The role of managers’ behavior in corporate fraud

Jeffrey Cohen\textsuperscript{a}, Yuan Ding\textsuperscript{b}, Cédric Lesage\textsuperscript{c} and Hervé Stolowy\textsuperscript{c,*}

\textsuperscript{a}Carroll School of Management at Boston College, USA  
\textsuperscript{b}China-Europe International Business School (CEIBS), Shanghai, China  
\textsuperscript{c}HEC School of Management, Paris, France

\textsuperscript{*}Corresponding author: Tel: +33 1 39 67 94 42. Fax: +33 1 39 67 70 86. 
E-mail address: stolowy@hec.fr.
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Abstract

Based on anecdotal evidence from press articles covering 39 high profile alleged or acknowledged corporate fraud cases, the objective of this paper is to examine one dimension partially unexplored: the role of managers’ behavior in the commitment of the fraud. A close analysis of professional auditing standards reveals that these standards do not sufficiently emphasize managers’ personality traits and ethics as fraud risk factors. This study uses a case analysis approach and combines the fraud triangle and the theory of planned behavior in order to gain a better understanding of fraud cases. The results of the analysis suggest that personality traits appear to be a major fraud risk factor. Therefore, it is potentially important to strengthen the emphasis on managers’ behavior in the auditing standards that are related to fraud detection.

Key words

Fraud auditing standards, fraud triangle, corporate fraud, theory of planned behavior, personality traits, ethics

Résumé

Sur la base d’articles de presse concernant 39 cas de fraudes présumées ou reconnues d’entreprise, l’objectif de ce papier est d’examiner une dimension partiellement inexplorée : le rôle du comportement des dirigeants dans la commission de la fraude. Une analyse approfondie des normes d’audit révèle que ces normes ne soulignent pas suffisamment les traits de personnalité des dirigeants et l’éthique comme constituant des facteurs de risque de fraude. Cette étude repose sur une analyse de cas et combine le triangle de la fraude et la théorie du comportement planifié pour obtenir une meilleure compréhension des cas de fraude. Les résultats de l’analyse suggèrent que les traits de personnalité semblent être un facteur majeur du risque de fraude. Il est donc potentiellement important de renforcer l’accent sur le comportement des dirigeants dans les normes d’audit traitant de la détection de fraude.

Mots clés

Normes d’audit, triangle de la fraude, fraude d’entreprise, théorie du comportement planifié, traits de personnalité, éthique
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Introduction

Starting in the late 1990s, a wave of corporate frauds involving many big names spread with Enron’s failure perhaps being the emblematic example. The objective of this study is to explore the behavior of managers involved in fraud cases as documented in the press and to determine if fraud related auditing standards need to perhaps be revised to incorporate more psychological factors than what is currently outlined in the professional literature.

An examination of prior literature reveals that the likelihood of committing fraud has been investigated in a number of different ways, using essentially financial and/or governance variables (e.g., Beasley, 1996; Abbott, Parker & Peters, 2004; Kinney Jr., Palmrose & Scholz, 2004; Agrawal & Chadha, 2005; Farber, 2005; Srinivasan, 2005; Erickson, Hanlon & Maydew, 2006).¹

The moral, ethical, psychological and sociological aspects of fraud have also been covered by the literature. Albrecht et al. (1982, p. 31-37) suggest that there are three explanations of crime: psychological, sociological and moral development. The ethical component of several corporate scandals has been documented. For example, Zandstra (2002, p. 16) posits that the central reason for Enron’s demise was a failure of the board of directors to function in a morally and ethically responsible manner.²

Rezaee (2002, 2005) finds five interactive factors which explain several high-profile financial statements frauds. These factors are: cooks, recipes, incentives, monitoring and end results (CRIME). Choo and Tan (2007) also explain corporate fraud by relating the fraud triangle to the “broken trust theory” introduced by Albrecht et al. (2004) and to an “American Dream”

¹ Some reviews have been published on fraud cases. Eilifsen and Messier (2000) study the role of auditors in error (whether intentional or not) detection while Nieschwietz et al. (2000) concentrate on the auditor’s role in terms of fraud detection. Caster et al. (2000), discussed by Kinney (2000), model the error generation and detection and Rezaee (2005) studies several fraud cases and proposes strategies for fraud prevention and detection.

² Shafer (2002) examines fraudulent financial reporting within the context of Jones’ (1991) ethical decision making model. He finds that quantitative materiality did not influence ethical judgments. Thorne et al. (2003) study the auditor’s moral reasoning, applying the cognitive developmental theory of Kohlberg (1958, 1979) and the measurement tools proposed by Rest (1979). They find that national institutional context is associated with differences in auditors’ moral reasoning. Elias (2002) examines the ethics of the earnings management practice. His results indicate a positive relationship between social responsibility, focus on long-term gains, idealism and the ethical perception of earnings management and a negative relationship between focus on short-term gains, relativism and the ethical perception of this practice.
theory\(^3\) which originates from the sociological literature. Schrand and Zechman (2007) relate executive overconfidence to the commitment of fraud.\(^4\) Collectively, these studies suggest that psychological and moral components are important for gaining an understanding of what causes fraud to occur. Interestingly, several articles have highlighted the importance of the social and ethical dimensions in tax fraud. For example, Blanthorne and Kaplan (Forthcoming) state that “researchers have generally concluded that economic models focusing on opportunity and penalties provide only a partial understanding of tax compliance choices made by taxpayers and that social norms and ethical beliefs also play a role”.

However, the manager’s behavior in the fraud commitment has been relatively unexplored. Accordingly, the objective of this paper is to examine managers’ behaviors in documented corporate fraud cases. On the basis of press articles, which constitute an ex-post evaluation of alleged or acknowledged fraud cases, we study the behavioral factors existing in auditing standards in relation to fraud risk assessment. Specifically, we are interested in exploring if there is any room for improvements in existing auditing standards that would result in auditors potentially being more effective in deterring and detecting corporate frauds in the future. Our research relates to “audit task” field, as identified by Nelson and Tan (2005) and is consistent with Knapp and Knapp (2001, p. 26) who suggest the “definite need to develop audit procedures or strategies more specifically focused on fraud detection”. In the same vein, Braun (2000, p. 257) believes that if “an auditor were to increase his or her knowledge of fraud, the cues should be more readily available during the execution of audit tests”.

To evaluate potential influences on committing corporate fraud, this paper combines the theory of the fraud triangle, which states that corporate fraud is a function of incentives, opportunities and attitudes/rationalizations, and the theory of planned behavior (Ajzen, 1991) (hereafter TPB), which incorporates attitude, subjective norms, and perceived behavioral control. We then apply the combined theories to a large number of high profile corporate frauds based on publicly available press articles using managers’ quotes and journalists’ analyses. The results of our analysis confirm that attitudes/rationalization appear to be a key risk factor of corporate

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\(^3\) This theory states that “an intense emphasis on monetary success induces corporate executive Fraud”, “corporate executives exploit/disregard regulatory controls to commit Fraud”, and “a corporate environment that is preoccupied with monetary success provides justification/rationalization for success by deviant means such as Fraud”.

\(^4\) Not referring specifically to fraud but to questionable payments issue, Rosenberg (1987) examines the effect of managers’ value systems and personality traits on ethical decision behavior.
frauds and that the fraud triangle, integrated with the TPB, is a useful framework in which to analyze corporate fraud.

