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The Role of Corporate Culture in Managing Occupational Fraud

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Abstract
Occupational fraud remains a menace in the corporate world. It involves a wide range of undercover crimes perpetrated by employees at all levels of an organizational hierarchy. In recent years, the media has constantly reported on these malfeasances to the disappointment of the public. In response to the several corporate scandals, many organizations have instituted strong internal control systems, procedures and programs as well as corporate governance to safeguard their organizations from occupational fraudsters. However, these efforts have proven futile because they don't touch the 'heart'. Therefore, we contend that corporate culture plays a critical role in managing the risks of fraudulent acts. Particularly, when ethics is solidly implanted in corporate culture and exemplified by top leadership, an organization is more likely to minimize internal scams. Consequently, and board and management should create and sustain an ethical corporate culture that integrates an organization's core values, motivates employees in doing what is right. Employees should be empowered to voice out their suspicions and see their crucial role in minimizing frauds.
Keywords: Corporate culture, ethical culture, Occupational fraud, risk management

1. Introduction

Occupational fraud, also known as white collar crime remains a menace in the corporate world. Fraedrich, Ferrell and Ferrell generally define fraud as any purposeful action that deceives, manipulates, or conceals facts in order to create a false impression (2017). Within an organizational context, the Association of Certified Fraud Examiners (ACFE) defines occupational fraud as "the use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets" (ACFE, 2014, p. 6). They further classify occupational fraud into three components: asset misappropriation (e.g., theft of cash, fraudulent disbursements, misuse of assets), corruption (e.g., bribery, conflicts of interest, illegal gratuities), and financial statement fraud (e.g., Net Worth/Net Income Overstatements, Net Worth/Net Income understatements)." Fraedrich, Ferrell and Ferrell (2017) also refer to occupational frauds as 'crimes of the suite'. These are nonviolent occupational criminals entrusted with responsibility and power who abuse such trust with their occupational positions. Thus, unlike open crimes, occupational fraud by its nature is a concealed crime designed to deceive and escape detection for ulterior motive.

In recent years, the media has constantly reported on these malfeasances in the corporate world. For example, the high-profile fraud cases of Enron, Parmalat, Adelphia, HealthSouth, WorldCom, American Insurance Group, Siemens, Lehman Brothers, Saytam, Johnson and Johnson and Toshiba are well known. However, equally alarming occupational fraudulent activities include employees stealing office supplies, inflating expense reports, claiming to have worked extra hours and many more. Occupational fraud is therefore a broad concept involving a wide range of white collar crimes perpetrated by employees at all levels of an organizational hierarchy (Kummer, Singh, & Best, 2015).

Occupational fraud risk management is very critical to the achievement of an organization's objectives. The 2016 report of the ACFE estimated that annually, over $6.3 billion is lost in fraud and a typical organization loses 5% of its revenue to fraud. Comparing this report to the previous report, the median loss per case has increased from $145,000 to $150,000, and cases causing $1 million or more also increased from 22% to 23.2%. More so, the Global Business Ethics survey revealed that 23% and 32% of bribe cases involved top and middle management respectively (Ethics Research Center, 2016). Similarly, Price Waterhouse Coopers (2016) found that "more than one in every three (36%) organizations experienced economic crimes" and "both developed and emerging markets are affected" but "company detecting methods are not keeping pace" with fraudsters (p. 2).

In response to the several corporate scandals, many organizations have instituted strong internal control systems, procedures and programs as well as corporate governance to safeguard their organizations from occupational fraudsters. However, these efforts have proven futile because they don't touch the 'heart'. Price Waterhouse Coopers noted that institutional internal controls were insufficient to detect frauds. Besides, occupational fraud is normally perpetrated by insiders who know the existing internal control systems and its corresponding weaknesses. In fact, "the most expensive frauds are committed by management team who have the ability to override control systems and collude to cover their tracks" (Hess & Broughton, 2014, p. 542). How, then, can occupational frauds be put to check?

In this article, we contend that corporate culture plays a critical role in managing the risks of fraudulent acts. Particularly, when ethics is solidly implanted in corporate culture, and exemplified by top leadership, an organization is more likely to minimize internal scams. Thus, culture is an important mechanism that shapes the behavior of organizational members including the organization's ethical atmosphere. Moreover, most organizations that remain successful in the long-run have leaders who include ethical values as part of the formal policies and informal cultures of their companies (Daft, 2015). The Ethics Resource Center's 2008 survey reported a reduction by 75% of misconduct in companies with strong ethical cultures (cited by Weiss, 2009). The survey also reported that ethics risk diminishes when a company adopts an enterprise-wide cultural approach to business ethics. Schwartz (2013) also reiterates that an ethical corporate culture not only helps avoid corporate scandals and frauds, it also leads to appropriate ethical behavior within all the organizational levels. Thus, without consistent ethical culture, any attempt to address scandalous status quo in the corporate world would be pointless.

