Securities and Exchange Commission (SEC) Litigation Releases (http://www.sec.gov/litigation.shtml), which provides information on civil lawsuits brought by the SEC (Khana et al. 2015).
- Stanford's Securities Class Action Clearing House (SSCAC) (http://securities.stanford.edu/index.html), which provides information on private securities fraud class actions (Khana et al. 2015).
- Accounting and Auditing Enforcement Releases (AAER), which provides financial reporting related enforcement actions concerning civil lawsuits brought by the SEC in federal court and notices and orders concerning the institution and/or settlement of administrative proceedings.

Researchers may also examine misappropriation-type fraud by accessing actual perpetrators of fraud, for example by analyzing court transcripts from fraud cases (Andon, Free, and Scard 2015), or interviewing convicted fraudsters (Dellaportas, Pereera, Gopalan, and Richardson 2018). Such research tends to focus on the fraud perpetrators' perspective (Free 2015) and may not be directly relevant to the present examination of "corporate culture".

Commonly used terms such as "white collar crime" are similarly broad and are defined by the Federal Bureau of Investigation (FBI) primarily in terms of the perpetrators: "the full range of frauds committed by business and government professionals. These crimes are characterized by deceit, concealment, or violation of trust and are not dependent on the application or threat of physical force or violence. The motivation behind these crimes is financial—to obtain or avoid losing money, property, or services or to secure a personal or business advantage" (FBI no date, p. 1). Accordingly, the examples and insights provided in this chapter as to culture and fraud are predominantly confined to fraud in terms of financial reporting fraud.

Financial Reporting Fraud

Based on the predominant research focus in corporate fraud accounting and finance literature, this chapter focuses on the role of corporate culture and instances of corporate reporting fraud. Because top-level insiders are perpetrators of financial reporting fraud, discussing the link between corporate culture and fraud is appropriate, as discussed in the next section.

Accounting scandals attract much media attention and they predominantly involve financial reporting fraud. The FBI identifies falsification of financial information presented by corporations as a critical area of its investigative jurisdiction (FBI no date). The SEC identifies financial reporting and accounting fraud as key areas of growing concern for enforcement action focus (SEC 2016).

Research on financial reporting fraud uses various measures and proxies to observe whether companies have, or may have, perpetrated financial reporting fraud: for example, using account restatements (Government Audit Office; Audit Analytics), securities class actions enforcements (SSCAC) and the SEC's AAERs (Karpoff, Koester, Lee, and Martin 2018). These are discussed below, before moving on to the connection with culture.

In an early fraud paper, Beasley (1996) examined fraud firms, identified whether they had been subject to AAER, supplemented by searching the Wall Street Journal Index. He compared the corporate governance of fraud firms matched to a sample of non-fraud firms. His evidence shows that independent (called "outside") directors on the board decrease the likelihood of financial statement fraud. As a result of this early study, top-level board structure (governance) can be seen as an approximate substitution for organizational culture. The AAERs continue to be used as a common indicator of fraud in financial statement fraud research.

Measuring Fraud to Operate as a Variable in Statistical Modeling

Given the covert nature of fraud, observing and measuring fraud can be difficult. When designing research to investigate the determinants (causes), antecedents (associations) or propensity (likelihood) for fraud, researchers generally aim to produce from the population of firms a sample of "fraud" firms and "non-fraud" firms as a point of comparison. As actual fraud is difficult to measure, the research in this area has established several commonly used measures (variables that are proxies) for fraud firms.

Three major threats to the validity with such research follow:

1. The risk of unobserved or omitted variables, which is generally 'solved' by resorting to a range of statistical modelling techniques.
2. The risk of false positives and false negatives, which is usually called type 1 or type 2 errors. That is, in including a firm in the non-fraud sample, it may be a false negative in that a firm may have in fact experienced undetected fraud. This is generally an acknowledged limitation.

3. The risk of misapplication of variables due to report lag, which is the prevailing conditions in the fraud firm operating at the time the fraud occurred. This time could be before someone detected the fraud. Researchers can mitigate this threat by carefully considering the definition of ‘fraud’ occurrence, collecting data from alternate or supplementary sources, and accommodating lag times in the research design (Karpoff et al. 2018).