A close analysis of existing auditing standards reveals that managers’ personality traits and ethics are perhaps not sufficiently emphasized to the extent that they potentially could be. In the relevant fraud detection standards in the U.S. (SAS 99) (AICPA, 2002) and internationally (ISA 240) (IFAC (International Federation of Accountants), 2005), personality traits and ethics are mostly covered under the rubric of “attitude”. In SAS 99, for example, this concept is not defined as such. The standard only refers to “some individuals [which] possess an attitude, character, or set of ethical values” (Para. 7). Therefore, our paper suggests that auditors should place greater consideration on the moral factor in the officially promulgated auditing standards in order to enhance the ability of auditors to be more effective in detecting corporate fraud.

We contribute to the existing literature on corporate fraud in the following ways: (1) from a theoretical perspective, we demonstrate a complementarity between the fraud triangle and the TPB as they are applied to fraud; (2) from a methodological perspective, we examine documented behaviors of corporate fraud cases, as identified by the press\(^5\), and not intentions of behaviors as previous studies did and (3), from a regulatory perspective, we highlight the incompleteness of fraud related auditing standards.

The remainder of this paper is organized as follows. The next section presents our theoretical framework, which is based on the fraud triangle and the TPB. The following section discusses our sample, research design and results. The last two sections present a discussion (with limitations) and some directions for future research.

**Corporate fraud: the theoretical framework**

Several conceptual frameworks have been put forward to investigate why managers engage in corporate fraud. In this section, we define the concept of fraud and the “fraud triangle”\(^6\) that leads to the pertinent auditing standards regulation. We will then highlight two complementary perspectives, the fraud triangle and the TPB that are of potential use to understand fraud.

\(^5\) Uzun et al. (2004) also used cases as identified in the financial press, but with a focus on governance mechanisms.

\(^6\) Loebbecke et al. (1989) use a reasoning equivalent to the “fraud triangle” and call it a “model”.
We are interested in accounting or corporate “fraud”, as defined in SAS No. 99 (AICPA, 2002, Para. 5): “fraud is an intentional act that results in a material misstatement in financial statements that are the subject of an audit”. Two types of misstatements are relevant to the auditor’s consideration of fraud—misstatements arising from fraudulent financial reporting and misstatements arising from misappropriation of assets (AICPA, 2002, Para. 6). In this paper, all of the cases that were examined represent documented examples of fraudulent financial reporting. However, some cases, as indicated in Table 1, also include a misappropriation of assets.

In the previous literature, decomposing overall fraud-risk assessments into separate assessments for management’s (1) incentives/pressures, (2) opportunities and (3) rationalizations/attitudes is often referred to as the fraud-triangle decomposition (Wilks & Zimbelman, 2004) or, in short, the fraud triangle. These elements were first identified by Sutherland (1949), and developed by Cressey (1953, p. 30). Albrecht et al. (1982, p. 37) adapted the concept from criminology to accounting and reinforced the decomposition with a review of over 1,500 references on fraud. Albrecht et al. identified 82 fraud-related variables which they combined into three forces: situational pressures, opportunities to commit fraud and personal integrity (character).

Auditing regulation (AICPA, 1988, 1997, 2002) has outlined numerous fraud-risk factors. These indicators are also called “red flags” and represent “potential symptoms existing within the company’s business environment that would indicate a higher risk of an intentional misstatement of the financial statements” (Price Waterhouse, 1985, p. 31; Pincus, 1989, p. 154).

For example, SAS No. 82 (AICPA, 1997) identified three categories of risk factors: (1) management’s characteristic and influence over the control environment, (2) industry conditions and (3) operating characteristics and financial stability. The same standard highlights two factors: (1) susceptibility of assets to misappropriation and (2) control, when it takes into account the risk factors relating to the second category of misstatements, those arising from misappropriation of assets.

Compared to its predecessors, the most recent standard, SAS No. 99 (AICPA, 2002, Para. 7) has structured the risk factors around three conditions which generally are present when fraud

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7 Albrecht et al. (1982, p. 34) and Comer (1977, p. 10-11) present Cressey’s theory.
occurs. “First, management or other employees have an incentive or are under pressure, which provides a reason to commit fraud. Second, circumstances exist—for example, the absence of controls, ineffective controls, or the ability of management to override controls—that provide an opportunity for a fraud to be perpetrated. Third, those involved are able to rationalize committing a fraudulent act. Some individuals possess an attitude, character, or set of ethical values that allow them to knowingly and intentionally commit a dishonest act” (italics in the original text). These definitions are directly linked to the fraud triangle.

Empirical research has already been carried out to demonstrate the importance of the “incentives” factor in the commitment of the fraud, namely because of aggressive earnings target (Albrecht & Romney, 1986; Loebbecke, Eining & Willingham, 1989; Bell & Carcello, 2000). However, when we look closer at the evolution of the regulation, we observe that there is an increasing concern for fraud in auditing regulation and an increasing integration of the attitudes/rationalizations factor. The individualization of this concept constitutes an improvement in the evolution of the auditing standards (from SAS 53 to SAS 998). However, if we pay more attention to the relevant section of SAS 99 quoted above, “attitude”, although highlighted with the italicized characters, is one of the individual’s characteristics: as mentioned earlier, the text also mentions the “character and set of ethical values” of the individual. The text does not explicitly define the concept of attitude. Further, in the “examples of fraud risk factors” relating to fraudulent financial reporting (AICPA, 2002, p. 44, Appendix), section “Attitudes/Rationalizations”, the first example concerns the “Ineffective communication, implementation, support, or enforcement of the entity’s values or ethical standards by management or the communication of inappropriate values or ethical standards”. This item is mostly related to the firm’s ethics. No other item focuses directly on behavior, including individual ethics or managers’ personality traits.9 This discussion leads us to a preliminary conclusion: the question of the comprehensiveness of auditing guidelines in relation to this factor remains open to further investigation. Thus, the concept of attitude, which proxies for the

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9 The international auditing standard ISA 240 (IFAC (International Federation of Accountants), 2005), treats ethics in a similar manner as SAS 99. However, the individual “morale” (and not morals) is mentioned. We carried out a line by line comparison of SAS 99 and ISA 240 with regard to the “examples of risk factors” provided in the appendix of each standard (see Appendices 1 and 2). Apart from a few wording differences, we noticed that a few items are present in ISA 240 and absent in SAS 99 (see Table 1).
manager’s behavior, is not defined as such in the auditing standards, hence the necessity to refer to a second theory to understand this concept.

Theory of planned behavior (TPB)

In the social psychology field, Ajzen (1991, p. 179, 2001) emphasizes the role of intentions in explaining behaviors and posits that intentions to perform behaviors of different kinds can be predicted with high accuracy from (1) attitudes toward the behavior, (2) subjective norms and (3) perceived behavioral control. This is known as the theory of planned behavior (TPB).

According to Ajzen (1991, p. 188), the “attitude toward the behavior … refers to the degree to which a person has a favorable or unfavorable evaluation or appraisal of the behavior in question”. Bailey (2006, p. 804-805) adds that the “attitude” toward the behavior is determined by a person’s beliefs that the behavior leads to certain outcomes and the person’s evaluation of those outcomes as favorable or unfavorable. A “subjective norm” refers to the social pressure a person feels from important others to perform or refrain from performing the behavior and to the person’s motivation to comply with those pressures (Hess, 2007, p. 1785). Finally, “perceived behavioral control” refers to an individual’s perception of the ease or difficulty of performing the behavior of interest (Ajzen, 1991). In other words, it represents the person’s ability to perform the behavior, based on their past experience, competence and any expected obstacles they may face (Hess, 2007, p. 1785). Perceived behavioral control represents “self-efficacy beliefs” (Ajzen, 1991, p. 184). The TPB is an extension of the “Theory of Reasoned Action” (TRA hereafter) (Fishbein & Ajzen, 1975; Ajzen & Fishbein, 1980) which only included the first two components of the model (attitude and subjective norms).