2. Theories of Fraud Triangle and Fraud Diamond

Several theories explain why employees at all levels commit occupational fraud. Some of the profound theories are the fraud triangle and the fraud diamond (Wells, 2007). The theory of fraud triangle explains that high pressure and perceived opportunity with low integrity leads to the perpetration of fraud (Albrecht, Turnbull, Zhang & Skousen 2010). Wells (2011) also explains that the first side of the fraud triangle represents the pressure factors to commit a fraudulent act, the second side shows the perceived opportunity to engage in fraud, and the third side stands for rationalization of the act of fraud. That is, these key three conditions are widely used to explain the perpetration of occupational frauds.

Nonetheless, the three-triangle theory has been criticized in recent literature. That is, a person may experience pressure factors, have the opportunity and can rationalize the act but may lack the ability to commit occupational fraud (Wolfe & Hermanson, 2004; Carcello & Hermanson, 2008). Therefore they expanded the fraud triangle by adding another part formulating a fraud diamond. In other words, the theory of fraud diamond posits that a person's ability can determine whether he/she may commit fraud or not. Explaining it differently, opportunities can be available, high incentive and good rationalization may also be available but an individual cannot commit fraud if he/she lacks the ability even when attracted.

Hence, anti-fraud strategies are policies, procedures, techniques, structures as well as the environment created to reduce the pressure to engage in fraud, minimize the opportunity to commit fraud, lessen the ability to perpetrate fraud and curtail the sense of rationalization in committing fraud. Management can only minimize occupational fraud risk through a proper understanding of pressure to engage in fraud factors, situations that provide the opportunity to commit fraud, what enhances potential (and actual) fraudster's ability and their sense of rationalization. When corporate culture is properly and intentionally designed, it can serve as an anti-fraud strategy in addressing occupational fraud risk. Though occupational fraud cannot be completely eliminated, the indicating signs and alerts can be managed by combining training and experience to detect and respond appropriately.

3. Occupational Fraud Risk Management

Occupational Fraudsters are typically not 'bad' people. They are ordinary people who take advantage of loopholes in the organization such as a weak culture. According to the 20-60-20 rule in extant literature, 20% of a given workforce will always do the right thing regardless of one's circumstances or the organizational culture. Another 60% of the workforce will engage in questionable behaviors depending on the environment in which they work. These individuals are influenced by the existing organizational culture and want to fit into the organization. Organizational factors such as pressure to meet aggressive organizational goals at all cost, wanting to belong, helping the organization to survive a difficult financial situation can trigger occupational frauds. Schwartz (2013) calls this group the 'fence sitters', it is this 60% that is amenable to doing the right thing if they work within an ethical culture. Alternatively, they would compromise ethical standards either periodically, fairly often, or all the time depending on the workplace environment (Collins, 2012). Fraedrich, Ferrell and Ferrell posit that though people have choices, the organization's values often have greater influence on employees' decisions than their own values (2017). The other 20% will always engage in fraudulent behavior when there is an opportunity to express greed and self-interest. Since there is a high probability that a large percentage (60%) of any work group will either take advantage of a situation or at least go along with the majority – everybody does it syndrome, there is a great need to deliberately design internal structures that will deter fraudulent actions and maintain an ethical culture.

3.1 Internal Controls Framework

Internal control is a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives (Committee for Sponsoring Organizations of the Treadway Commission (COSO), 2013, p. 2). In other words, internal control is an ongoing task implemented by people through an organizational structure to ensure the achievement of organizational objectives relating to operations, reporting, and compliance to provide reasonable assurance to management and other stakeholders. There are five main components of internal controls— control environment, risk assessment, control activities, information and communication and monitoring.

The control environment provides the set of standards and policies, procedures and processes, and structure for which internal control should be carried out throughout an organization. Control environment usually consists of management philosophy, operating style, expectations regarding integrity and ethical tone at all levels, committed and competent human resources, organizational structure and assignment of authority and responsibility, human resource policies and procedures, the board of directors, and audit committee. It is important to indicate that, internal controls can only be effective when all the components of internal controls are functioning properly. A compromise of any of the components can render the internal controls ineffective including corporate culture. Moreover, management's ability to override internal controls, other employees and or third parties circumventing the controls through collusion, human errors and poor judgment are some of the key factors that can render internal control ineffective (COSO, 2013). Therefore, corporate culture should be incorporated into control environment of an entity to manage occupational fraud risk effectively. Nonetheless, corporate culture goes beyond the control environment of organizations.