According to Karpoff et al. (2018), the most commonly used proxies for financial statement fraud are: financial statement restatements, investor lawsuits called securities class actions, and AAERs. The reason for the popularity of such proxies could be due to the availability of databases that report these respective events, as described above.

Financial reporting fraud data are also available to be ‘hand-collected’ from various sources, predominantly regulatory or media sources, to find evidence of actual cases investigated or violations litigated. Karpoff et al. (2018) illustrate this by searching case histories of enforcement actions brought by the SEC and Department of Justice (DOJ) for charges of financial misrepresentation pursuant to Section 13(b) of the Securities Exchange Act of 1934. Recall that Beasley (1996) corroborated fraud firm sample selection with evidence from the Wall Street journal.

CORPORATE CULTURE AND IDENTITY

This section examines the meaning of corporate culture. Understandably, many contexts and uses of the word culture exist when applied to business organizations. This section focuses on how culture is conceptualised in the finance and accounting literature to explain fraudulent financial reporting.

What Is Culture?

A distinction exists between corporate governance and corporate culture. As discussed in later chapters, corporate governance refers to systems or structures of accountability. Corporate governance is generally considered as structures or processes of accountability (OECD 2015).

Corporate culture has become aligned with accountability. “Culture” itself is a difficult word to define, and business researchers borrow from other disciplines (such as anthropology and social psychology) for use in a business setting. Culture here is defined as the values, beliefs and norms shared by a particular group in the context of their endeavours; in this case, in the context of operating a business organization. Culture is referred to by the metaphor of a biological system, to explain how organizations develop and survive or fail (Shultz 2012, p.8). This is the functionalist perspective of culture, and views culture as “top down” to be manipulated to serve the organization’s interests. Culture can also permeate up, that is interpretive or “bottom-up”, which may not necessarily be in management’s control (Glendon and Stanton 2000).

Finally, researchers identify four attributes of corporate culture (Groysberg, Lee, Price, and Cheng 2018), which are useful in measuring corporate culture:

1. Shared: culture is the shared behaviors and values of a group.
2. Pervasive: culture permeates the organization.
3. Enduring: culture develops over the long-term.
4. Implicit: culture is the instinctive, silent understanding for the group.

How Is Culture Measured?

In accounting and finance research, insider type fraud, such as financial reporting fraud, is attributed to the risk-taking culture or the risk appetite of the senior management team. The term “tone at the top” is often used to refer to the senior management team. The phrase “tone at the

top" is a short hand way to describe how management is tasked with designing and maintaining an effective system of internal control over the firm's assets and reporting.

Measuring Culture: Tone at the Top

So far the chapter shows the extent to which the determinants, antecedents or propensity for financial reporting fraud is a function of or associated with corporate culture. This part of the chapter examines how researchers identify and measure corporate culture. Fraudulent financial reporting suggests deliberate override or manipulation of controls, which can ultimately be enforced by SEC action under section 13(b) Securities and Exchange Commission Act. Accordingly, researchers ascribe to the company's culture the attributes of its senior management personnel, predominantly the chief executive officer (CEO).

The SEC equates corporate culture with the attributes and characteristics of key management personnel. In 2006, Linda Chatman Thomsen, Director, Enforcement, SEC, stated:

> Corporate character matters — and employees take their cues from the top. In our experience, the character of the CEO and other top officers is generally reflected in the character of the entire company. If a CEO is known for his integrity, integrity becomes the corporate norm. If, on the other hand, a company's top executives are more interested in personal enrichment at the expense of the shareholders, our … investigations demonstrate yet again that other employees will follow suit. (Chatman Thomsen 2006, p. 6).

The character and integrity of the CEO and other top executives are presented below according to four main constructs: (1) individual risk-taking, (2) individual integrity, (3) narcissism/optimism and (4) CEO power. Examples of the way these four constructs have been measured in the academic research are described in Figure 5.1 and explained below.

(Insert Figure 5.1 about here)

The key literature examined below focuses on research that links CEO and executive risk-taking characteristics and fraudulent financial reporting. The scholarly literature examines many other risk profile characteristics of CEOs in other business contexts, such as decision-

making, crisis management, and firm performance. These other proxies for risk-taking, such as holding an aircraft pilot license (Cain and McKeon 2016; Sunder, Sunder, and Zhang 2017), running a marathon (Limbach and Sonnenburg 2014), facial or voice characteristics as markers of testosterone (Kamiya, Kim, and Park 2019), surviving early life or career crises (Schoar and Zuo 2017; Bernile, Bhagwat, and Rau 2017) or cultural heritage (Nguyen, Hagendorf, and Eshraghi 2017) are not examined further.