As noted by Hess (2007, p. 1784), the TPB is a “parsimonious model but has significant power in explaining variations in intentions. The simplicity of the model also makes it useful for understanding and explaining the various studies that have been conducted on ethical behavior in organizations”.

TPB and TRA have already been used to explain the intentions of fraudulent financial reporting. Beck and Ajzen (1991) apply the TPB to the prediction of dishonest actions.\(^1\) They showed that the TPB predicted intentions with a high degree of accuracy, and that it was moderately successful in the prediction of actual behavior.

\(^{10}\) A good example of subjective norms and “significant others” is provided by Abernethy and Vagnoni (2004, p. 211) who focus on the power of physicians in hospitals, as this is the group that has traditionally been the dominant coalition in hospitals.

\(^{11}\) They showed that the TPB predicted intentions with a high degree of accuracy, and that it was moderately successful in the prediction of actual behavior.
study, they add a fourth concept: personal feelings of moral obligation, i.e., the responsibility to perform or refuse to perform a certain behavior. “Moral norms” (or “moral obligation”) can be considered as an additional determinant of intentions in situations where ethical behavior is involved (Ajzen, 1991, p. 199; Hess, 2007, p. 1785-1786). In addition to one’s own moral belief system, these moral obligations can be derived from laws, professional code or ethics, and other similar sources.

Gillett and Uddin (2005) test a structural model based on TRA, including attitude, size, and compensation structure. Based on responses from 139 CFOs they find that the model globally explains the intentions of fraudulent reporting and that attitude and size are the main drivers of fraud. Further, Carpenter and Reimers (2005) find, with a survey analysis and an experiment, that the TPB can help explain unethical and fraudulent financial reporting.12

Combining fraud triangle and theory of planned behavior (TPB)

Both theoretical frameworks (fraud triangle and the TPB) have already been used to analyze fraud behavior, but until now they have been used separately by researchers. For instance, Carpenter and Reimers (2005) who applied the TPB to the prediction of fraudulent reporting did not use the fraud triangle in their design.

Before analyzing the fraud cases we identified, we combine the fraud triangle and the TPB to explain fraud behavior. Figure 1 details the combined theories. These two theories do not share the same concept of attitudes. The “attitudes” concept, in the fraud triangle, is a broad concept which encompasses the three traditional dimensions of the TPB: attitude, subjective norms and perceived behavioral control. It can also include the fourth dimension mentioned above: moral obligation because “it seems likely that moral issues are salient in the case of … dishonest behaviors” (Beck & Ajzen, 1991, p. 289). We then use the concept of “extended TPB” in Figure 1, because of the inclusion of the fourth component.

The second and third components of the fraud triangle, the “incentives/pressures” and “opportunities” are not covered by the TPB because they represent external stimuli for the fraud behavior. For instance, opportunities could be considered as an actual behavioral control, while “perceived behavioral control”, as indicated by its name, reflects the person’s perception of how easy or difficult it is to engage in the particular behavior (Bailey, 2006, p. 804-805). However,  

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12 Almer et al. (2003) use the TPB (without explicitly testing for it) to understand factors that lead to the adoption of flexible work arrangements.
the concept of “opportunities” is familiar to Beck and Ajzen (1991, p. 286-287) who acknowledge that the actual behavior will depend not only on one’s desire or intention, but “also on such partly non-motivational factors as availability of requisite opportunities and resources (e.g., time, money, skills, cooperation of others, etc.). Collectively, these factors represent people’s *actual control* over the behavior” (italics in the original text).

In summary, the TPB allows detailing the broad and undefined concept of “attitudes” in the fraud triangle. The intention to engage in fraud is then the aggregation of the TPB (attitude, subjective norms and perceived behavioral control), incentives/pressures and opportunities.

**Insert Figure 1 About Here**

Given that the fraud triangle and the TPB, as shown in Figure 1, are complementary theories, we will use the combined theories in the rest of this article. We label this association “FT/TPB” (for “fraud triangle/theory of planned behavior applied to fraud”).

In this study, we are interested in behavior (including personality traits and ethics), mainly at the individual level. The individual’s role is relevant because as noted by Sauer (2002, p. 956), a company engages in financial fraud only if its reasons for doing so are consonant with the specific motivations of the individuals who control its reporting process. Further, Hess (2007, p. 1787) argues that the studies which have used the TPB to explain unethical behavior have found that the determinant, that has the greatest impact on individual intentions is attitude (see, e.g., Carpenter & Reimers, 2005). Previous studies also show that auditors generally perceive “attitude” factors to be more important warning signs of fraud than “situational” factors (Heiman-Hoffman, Morgan & Patton, 1996).

**Managers’ behavior in real-life cases of corporate scandals**

*Research questions*

Based on the above literature review and the potential of incorporating to a greater extent behavioral factors into corporate fraud detection auditing guidelines, we will examine two research questions (RQs).

**RQ1:** Can the fraud triangle/theory of planned behavior (FT/TPB) framework be applied to explain ex-post alleged or acknowledged fraud cases? In other words, are the actual reasons behind fraud, as mentioned in the press articles, in line with the categories of the FT/TPB?
RQ2: If the FT/TPB framework is validated, are the new auditing regulations comprehensive enough to effectively aid fraud detection? In other words, are some categories of the FT/TPB sufficiently reflected in current auditing standards, when compared with their relevance in actual fraud cases?

Sampling and research design

To complement prior literature (Carpenter & Reimers, 2005; Gillett & Uddin, 2005), we examine documented behaviors in 39 cases of corporate scandals, using evidence taken from press articles such as managers’ quotes and journalists’ analyses. Media’s role as a monitor for accounting fraud has been recently studied (Miller, 2006; Dyck, Morse & Zingales, 2007) and has been shown to be important due to the pressure it places on management (Dyck, Volchkova & Zingales, 2008). Although we recognize that the media may have incentives to highlight fraudulent behavior to sell newspapers, the press still fulfills two main roles. First, by rebroadcasting information from other intermediaries (auditors, analysts, lawsuits), the press appears to play a role by attracting the attention of institutions that may take actions (e.g., regulatory bodies, consumer groups, investment funds) (Dyck, Volchkova & Zingales, 2008). Second, the press can issue new information by undertaking original investigation and analysis. Miller (2006) has documented a negative reaction of markets after the issuance of reporter investigation, which suggests that the press plays an important role as a monitor or information intermediary in financial markets.

To design our sample, we started from the Corporate Scandal Fact Sheet13, which includes a list of 61 short vignettes on companies. We deleted from this list several companies which are linked to other companies involved in different scandals: accounting firms (e.g., Andersen, KPMG) and banks (e.g., Citigroup, Morgan Stanley). We also deleted from the list companies that had no data available on the personality of the managers (e.g., Cornell). Finally, we added three companies that do not appear in the Corporate Scandal Fact Sheet but had received a lot of adverse publicity and for which press articles were available (AIG, Delphi and Freddie Mac). The resulting sample includes 39 companies. For the sake of comparability in interpretation, we only used U.S. cases. However, we also included Royal Ahold, although it is a Dutch group, because the corporate scandal was mainly based in its U.S. subsidiary – U.S. Food Service.