A corporate culture that encourages reporting of fraud cases can detect fraud quickly. For instance, companies with good communication systems detect more occupational frauds through tips. According to the Association of Certified Fraud Examiners (2016), tips are the most common detecting method (39.1% of cases studied) and organizations which provide hotlines detected more occupational frauds than those which do not provide hotlines (47.3% as compared to 28.2%).

3.2 The Potency of Corporate Culture

There's no doubt that corporate culture plays a crucial role in shaping and guiding the behavior of organizational members. The Centre for Audit Control in their report on Deterring and Detecting Financial Reporting Fraud (2010) affirms that corporate culture influences all three sides of the fraud triangle. A strong ethical culture creates an expectation to do what is right, thereby limiting the propensity to rationalize fraudulent actions. It also supports effective controls and reduces opportunities for fraud; which in turn will increase the likelihood that fraud will be detected quickly and lessen pressure and incentives to commit fraud.

Culture comprises the beliefs and values, attitudes and behaviors that are exhibited within an organization and its operations. It represents what an organization stands for and how it is seen from within and from without. Corporate culture represents the personality of an organization and its shared beliefs, values, behaviors, the way things are done and it's explicit and implicit rules (Bouwman, 2013). Organizational cultures are both visible and invisible, formal and informal (Weiss, 2009). Culture is often expressed informally through passing comments, gestures, and behaviors of especially top management. KPMG International (2017) also explains that corporate culture is not aspirational value … but the unwritten rules that drive the thousands of decisions employees make every day throughout the company (p.4).

Culture can be an antidote to many organizational problems and can significantly affect how an organization is run (Warrick, 2017). That is, sustainable culture can be achieved through the pursuance of strong corporate culture. According to Chatman and Cha (2003), strong cultures are based on two characteristics, high levels of agreement among employees about what is valued and high levels of intensity about these values. If both are high, a strong culture exists; and if both are low, the culture is not strong at all. Graham, Harvey, Popadak, and Rajgopal (2015) also revealed that a strong corporate culture influences performance through better execution, reduction in agency cost, empowerment of employee consistent decision making in difficult times and value more than strategic decisions. They added that it also affects creativity, productivity, firm's value and profitability. Google's success has been attributed to strong corporate culture (Schmidt & Rosenberg, 2014; Edwards, 2012).

Additionally, corporate culture has been conceptualized in many ways. Graham et al. (2015) classified corporate culture into seven main types.These are entrepreneurial (dynamic and aggressive), hierarchical (buttoned down and centralized), collaborative (corporative and participatory), result-oriented (result-driven and customer focus), high integrity (compliance-driven and credibility focused), in transition (characterized by high growth) and dysfunctional (not favorable for growth and profitability).Corporate culture can be built by design or default. Leaders can intentionally build and sustain healthy corporate culture through their corporate strategies. Hence corporate culture can serve as powerful internal rules of behavior and identity.

When management seems not to care about or reward appropriate behavior, and there is lack of recognition for proper job performance as well as perceived inequalities and discrimination in the form of favoritism, nepotism, racism, etc., the level of employees moral or loyalty reduces and they turn to hurt the organization by committing occupational fraud. More so, autocratic management, fear of reporting bad news to supervisors, poor performance evaluation, poor training and promotional opportunities, unfair and unclear organizational responsibilities and poor internal communication practices can encourage poor and weak corporate culture (Association of Certified Fraud Examiners, 2011; Jennings, 2006).

To a large extent, leaders influence organizational culture through their strategies, practices, values, leadership styles and example. Therefore, healthy and strong corporate cultures are engineered by effective leadership and management whereas unhealthy and weak corporate cultures are the results of ineffective leadership and management. For this reason, leaders need to have better understanding of the dominant and subcultures, consider visible and invisible factors that define culture, the impact of traditions and group dynamics, the key internal and external circumstances that may influence culture, valued and devalued behaviors, influential members, strong and weak cultures, international cultural differences, and the vulnerability of culture (Warrick, 2017). These factors when considered and worked upon by leaders, culture can be used to bring the right change in an organization.

By extension, Leaders need to create an atmosphere whereby employees feel psychologically safe to report questionable and unethical acts. Consequently, an important element of organizational culture is the company's ethical culture. Fareadrich, Ferrell and Ferrell (2011) clarify the difference between corporate culture and ethical culture by explaining that while corporate culture involves values and norms that prescribe a wide range of behavior for organizational members, the ethical culture reflects whether the firm also has an ethical conscience.