Individual Risk-taking

Culture represents the social norms or ethics of a particular social group. The heartier the demonstrated risk appetite in one or some facets of life as demonstrated by the CEO's deviation from general social expectations predicts how much risk the CEO is willing to take in pushing the boundaries of corporate reporting. Key literature refers to several theoretical bases for focusing on individuals' characteristics to infer corporate culture. For example, *behavioral consistency theory* explains that individuals behave consistently across situations (Epstein 1979), and is applied to the corporate setting to help explain why CEO and executives' conduct is attributed to the corporate culture (Cronqvist, Makhija, and Yoner 2012). Alternatively, *upper echelons theory* (Hambrick and Mason 1984), posits that organizational outcomes are predicted by managerial background characteristics; again permitting attribution of CEO and executives' conduct to the corporate culture (Biggerstaff, Cicero, and Puckett 2015).

Criminality and Legal Infractions

Motivated by the criminology literature, Davidson, Dey, and Smith (2015, p. 5) posit that an executive's prior legal infractions, including driving under the influence of alcohol, other drug related charges, domestic violence, reckless behavior, disturbing the peace, and traffic violations can be used as symptoms of a relatively high disregard for laws and lack of self-control. They predict that such symptoms are related to the likelihood of future misstated financial statements. Interestingly, private investigators collect the data on executives' legal

infractions from publicly available data. The study predicts and finds that prior legal infractions by CEOs and chief financial officers (CFOs) are related to financial reporting risk. This research is based on earlier findings by Fisman and Miguel (2003) that even minor infractions such as parking ticket violations in Manhattan are sensitive to cultural norms.

Marital Infidelity

In 2015, an online 'dating' service known as Ashley Madison infamously suffered a data hack resulting in publicly releasing its subscribers' personal details without subscribers' authorization. The firm's business model focused on the concept of 'discreet affairs' (Griffin, Kruger, and Maturana 2017). This leaked database has become a source of data for researchers interested in examining the personal ethics and risk-taking appetite of corporate executives, either through matching names and addresses from transactions to publicly available data of corporate executives (Griffin et al. 2017) or more broadly matching the number of email addresses in Ashley Madison's data with a company's domain name (Grieser, Kapadia, Li, and Siminov 2016). The corporate culture as represented by greater the number of a firm's employees with Ashley Madison membership predicts a firm's likelihood of future SEC enforcement actions due to accounting misstatements.

Personal Financial Affairs

Personal investment choices also evidence corporate executives' risk appetite. Cronqvist et al. (2012) find that a CEO's personal leverage choices (debt encumbered on their personal residence) aligns with the debt tolerance of the firms they manage. Similarly, executives' tax aggressiveness could spill-over to their corporate tax stance. According to Chyz (2013, p. 311), "executives who appear willing to push the envelope for personal tax savings appear to do the same at the firms they manage." In this regard, executives' tax aggressiveness is measured as option-backdating. The practice of option-backdating by executives, while not illegal (Parsons, Sulaeman, and Titman 2018) is widely considered to constitute questionable personal conduct

(Chatman Thomsen 2006). Biggerstaff et al. (2015) show that firms with CEOs who backdate options are more likely to commit financial fraud to overstate earnings, which is suggestive of an unethical corporate culture.

Individual Integrity

Individual integrity is an innate characteristic of a person, which although may be reflected through their risk-taking actions, may be observed more broadly through other channels. Simplistically, the argument is that firms managed by a CEO with heightened ethical awareness and integrity is likely to carry those standards forward into his or her work decisions and insist on a high standard of integrity in the firm's financial reporting. Recall that researchers use proxies for integrity. Although a researcher may design surveys and instruments to elicit a personal integrity score either through self-review surveys (Ponemon 1995) or third person surveys (Ou, Waldman, and Peterson 2018), the literature examined herein refers to four manifestations of integrity: (1) philanthropy, (2) frugality, (3) public service, and (4) religiosity.