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13 Available at the following address: http://www.citizenworks.org/corp/corp-scandal.php.
To evaluate the research questions, we searched for evidence from the press in the Factiva\textsuperscript{14} database. SEC documents\textsuperscript{15} listed in Appendix 3 were not directly used to fill Table 1 but only to understand the technical and accounting aspects of the corporate fraud. For some companies (Adelphia Communications, Enron, MicroStrategy, Rite Aid, Sunbeam, Waste Management, and Xerox), we also used the GAO report (United States General Accounting Office, 2002) on restatements.

Table 1 isolates the three main influences known to be indicators of corporate fraud according to the fraud triangle and the TPB:

- Incentives
- Opportunities
- Attitudes/Rationalizations (split into four sub-columns) (corresponding to attitude, subjective norms, perceived behavioral control and moral obligation).

To enhance reliability, two different researchers analyzed separately the same press articles on a sample of 10 cases. The major issue was the extraction of the relevant pieces of information from the articles and the allocation of these pieces of information to the columns of Table 1. The result was a 95\% rate of convergence which indicates that the coding showed strong signs of reliability. The only source of divergence arose because the pressure from analysts is mentioned in two different examples of the appendices of SAS 99: in the incentives/pressures, § 2.1 (see Appendix 1) mentions the “Excessive pressure … to meet the requirements or expectations of third parties due to … trend level expectations of … analysts” while, in the “attitudes/rationalizations” section of SAS 99, Para. 5 refers to “a practice by management of committing to analysts … to achieve aggressive or unrealistic forecasts”. An examination of the two paragraphs suggests that the first one refers to the pressure exerted by analysts while the second one deals with the attitude of the managers to commit to or to accept this pressure. In other words, an “external incentive” becomes an “internal incentive” only when internalized by the individual. Internalization is based on attitudes, values and beliefs. This discussion illustrates the difficulty to classify some elements of the fraud cases between “incentives” and “attitudes/rationalizations”. For example, the “reputation at stake” may both refer to external pressures (social expectations) and to internal commitment to these pressures (fear of loss of

\textsuperscript{14} www.factiva.com.
\textsuperscript{15} www.sec.gov.
reputation). In this case, we have decided to allocate the element to the “attitudes” column (sub-

column “attitude toward the fraud”) because we concluded that the internalization of this pressure

is the cause of the fraudulent behavior.

After resolving this issue, all the other cases were coded by one researcher and five cases

were checked randomly by a second researcher, with no tangible problem. Finally, for the sake of

transparency and replicability, we provide in Appendix 3 the references of press articles and SEC
documents used for each case study.

**Insert Table 1 About Here**

**Analysis of the results**

The numbers displayed after each element of Table 1 refer to the “examples of risk factors”

provided in SAS 99 and ISA 240 (see Appendices 1 and 2). We find that the four last components

(which correspond to the third part of the fraud triangle and the four elements of the extended

TPB) that are heavily related to managers’ personality traits and ethics are present in many cases.

In the same Table 1, the column “opportunities”, which corresponds to a form of “actual

behavioral control” (see above), is completely filled with components found in promulgated

auditing standards (SAS 99 and ISA 240). In several instances, the managers benefited from the

existence of complex transactions (e.g., AIG, Datek Online) and the possibility of “round-trip

trades” (e.g., CMS Energy, Duke Energy, Dynegy, Enron, Homestore.com, Network Associates,

reliant Energy). In other instances, the auditor’s alleged failure perhaps made the fraud easier to

perpetuate (e.g., Cendant, Delphi, Halliburton, HPL Technologies, Merck, Sunbeam, Tyco,

Waste Management, Xerox).

The “attitudes/rationalizations” component is split in four, following the extended TPB:

“attitude toward the fraud”, “subjective norms”, “perceived behavioral control” and “moral

obligation”. We explain below how each column of this last component is defined. It appears that

since the columns of Table 1 are generally filled, the actual reasons behind fraud, as mentioned in

the press articles, are in line with the categories of the FT/TPB.

Interestingly, several examples noted in the auditing standards and corresponding to the

“attitude toward the fraud” component of the TPB are found in the case studies (column 3 of

Table 1):

- Para. 4 (SAS 99 and ISA 240): “Excessive interest by management in maintaining or

  increasing the entity’s stock price or earnings trend”: represented by stock options (Ahold,
AIG, AOL, Bristol-Myers Squibb, Computer Associates, Freddie Mac, Halliburton, Peregrine Systems, WorldCom and Xerox), and the fluctuations on company’s stock price (AIG). This evidence is in line with Coffee (2005) who states that “when one pays the CEO with stock options, one creates incentives for short-term financial manipulation and accounting gamesmanship” (p. 202). Several empirical studies have confirmed the role of stock options as incentives in cases of restatements (Efendi, Srivastava & Swanson, 2007) or securities fraud allegations (Denis, Hanouna & Sarin, 2006). In the same vein, Cheng and Warfield (2005) found that corporate managers with equity incentives engage more frequently in earnings management and Bergstresser and Philippon (2006) document that earnings management is more pronounced at firms where the CEO’s potential total compensation is more closely tied to the value of stock and option holdings. Our evidence is not surprising, given that our sample-firms are from the U.S., (with one exception; see above the description of the sample) and given the explanation of Coffee (2005) on the importance of stock options in the composition of compensation in the United States.

- Para. 5 (SAS 99 and ISA 240): “A practice by management of committing to analysts, creditors, and other third parties to achieve aggressive or unrealistic forecasts,” was found in both Adelphia Communications and Network Associates.

- Para. 9 (ISA 240): “The owner-manager makes no distinction between personal and business transactions”. It should be noted that this example taken from ISA 240 could also be considered as a case of misappropriation of assets. Interestingly, we found several instances of the use of personal expenses paid for by the company’s resources (Cendant, Enron, Global Crossing, HealthSouth, K-Mart, Peregrine Systems, Phar-Mor, and Tyco). In Adelphia Communications, the fraud consisted of the improper use of the company’s funds for self-dealing by the Rigas family. The money was used to buy stock and luxury condominiums in Mexico, Colorado and New York City, to construct a golf course of $12.8 million, to purchase timber rights to land in Pennsylvania and to pay off margin loans.16

The examples provided in the auditing standards in relation to misappropriation of assets (see Appendix 2) are difficult to find in press articles. For example, we were able to identify only one case of “changes in behavior or lifestyle that may indicate assets have been misappropriated”:

Charles Wang, CEO of Computer Associates, and Sanjay Kumar, COO, wanted to pocket the money resulting from the increase of their stock options to buy expensive cars (Ferrari Maranello, Land Rover) and holiday homes.\textsuperscript{17} Several cases of extremely high living standards, but not necessarily changes in the lifestyles, are often mentioned (see below).

However, several explanations we found to explain the fraud-related behaviors and relating to attitude toward the fraud and the three other components of the TPB are not present in the auditing standards (see RQ2). All of these elements are identified in italics in Table 1. Starting with the “attitude toward the fraud” component of the TPB (column 3 of Table 1), we found two categories of explanations not present in auditing standards: (1) To maintain a high living standard, sometimes linked to a passion for sports and (2) Reputation at stake. Thus, using Ajzen’s (1991) definition of “attitude toward the behavior”, these elements can help explain why a person has a favorable attitude towards the consequences associated with the actions that lead to fraud.