4. The Role of Ethical Culture in Creating an Ethical Workplace

Developing a sound ethical corporate culture is key to help prevent, detect, deter and respond to minimizing of occupational fraud risks. Creating an environment that encourages adherence to high ethical values can go a long way to reduce the perpetration of frauds in organizations especially the attitude and behavior of leaders. In other words, organizations that uphold integrity and do not compromise on ethical standards set an ethical tone at the top that trickles down to the rank and file of the organization. Top management must provide that environment and guidance by harnessing multiple formal and informal cultural systems.

The Association of Certified Fraud Examiners (2011) posits that, if top management does not uphold and prioritize high ethical standards, employees are likely to commit fraud. Employees closely watch the behavior of their leaders and that informs their behavior as well. The Association of Certified Fraud Examiners further proposes four key steps that top management should follow — communicate expectations to employees, lead by their examples, provide safe mechanisms to report culprits, and reward integrity (2011). That is, a high ethical culture created within an organization through the practices of and values of management can deter unethical behavior of employees. In addition, according to Schein (as cited by Rae & Wong, 2012, p. 460), "the most powerful mechanisms for embedding and reinforcing culture are (1) what leaders pay attention to, measure and control; (2) leader reactions to critical incidents and organizational crises; deliberate role modeling, teaching and coaching by leaders; (3) criteria for allocation of rewards and status; and (4) criteria for recruitment, selection, promotion, retirement and excommunication". Nevertheless, for these strategies to gain genuineness and touch the 'heart' of employees, they must go beyond lip service – words and deeds must correspond. Employees are constantly evaluating management's decisions and behaviors as key indicators of what is practically acceptable and unacceptable in the organization. They watch to see if leaders show commitment to what they profess in their talk and daily behavior. Hence, if top management don't set worthy examples, they would have no moral courage to deter corporate fraud.

Therefore, personal integrity is an essential component of leadership and ethical culture. In the classic words of Peter Drucker, "the final proof of its (leadership) sincerity and seriousness is uncompromising emphasis on integrity of character. For it is character through which leadership is exercised, it is character that sets the example and is imitated in turn" (cited in Drucker, 2007, p. 157).

Nonetheless, top management team must be more than individuals of high character. They must influence their followers to behave ethically. Influence means that the relationship between top management and other employees is not passive; and that influence is not coercive (Daft, 2015). Thus, in order to be effective, top leaders must be perceived as both moral persons and moral managers (Rae & Wong, 2012). Therefore, top management should communicate clear and consistent message to their followers. Besides, the reward system should be designed to reward acceptable behaviors and the entire reward system should be periodically checked to ensure it is rewarding what the organization approves.

Although we often think of top leadership as the most important leaders in the organization, corporate boards are equally responsible for creating an ethical culture within the organization. As such, we suggest that organizations through their boards must seek to strengthen internal reporting mechanisms as an antifraud strategy. Since almost all occupational frauds are deliberate, hidden and veiled; employees are more likely to witness the crime right from the onset. Therefore, the existing corporate culture should give voice to employees at all functional and hierarchical levels to speak out their concerns, ask questions and report emerging frauds so that corrective actions could be taken against such acts. However, encouraging employees to speak out is not guaranteed unless they perceive it as safe and effective. Consequently, we support Jennings (2006) proposed antidotes to curb fear and silence corporate culture. First, employees must be told, reminded, and reassured that it is safe to voice their concerns and be provided with some form of anonymous reporting system such as fraud hotlines. Second, the board and the management team must clearly communicate to employees how they will be protected for reporting misconducts that involves even top leaders. More so, employees who speak up can be rewarded through recognition programs. In addition, management should make employees feel that their thoughts and judgements are valuable. Top management will build credibility if they listen to their employees and show that they have their best interests at heart. Most importantly, the corporate board has a fiduciary responsibility to make organizational members understand and appreciate why it is necessary to safeguard their organization against occupational frauds and other unethical practices. Both managers and employees should understand their personal role and responsibility in the whole process of fraud risk management. So, employees' behavior must be guided by a shared commitment to creating an ethical culture rather than mere obedience to authority. When appropriate ethical culture is in place, it becomes easier to design and implement effective organizational controls.

5. Conclusion

Occupational fraud is a real challenge in the corporate world irrespective of the size of the organization. Much of the occupational fraudulent acts is as a result of poor organizational culture and neglectful leadership that send mixed messages about what is important and what is expected. Corporate culture can negatively or positively influence the management of occupational fraud risk.

Creating an organizational culture of ethical values such as integrity and openness can help to reduce the risk of fraud. Top management should create and sustain an ethical corporate culture that integrates an organization's core values, motivates employees in doing what is right. Employees should be empowered to voice out their suspicions and to see their crucial role in minimizing frauds.

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