Philanthropy by Stock Donation

Stock donations by a CEO is a scrutinized activity and raises two competing conjectures: either the CEO is an altruistically-minded person, or the CEO manipulates the tax rules to derive a personal benefit, with the incidental reputation benefit of publicized philanthropy (Avci, Schipani, and Seyhun 2015). Nguyen (2018) finds that firms are less likely to commit financial fraud when they are run by CEOs with a record of stock donations.

Frugality

The research is based on an intuition that executives' personal consumption and lifestyle choices relating to luxury goods manifests their relative frugality. Executives, particularly CEOs who refrain from acquiring luxury goods are less likely to engage in fraudulent reporting (Davidson et al. 2015). Luxury goods refer to status items such as cars, boats, motorcycles, and

real estate. The authors employ private investigators to compile luxury goods portfolios for the sample firms' executives. There is no evidence that non-frugal executives (apart from the CFO) impact fraudulent financial reporting.

Public Service

Based on the changing demographics and observed career paths for retired military personnel, Benmelech and Frydman (2015) ask the question whether the diminishing numbers of executives with military service serving corporate America affects corporate conduct. Military service is a proxy for values and culture because CEOs with military experience are expected to make ethical decisions for the benefit of companies they run rather than their own self-interest (Franke 2001; Simpson and Sariol 2018). This research finds that CEOs with military experience are significantly less likely to be involved in corporate fraudulent activity compared to non-serving CEOs. However, Malmendier, Tate and Yan (2011) find that CEOs with military experience (as a proxy for aggressiveness) choose more aggressive policies (including higher leverage ratios), which implies that personal events can have life-long impact on risk attitudes and choices.

Religiosity

As corporate culture is derived from the social norms of the executives as a group, it has been investigated whether executives' religiosity affects corporate behavior. Personal religiosity affects individuals' perceptions of accounting manipulations in an experimental setting (Conroy and Emerson 2004), but its effect in the corporate setting remains unknown. The closest test to executives' religiosity utilizes the religiosity of the geographical location of the corporate headquarters (McGuire, Omer, and Sharp 2012; Dyreng, Mayew and Williams 2012; Parsons et al. 2018). Both McGuire et al. (2012) and Dyreng et al. (2012) find that firms headquartered in areas with high religiosity exhibit lower incidences of financial reporting fraud.

CEO Narcissism

Since the early 2000s, the business literature and financial press, in commenting on the rising power of the CEO, has observed the phenomenon of the "cult" of the CEO (Haigh 2003). The CEO as a person of mythical proportions, achieves status benchmarked on salary, as CEO salaries vastly exceed other executives as well as political and community leaders. The scholarly literature examines the traits of leadership including narcissism. A narcissistic personality displays traits of grandiosity, lack of empathy and a need for admiration (Glover et al. 2012). Figure 5.2 sets out the diagnostic parameters.

(Insert Figure 5.2 about here)

According to Kets de Vries and Miller (1985), narcissism is an expected trait of CEOs, given the self-selection bias demonstrated by such individuals to seek out and accept corporate positions of power. Narcissism relates to over-inflated sense of self and is a personality trait that everyone has to some extent (Amernic and Craig 2010). However, it is a matter of balance and "too much" narcissistic behavior leads to impaired judgment. Researchers also use a less provocative construct or subset of narcissism when referring to CEO "overconfidence" or "optimism".

So what is wrong with narcissistic CEOs? Narcissistic behavior is associated with a sense of superiority and a propensity to engage in questionable and aggressive behavior in pursuing what someone believes is his or her entitlement. In the context of narcissistic CEOs, Olsen and Stekelberg (2015) find that narcissistic traits increase the likelihood that the CEO's firm engages in corporate tax shelters. Structuring the company's affairs into tax shelters may not be illegal, but is questionable conduct. In relation to fraud and financial statement manipulations, prior research shows that a narcissistic CEO or CFO is associated with financial statement manipulation and fraud (Schrand and Zechman 2012; Rijsenbilt and Commandeur 2013; Ham, Lang, Seybert, and Wang 2017; Capalbo, Frino, Lim, Mollica, and Palumbo 2018).