Anecdotal evidence exists in the press to highlight these two elements. For example, to maintain a high living standard, former Tyco CEO Dennis Kozlowski acquired a “$6,000 shower curtain for his highfalutin apartment” (Jennings, 2006b, p. 2-3). Martin Grass, CEO of Rite Aid Corporation, and Jeffrey Citron, CEO of Datek Online, had something in common: they liked to commute to work by personal helicopter.\textsuperscript{18} Several CEOs had a real passion for sports which perhaps influenced them to commit fraud. Mickey Monus “borrowed” about $10 M of Phar-Mor’s funds to cover the debts of one of his sports team: the World Basketball League. As he controlled more than 60% of the teams, he was responsible for the WBL’s expenses and losses. Whenever the league needed cash, he drew money from the company.\textsuperscript{19} Philip Anschutz, Qwest’s Chairman, wanted to finance his burgeoning sports and entertainment empire. He liked to be seen as a “sports and entertainment

Thus, it appears that the need to prove themselves as “players” in the field of sports, led at least some executives to be susceptible to lapses in moral judgments and behaviors.

The “subjective norms” component of the TPB (column 4 of Table 1), which represents the opinion of “significant others” are less prevalent in the press, probably because it is more difficult to be identified, even in the ex-post perspective of journalists. We found a few cases where the managers were heavily influenced by some other individuals in the firm to commit fraud (e.g., Phar-Mor and the importance of the CEO). In the case of WorldCom, the personality of the CEO had an impact on the behavior of the CFO.

The “perceived behavioral control” (column 5 of Table 1), as explained earlier, represents the perceived ease or difficulty of performing the fraud. It can also be referred to as the “self-efficacy beliefs” of the fraud perpetrator. As we posit that praise/admiration from the press and some personality traits contribute to these self-efficacy beliefs, we included in this column all the elements from the press pertaining to these two explanations.

Several managers of the studied firms were indeed praised/admired by the press or benefited from a superlative or a very favorable image. For example, Cal Turner, Dollar General’s CEO, was considered a “marketing genius,”21 while Jeffrey Citron (Datek Online) had been heralded as a “technology wizard” by Forbes magazine and as “one of the 20 most important players on the financial Web” by Institutional Investor.22 Corporate America treated Al Dunlap [Sunbeam’s CEO known as “Chainsaw Al”] as “a miracle worker and he did everything possible to promote this image”.23 It appears that the managers believed in their own press and were susceptible to do almost anything to keep the favorable image intact.

Several egregious personality traits are also found in the CEOs involved in the cases studied. Network Associates’ CEO, Bill Larson, is a good example of tyrannical behavior. He was prone to bullying his employees, giving them unreachable targets to meet and berating them if they failed. He liked to remind managers that “suicide was sometimes an appropriate response to

20 Smith, J. (2002). Is troubled Qwest missing Anschutz’s golden touch? Ailing stock, SEC probe and management questions are pulling Qwest’s billionaire founder away from his sports and entertainment empire. *Rocky Mountain News*, April 27, 1C.
failure”. In the grand jury indictment, Martin Grass (Rite Aid Corporation), “emerged as an arrogant bully, pressuring underlings to endorse phony documents and bragging that coverups would never be discovered”. Grass even threatened Rite Aid’s accounting firm, KPMG, retaliation if the Company suffered as a result of the audit. In a different style, Michael Monus (Phar-Mor) fascinated his co-executives. He was the mastermind of the fraudulent scheme and encouraged a form of hero worship. For example, Patrick B. Finn, the CFO and Senior VP, who orchestrated the fraud with Monus, characterized Monus as “his god”. This resulted in a blind loyalty to Monus and his orders were followed without any substantive checks and balances.

Finally, we identified the “moral obligation” component of the TPB (column 6 of Table 1) on the basis of Beck and Ajzen (1991, p. 293) who refer to the feeling of guiltiness in one of the questions they used to evaluate this component of the behavior. We identified one major argument put forward by managers and which, in our view, reduces their guiltiness: the fact that their actions helped other people or organizations via their work with charitable causes (Adelphia Communications, Computer Associates, Enron, Freddie Mac, HealthSouth, and WorldCom) or the fact that the managers felt that they were acting for the good of the company (Ahold). For example, at Adelphia, Charles Wang was a “caring executive who reportedly ends every meeting by talking about the charities he’s working on”. Richard Scrushy (HealthSouth) used his money also for seemingly good purposes: he donated to charities and gave money for the creation of a church.

Table 2 summarizes the elements of fraud behavior not present in auditing standards.

Insert Table 2 About Here

27 The addition of “perceived moral obligations” to the prediction equation improved prediction of reported lying behavior, but did not help to account for much variance in cheating and shoplifting.
Discussion and limitations

This study provides evidence that the theoretical framework we use (the FT/TPB) is relevant when matched with cases of corporate frauds (RQ1), although some progress could be made in the coverage of the “subjective norms” concept. However, our findings related to RQ2 (the comprehensiveness of auditing standards) are much more mitigated. We acknowledge that, in line with SAS 99, risk factors reflective of attitudes/rationalizations by board members, management, or employees, that allow them to engage in and/or justify fraudulent financial reporting and misappropriation of assets, may not be susceptible to observation by the auditor. However, we should recall that, as stated by SAS 99 (p. 47, 50), “the auditor who becomes aware of the existence of such information should consider it in identifying the risks of material misstatement arising from fraudulent financial reporting [or] misappropriation of assets”.

Our results are consistent with and reinforce this statement from SAS 99. Economic motivations (“incentives”) exist in almost all companies. However, it is still evident that not all managers enter into corporate fraud. The psychological aspects of the individual manager and the existence of opportunities to engage in fraud both play an important role in explaining the fraud. Consequently, the auditing regulation should be extended to better integrate the attitudes/rationalizations component (with the four sub-divisions related to the TPB). SAS 99 should include more examples of ethical behavior and ISA 240 should also be modified because many examples we found are not covered properly by this standard. Moreover, the quasi-absence of the subjective norms, one of the components in the TPB, in our press analysis points to the apparent lack of interest for this concept by the press as well as not being prevalent in the auditing standards. One explanation for this finding is that it may be difficult for the press to accurately ascertain the subjective norms of individuals.

Our study is not the first to stress the incompleteness of auditing standards. Loebbecke et al. (1989, p. 4) explain that in their previous work (Loebbecke & Willingham, 1988) where they applied the equivalent of the fraud triangle to fraud cases as identified by the SEC, they found some inaccuracy and incompleteness in the SAS list [of risk factors]. However, this survey was based on SAS 53 and our research uses the more recent SAS 99. Although the auditing standards have been improved over time, as mentioned earlier, there is still room for improvement.

From a practical point of view, the auditing standard SAS 99 could perhaps be enhanced by adding the following non comprehensive list to the fraud-risk factors displayed in its appendix:
- The manager has a very high living standard which could lead him/her to unethical/fraudulent decisions.
- The manager has a personality, namely tyrannical or autocratic which does not favor a collective and sound culture in the firm. This personality makes it difficult to promote an honest dialogue between all levels of the hierarchy.
- The manager has benefited from articles of praise from the press. This situation, which is not problematic, *per se*, has given the manager a high level of self-confidence that may at times lead to promoting one’s press at any cost. The manager has lost perspective about his/her authority and judgment even being questioned.
- The manager has benefited from a dominant position in respect to other employees. This situation is not problematic *per se*. However, the employees have such a respect for their manager (or are so impressed) that some checks and balances might disappear. The employees cannot critically evaluate what the manager requires from them is unethical or fraudulent.

In summary, the auditors should better integrate the attitudes component when evaluating the potential for fraud and the press is a potentially useful tool to understand the managers’ personality. Thus, our exploration of fraud cases reinforces the conclusion of Martin (2007) who addresses the demand for auditors to assess the integrity and ethical values of clients. This is already part of the control environment audit mandated by the Sarbanes-Oxley Act (2002) in section 404. The audit requires auditors to evaluate controls via a framework which lists management control philosophy as an important element of the control environment. Auditors should place a special emphasis on evaluating the ethics of individuals through the assessment of attitude, subjective norms, perceived behavioral control and moral obligation, the components of the TPB (see Figure 1).\(^{30}\)

The advantage of the TPB is that it allows auditors, researchers and regulators to understand the role that the elements underlying the attitude (in a broad sense) play in perpetuating fraud.

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\(^{30}\) Our study is also in line with past research (Gillet & Uddin, 2005) which highlighted the importance of red flags questionnaires, although Pincus (1989) found mixed results concerning the efficacy of these red flags, and automated decision aids to improve the auditor’s ability to detect fraud. Further, this study is in line with Jennings (2006b, 2006a) who identifies “seven signs of ethical collapse”, which we can classify into the three dimensions of the fraud triangle and the TPB: (1) incentives (“sign 1: Pressure to meet numbers”), (2) opportunities (“sign 4: A weak board”, “sign 5: Conflicts of interest”) and (3) incentives/rationalizations (“sign 2: Fear and silence”, “sign 3: Sycophantic executives and an iconic CEO”, “sign 6: Over-confidence”, “sign 7: Social responsibility is the only measure of goodness”).
example, using Ajzen’s (1991) methodology, auditors can look at the perception managers have of the consequences of committing fraud and the perceived likelihood that managers have that these consequences will occur. Further, other elements of the TPB can be examined as well. For example, auditors may look at the role important referents (such as their spouse or colleagues) play on influencing a manager to commit or not commit fraud (importance of subjective norms).

Auditors must also place emphasis on evaluating the organizational culture. As explained by Carpenter and Reimers (2005, p. 118), attitudes for managers can be shaped by the firm’s culture and direction of top executives and the board of directors. This view is also supported by the work of Kemmerer and Shawver (2007). They argue that the responsibility for ethical behavior rests upon the organization and the organizational values. Thus, a person may be more likely to behave unethically if the perceived consequences will not be punished but rewarded (Carpenter & Reimers, 2005, p. 118). Further, auditors should evaluate the fairness of the work climate (Cohen, Holder-Webb, Sharp & Pant, 2007). For example, are some employees overworked or ill compensated? If so, this situation could lead to resentment and possible cheating.

Finally, a limitation of our results arises in that we don’t mean to imply that the red flags we identified from the press will always lead to corporate fraud. The majority of managers who have a high standard of living and have been identified as high-profile leaders will probably not engage in fraudulent acts. However, we believe that the existence of these red flags is a relevant indicator of a potential fraud. Cooper (2008), in the book telling her story as the WorldCom’s whistleblower, explains that the accountants who accepted the order to record the fraudulent entries took into consideration the personality of the managers to rationalize their behavior: “Troy [one of the involved accountants] wonders if maybe he’s making too much out of this. After all, Scott [the CFO]’s very smart and highly regarded. He must know what he’s doing” (p. 7). In this example, the fact that the CFO was considered a “financial wizard”, if it did not generate a fraudulent behavior per se, played a major role in the “rationalization” phenomenon by the accountants pushed to behave fraudulently.

Another limitation is related to the ex-post rationalization phenomenon. If we don’t exactly know what caused the fraud, every reason that seems appropriate is welcome and press articles have to tell consistent stories. Although as stated earlier the press may have incentives to highlight fraud in order to sell papers, the press articles are generally based on facts and actual testimonies which work to reduce the weight of the rationalization. Choo and Tan (2007) also
used anecdotal elements in their research mentioned earlier. Finally, in the case of attributes, there may be a “fundamental attribution error” (or “correspondence bias”). For example, individuals have a tendency to assume that a person’s actions depend on what “kind” of person that person is rather than on the social and environmental forces influencing the person (Gilbert & Malone, 1995) and the bias is reinforced when explaining someone else’s failures.

**Future research**

In the field of social sciences, evidence is not always easily objective, especially if we consider the main topic of our study: corporate fraud. However, our analysis is based on quotes from the involved managers, which represent a first level of evidence and, more generally, on press articles which constitute a second level of evidence. We found an extensive number of press articles on the studied cases, and no case of inconsistency among the articles, which is a sign of reliability of the sources used in this study. A future study can explore different qualitative methods to ascertain the reliability and objectivity of these sources.

In our analysis, we have granted an equal weight to the three major components of the combined: FT/TPB: incentives, opportunities and attitudes. In actuality, the weights of the three components can vary from situation to situation. When the weight of the economic motivations is too high, the ethical threshold potentially decreases, and vice versa. When there are numerous opportunities, the probability to commit a fraud is high. One area of future research would be to investigate the relative weight of each component for different types of fraud.

For the sake of simplicity and consistency, we focused on U.S. cases of alleged or acknowledged corporate frauds. However, fraud is of course not limited to the U.S. and many countries have faced similar situations. It would be interesting to extend the scope of study to non-U.S. companies (e.g., Parmalat – Italy –, Shell – U.K./Netherlands, Marionnaud – France, etc.) to investigate the robustness of our results in different cultural and institutional contexts.

Finally, our results could be useful in two contexts. First, forensic auditing could benefit from the combined fraud triangle/TPB theories in order to develop new red flags for forensic

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31 Money shifted from Parmalat’s coffers to loss-making travel businesses controlled by the founder’s family.
32 Overestimation of oil reserves.
33 Underestimation of the accrual for gift certificates.
34 Definition of the Institute of Forensic Auditors: “Forensic audit is the activity that consists of gathering, verifying, processing, analyzing of and reporting on data in order to obtain facts and/or evidence - in a predefined context - in
auditors. Second, the decision taken by auditors to accept new clients or to discontinue the service provided to a current client could also include a risk assessment based on these combined theories.

the area of legal/financial disputes and or irregularities (including fraud) and giving preventative advice” (http://www.ifa-iaf.be/v1/frontEnd/presentation/introduction.html).
Appendix 1: Comparison SAS 99 – ISA 240: Risk factors relating to misstatements arising from fraudulent financial reporting

The following elements are examples of risk factors relating to misstatements arising from fraudulent financial reporting. They are taken from SAS 99 and ISA 240. We display both classifications: letters in SAS 99 and figures in ISA 240. The figures in italics have been added by the authors for a better reference to the examples in Table 1.

There are two types of differences between the two standards:
- Type 1: wording difference: “board of directors or audit committee” (SAS 99) vs. “those charged with governance” (ISA 240); other wording difference: “reportable conditions” (SAS 99) vs. “material weaknesses in internal control” (ISA 240)
- Type 2: content difference: areas covered by ISA 240 but not by SAS 99.