Given the availability of a psychological diagnostic tool to identify narcissists, how do researchers do it? Regarding a diagnostic tool, O'Reilly, Doerr, and Chatman (2018) administer an online survey to a company's employees asking them to identify and rate their CEO's narcissistic tendencies. However, as Rijsenbilt and Commandeur (2013, p. 414) note, "One of the major hurdles in investigating CEO narcissism is that for purely practical reasons, large-scale CEO surveys are difficult to conduct." Several proxies have become acceptable in the recent literature, as summarized below.

- *Compensation*: Power is valued by compensation, both in absolute dollar value, but also benchmarked to the proportion of other executive salaries paid by the firm (Rijsenbilt and Commandeur 2013).
- *CEO exposure*: Importance is measured by external awards, media profile, and publications (Rijsenbilt and Commandeur 2013).
- *Use of first person pronouns*: The CEO announces his or her self-importance by frequently using first person pronouns in transcripts of conference calls with analysts (Capalbo et al. 2018).
- *Consumption of perquisites* ("perks"): A corporate jet is an example of a corporate perk (Rijsenbilt and Commandeur 2013; Yermack 2006).
- *Photograph size in the annual report*: High visibility of the CEO alone compared to group shots indicates CEO self-importance (Rijsenbilt and Commandeur 2013) as does the relative positioning of the CEO's photo (Ingersoll, Glass, Cook, and Olsen 2017).
- *Signature size*: Signatures are a powerful representation of self (Ham et al. 2017; Ham et al. 2018).

In contrast to narcissistic CEOs, researchers have also begun to take an interest in CEOs who are humble or modest to document associated effects on ambidextrous strategies and stronger firm performance through top management team integration (Ou et al. 2018). Humility

refers to traits such as willingness to obtain self-knowledge, open-mindedness and appreciation of others' contributions (Morris, Brotheridge, and Urbanski 2005) Ou et al. 2018 measure CEO humility by surveying their CFOs.

CEO Power

With increasing occurrences of corporate fraud, the connectedness of CEOs with top executives comes under scrutiny. CEOs power is predominantly determined by their connections with top executives and directors through networked appointment decisions, which increase the likelihood of corporate fraud (Khana et al. 2015). Network appointments refers to ties through past employment, education, or social organization memberships. Other sources of CEO power are attributed to founder CEOs, CEOs who chair the board, and older CEOs, who are considered more powerful through experience, which may help them evade fraud detection (Khana et al. 2015). Furthermore, Johnson, Ryan, and Tian (2009) find that CEOs who are long-tenured are more likely to influence other executives to cooperate in committing fraud.

SUMMARY AND CONCLUSIONS

In a business climate where trust in public and private institutions are questioned, and where accounting and reporting scandals continue to occur, researchers are increasingly turning their investigative skills to examining questions as to the determinants (causes), antecedents (associations) or propensity (likelihood) for financial reporting fraud. Practitioner and professional commentary such as global accounting firms and industry bodies such as the Association of Certified Fraud Examiners, also contribute evidence as to the sustained business practices encompassing financial fraud.

Within the constraints of research methods and data collecting, the research overwhelmingly shows a link between tone at the top and such practices as fraudulent financial reporting, earnings management, and tax sheltering. Tone at the top, an expression used as

shorthand to describe corporate culture, tends to conflate around data that show the risk-taking appetite and propensity of a firm's senior management team, particularly the CEO. Risk appetite, up to a point, is a desirable characteristic for senior business leaders. However, pushing the boundaries on social norms such as personal ethics, integrity, law breaking, rule breaking, and risky extra-curricular pursuits, translates into the business environment in unhealthy ways and a reckless attitude toward fidelity in financial reporting.

Corporate culture comprises four attributes. It is shared, pervasive, enduring, and implicit. Corporate cultures that are driven by an imbalance in risk appetite as demonstrated by the senior leadership teams' attributes and activities may be re-balanced by addressing these organizational cultural attributes. First, fraudulent financial reporting occurs inhouse and requires more than one member on the senior management team to be complicit in "cooking the books." Second, the culture is discernible to the organization from the top down; as the Toshiba example shows, other staff felt they could not resist the pressure from their superiors. Third, as the value of financial reporting integrity is diminished in the organization, it endures potentially beyond the tenure of one management team as the team is replenished. Fourth, fraudulent financial reporting is by its nature covert, meaning such a shared value is implicit.