<table>
<thead>
<tr>
<th>Incentives/Pressures</th>
<th>SAS 99</th>
<th>ISA 240</th>
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<tbody>
<tr>
<td>a./1.</td>
<td>Financial stability or profitability is threatened by economic, industry, or entity operating conditions, such as (or as indicated by) the following:</td>
<td></td>
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<tr>
<td>1.1</td>
<td>High degree of competition or market saturation, accompanied by declining margins.</td>
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<tr>
<td>1.2</td>
<td>High vulnerability to rapid changes, such as changes in technology, product obsolescence, or interest rates.</td>
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<tr>
<td>1.3</td>
<td>Significant declines in customer demand and increasing business failures in either the industry or overall economy.</td>
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<tr>
<td>1.4</td>
<td>Operating losses making the threat of bankruptcy, foreclosure, or hostile takeover imminent.</td>
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<tr>
<td>1.5</td>
<td>Recurring negative cash flows from operations or an inability to generate cash flows from operations while reporting earnings and earnings growth.</td>
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<tr>
<td>1.6</td>
<td>Rapid growth or unusual profitability especially compared to that of other companies in the same industry.</td>
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<tr>
<td>1.7</td>
<td>New accounting, statutory, or regulatory requirements.</td>
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<tr>
<td>b./2.</td>
<td>Excessive pressure exists for management to meet the requirements or expectations of third parties due to the following:</td>
<td></td>
</tr>
<tr>
<td>2.1</td>
<td>Profitability or trend level expectations of investment analysts, institutional investors, significant creditors, or other external parties (particularly expectations that are unduly aggressive or unrealistic), including expectations created by management in, for example, overly optimistic press releases or annual report messages.</td>
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</tr>
<tr>
<td>2.2</td>
<td>Need to obtain additional debt or equity financing to stay competitive, including financing of major research and development or capital expenditures.</td>
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<td>2.3</td>
<td>Marginal ability to meet exchange listing requirements or debt repayment or other debt covenant requirements.</td>
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<tr>
<td>2.4</td>
<td>Perceived or real adverse effects of reporting poor financial results on significant pending transactions, such as business combinations or contract awards.</td>
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<tr>
<td>c./3.</td>
<td>Information available indicates that management or the board of directors’ personal financial situation is threatened by the entity’s financial performance arising from the following:</td>
<td>Information available indicates that the personal financial situation of management or those charged with governance is threatened by the entity’s financial performance arising from the following:</td>
</tr>
<tr>
<td>3.1</td>
<td>Significant financial interests in the entity.</td>
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<tr>
<td>3.2</td>
<td>Significant portions of their compensation (for example, bonuses, stock options, and earn-out arrangements) being contingent upon achieving aggressive targets for stock price, operating results, financial position, or cash flow.</td>
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<tr>
<td>3.3</td>
<td>Personal guarantees of debts of the entity.</td>
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<tr>
<td>d./4.</td>
<td>There is excessive pressure on management or operating personnel to meet financial targets set up by the board of directors or management, including sales or profitability incentive goals.</td>
<td>There is excessive pressure on management or operating personnel to meet financial targets established by those charged with governance, including sales or profitability incentive goals.</td>
</tr>
<tr>
<td>Opportunities</td>
<td>ISA 240</td>
<td></td>
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<td>-------------------------------------------------------------------------------</td>
<td>-------------------------------------------------------------------------</td>
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<tr>
<td>a./1. The nature of the industry or the entity’s operations provides</td>
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<tr>
<td>opportunities to engage in fraudulent financial reporting that can arise</td>
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<td>from the following:</td>
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<tr>
<td>1.1 Significant related-party transactions not in the ordinary course of</td>
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<tr>
<td>business or with related entities not audited or audited by another firm.</td>
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<tr>
<td>1.2 A strong financial presence or ability to dominate a certain industry</td>
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<tr>
<td>sector that allows the entity to dictate terms or conditions to suppliers</td>
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<tr>
<td>or customers that may result in inappropriate or non-arm’s length transactions.</td>
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<tr>
<td>1.3 Assets, liabilities, revenues, or expenses based on significant estimates</td>
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<tr>
<td>that involve subjective judgments or uncertainties that are difficult to</td>
<td>Use of business intermediaries for which there appears to be no clear</td>
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<tr>
<td>corroborate.</td>
<td>business justification.</td>
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<tr>
<td>1.4 Significant, unusual, or highly complex transactions, especially those</td>
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<tr>
<td>close to period end that pose difficult “substance over form” questions</td>
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<tr>
<td>1.5 Significant operations located or conducted across international borders</td>
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<td>in jurisdictions where differing business environments and cultures exist.</td>
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<tr>
<td>1.6 -</td>
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<tr>
<td>1.7 Significant bank accounts or subsidiary or branch operations in [tax</td>
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<td>haven] jurisdictions for which there appears to be no clear business</td>
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<td>justification.</td>
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<td>b./2. There is ineffective monitoring of management as a result of the</td>
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<tr>
<td>following:</td>
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<tr>
<td>2.1 Domination of management by a single person or small group (in a non</td>
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<td>owner-managed business) without compensating controls.</td>
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<tr>
<td>2.2 Ineffective board of directors or audit committee oversight over the</td>
<td>Ineffective oversight by those charged with governance over the financial</td>
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<tr>
<td>financial reporting process and internal control.</td>
<td>reporting process and internal control.</td>
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<tr>
<td>c./3. There is a complex or unstable organizational structure, as evidenced</td>
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<tr>
<td>by the following:</td>
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<tr>
<td>3.1 Difficulty in determining the organization or individuals that have</td>
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<tr>
<td>controlling interest in the entity.</td>
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<td></td>
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<tr>
<td>3.2 Overly complex organizational structure involving unusual legal entities</td>
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<td></td>
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<tr>
<td>or managerial lines of authority.</td>
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<tr>
<td>3.3 High turnover of senior management, legal counsel, or board members.</td>
<td>High turnover of senior management, legal counsel, or those charged with</td>
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<tr>
<td></td>
<td>governance.</td>
<td></td>
</tr>
<tr>
<td>d./4. Internal control components are deficient as a result of the following:</td>
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<tr>
<td>4.1 Inadequate monitoring of controls, including automated controls and</td>
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<tr>
<td>controls over interim financial reporting (where external reporting is</td>
<td></td>
<td></td>
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<tr>
<td>required).</td>
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<td></td>
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<tr>
<td>4.2 High turnover rates or employment of ineffective accounting, internal</td>
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<tr>
<td>audit, or information technology staff.</td>
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<td></td>
</tr>
<tr>
<td>4.3 Ineffective accounting and information systems, including situations</td>
<td>Ineffective accounting and information systems, including situations</td>
<td></td>
</tr>
<tr>
<td>involving reportable conditions.</td>
<td>involving material weaknesses in internal control.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Attitudes/Rationalizations</td>
<td>ISA 240</td>
</tr>
<tr>
<td>---</td>
<td>--------------------------------------------------------------------------------------------</td>
<td>-------------------------------------------------------------------------</td>
</tr>
<tr>
<td>1</td>
<td>Ineffective communication, implementation, support, or enforcement of the entity’s values or ethical standards by management or the communication of inappropriate values or ethical standards.</td>
<td>Known history of violations of securities laws or other laws and regulations, or claims against the entity, its senior management, or board members alleging fraud or violations of laws and regulations.</td>
</tr>
<tr>
<td>2</td>
<td>Nonfinancial management’s excessive participation in or preoccupation with the selection of accounting policies or the determination of significant estimates.</td>
<td>Known history of violations of securities laws or other laws and regulations, or claims against the entity, its senior management, or those charged with governance alleging fraud or violations of laws and regulations.</td>
</tr>
<tr>
<td>3</td>
<td>Known history of violations of securities laws or other laws and regulations, or claims against the entity, its senior management, or board members alleging fraud or violations of laws and regulations.</td>
<td>Known history of violations of securities laws or other laws and regulations, or claims against the entity, its senior management, or those charged with governance alleging fraud or violations of laws and regulations.</td>
</tr>
<tr>
<td>4</td>
<td>Excessive interest by management in maintaining or increasing the entity’s stock price or earnings trend</td>
<td>-</td>
</tr>
<tr>
<td>5</td>
<td>A practice by management of committing to analysts, creditors, and other third parties to achieve aggressive or unrealistic forecasts.</td>
<td>-</td>
</tr>
<tr>
<td>6</td>
<td>Management failing to correct known reportable conditions on a timely basis.</td>
<td>Management failing to correct known material weaknesses in internal control on a timely basis.</td>
</tr>
<tr>
<td>7</td>
<td>An interest by management in employing inappropriate means to minimize reported earnings for tax-motivated reasons.</td>
<td>-</td>
</tr>
<tr>
<td>8</td>
<td>Low morale among senior management.</td>
<td>-</td>
</tr>
<tr>
<td>9</td>
<td>The owner-manager makes no distinction between personal and business transactions.</td>
<td>-</td>
</tr>
<tr>
<td>10</td>
<td>Dispute between shareholders in a closely held entity.</td>
<td>-</td>
</tr>
<tr>
<td>11</td>
<td>Recurring attempts by management to justify marginal or inappropriate accounting on the basis of materiality.</td>
<td>-</td>
</tr>
<tr>
<td>12</td>
<td>The relationship between management and the current or predecessor auditor is strained, as exhibited by the following:</td>
<td>-</td>
</tr>
<tr>
<td>12.1</td>
<td>Frequent disputes with the current or predecessor auditor on accounting, auditing, or reporting matters.</td>
<td>-</td>
</tr>
<tr>
<td>12.2</td>
<td>Unreasonable demands on the auditor, such as unreasonable time constraints regarding the completion of the audit or the issuance of the auditor’s report.</td>
<td>-</td>
</tr>
<tr>
<td>12.3</td>
<td>Formal or informal restrictions on the auditor that inappropriately limit access to people or information or the ability to communicate effectively with the board of directors or audit committee.</td>
<td>Formal or informal restrictions on the auditor that inappropriately limit access to people or information or the ability to communicate effectively with those charged with governance.</td>
</tr>
<tr>
<td>12.4</td>
<td>Domineering management behavior in dealing with the auditor, especially involving attempts to influence the scope of the auditor’s work or the selection or continuance of personnel assigned to or consulted on the audit engagement.</td>
<td>-</td>
</tr>
</tbody>
</table>
### Appendix 2: Comparison SAS 99 – ISA 240: Risk factors relating to misstatements arising from misappropriation of assets (attitudes/rationalizations)