Finally, although attributes of the senior management team driving culture may in some ways seem innate, these characteristics may also be behavioral. This observation is recognized by recent moves to include psychological testing of boards' performance and resilience as a tool to adjust behavioral-driven cultural dysfunction (Boyd 2019).

DISCUSSION QUESTIONS

1. Define fraud and identify its main perpetrator.
2. Define culture and explain who is responsible for a firm's culture.
3. Identify the attributes of corporate culture.

4. Discuss why researchers have difficulty in researching corporate fraud and the strategies used to mitigate these difficulties.
5. Discuss how to collect data on corporate culture if the goal is to research the possibility of an association with a firm's propensity to engage in financial reporting fraud.

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Figure 5.1 Corporate Culture as Attributed from Key Management Personnel Characteristics

The character and integrity of the CEO and other top executives are presented below according to four main constructs: (1) individual risk-taking, (2) individual integrity, (3) narcissism/optimism and (4) CEO power.

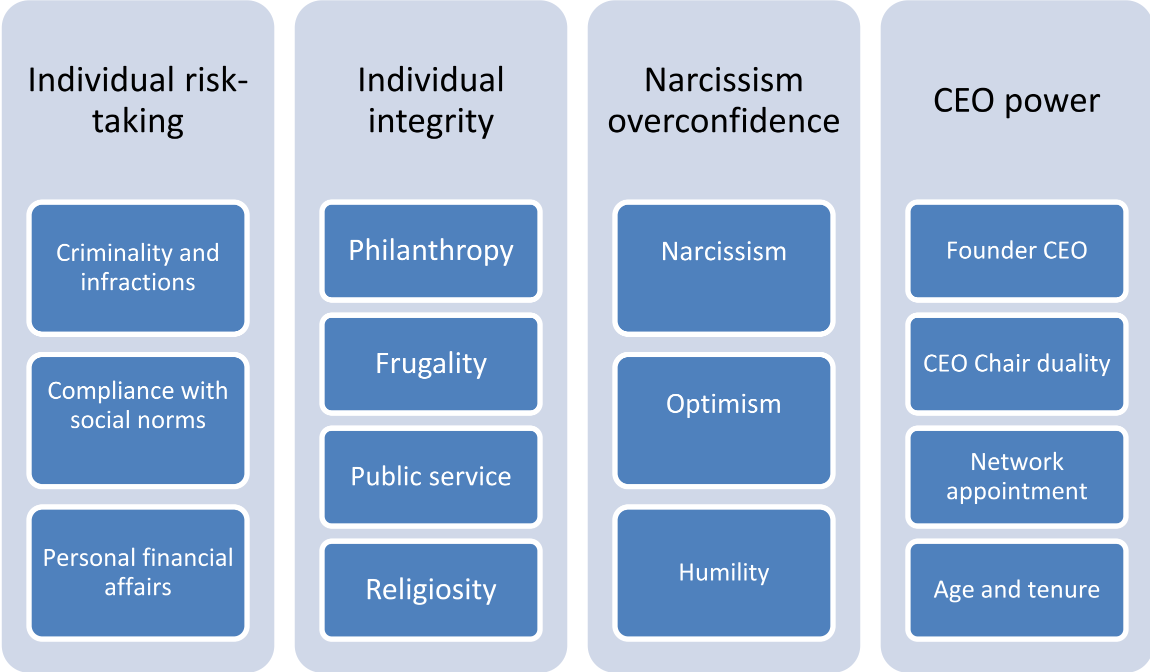

Figure 5.2 Diagnostic Criteria of Narcissism

Symptoms of Narcissism include a pervasive pattern of grandiosity, need for admiration, and a lack of empathy indicated by at least five of the following traits:

DSM-IV TR Diagnostic Criteria (at least five)
Displays an exaggerated or grandiose sense of self-importance
Has fantasies of unlimited success, power, beauty or ideal love
Believes they are "special" or unique
Requires constant, excessive admiration and has a sense of entitlement
Is interpersonally exploitative
Shows a lack of empathy for others
Is often envious, or believes other are envious of them
Behaves in an arrogant or haughty manner

Source: Raskin and Hall (1981).