The following elements are examples of risk factors relating to misstatements arising from misappropriation of assets. We reproduce only the elements corresponding to Attitudes/Rationalizations. They are taken from SAS 99 and ISA 240. We display both classifications. The figures in italics have been added by the authors for a better reference to the examples in Table 1.

<table>
<thead>
<tr>
<th></th>
<th>SAS 99</th>
<th>ISA 240</th>
</tr>
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<tr>
<td><strong>Attitudes/Rationalizations</strong></td>
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<td>13</td>
<td>Disregard for the need for monitoring or reducing risks related to misappropriations of assets</td>
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<td>14</td>
<td>Disregard for internal control over misappropriation of assets by overriding existing controls or by failing to correct known internal control deficiencies</td>
<td>Behavior indicating displeasure or dissatisfaction with the entity or its treatment of the employee</td>
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<td>15</td>
<td>Behavior indicating displeasure or dissatisfaction with the company or its treatment of the employee</td>
<td>Behavior indicating displeasure or dissatisfaction with the company or its treatment of the employee</td>
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<tr>
<td>16</td>
<td>Changes in behavior or lifestyle that may indicate assets have been misappropriated</td>
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<td>17</td>
<td>-</td>
<td>Tolerance of petty theft</td>
</tr>
</tbody>
</table>
Appendix 3: References of press articles and SEC documents\textsuperscript{35} used for the case studies

\textbf{Adelphia Communications}


\textbf{Ahold}


\textbf{AIG}

Kadlec, D. (2005). Down... But not out prosecutors are swarming around him, but Hank Greenberg is as focused as ever--and not giving an inch. How he rose so far and fell so fast. \textit{Time}, June 20, 50.


\textbf{AOL}


Loomis, C.J. (2003). Why AOL’s accounting problems keep popping up; The online giant created ad “revenues” out of thin air. Now, it’s got scandals! \textit{Fortune}, 147(8), 85.


\textbf{Bristol-Myers Squibb}


\textbf{Cendant}


\textsuperscript{35} SEC documents listed in this Appendix were not directly used to fill Table 1 but only to understand the technical and accounting aspects of the corporate fraud.


**Computer Associates**


**CMS Energy**


**Datek Online**


**Delphi**


**Dollar General**


**Duke Energy**


Dynegy

El Paso Corporation

Enron
Saporito, B. (2002). Speak no evil; Andrew Fastow built a reputation as Enron’s financial wizard. though he’s refusing to testify, it’s clear he was in over his head. Time, 159(7), 34.
SEC. Enron-related enforcement actions (see http://www.sec.gov/spotlight/enron.htm).

Freddie Mac
Jones, D. (2003). Friends say ousted Freddie Mac exec is a straight arrow; David Glenn was fired in accounting investigation. USA Today, June 24, B01.

Global Crossing
Creswell, J. & Prins, N. (2002). The Emperor of greed; With the help of his bankers, Gary Winnick treated Global Crossing as his personal cash cow--until the company went bankrupt. Fortune, 145(13), June 24, 106.

Halliburton
Anonymous. (2002). A legal watchdog group files suit against Halliburton and vice president Dick Cheney after Wolf Haldenstein Adler Freeman and Herz LLP commenced class action suit against Halliburton Company and Arthur Andersen, LLP on behalf of Halliburton shareholders. PR Newswire, July 12.
MacLaren, L. (2002). Now he’ll have to come out of hiding. The Herald, July 13, 15.


### Harken Energy


### HealthSouth


### Homestore.com

Krantz, M. (2002). Homestore’s former CEO under scrutiny; Investigators suspect ruse too big for Wolff not to know. *USA Today*, November 18, B.03.


### HPL Technologies


### ImClone Systems


**K-Mart**


**Lucent**


**Merck**


**MicroStrategy**


**Network Associates**


**Peregrine Systems**


**Phar-Mor**


**Qwest**

Kilzer, L. Milstead, D. & Smith, J. (2002). Qwest’s rise and fall; Nacchio exercised uncanny timing in selling stock. *Rocky Mountain News*, June 03, 1C.


Smith, J., Kilzer, L. Milstead, D. & Accola, J. (2003). Split decisions; Phil Anschutz rarely seeks the spotlight, but the collapse of the market has illuminated Qwest founder’s overlapping business deals. *Rocky Mountain News* February 08, 1C.

Smith, J. (2002). Is troubled Qwest missing Anschutz’s golden touch? Ailing stock, SEC probe and management questions are pulling Qwest’s billionaire founder away from his sports and entertainment empire. *Rocky Mountain News*, April 27, 1C.

Smith, J. (2002). Nacchio’s out; Qwest CEO resigns amid company’s financial, regulatory woes. *Rocky Mountain News* June 17, 1B.

**Reliant Energy**


**Rite Aid Corporation**


**Sunbeam**


**Tyco**


Ullico

Waste management

WorldCom

Xerox
References


Figure 1: A combination of fraud triangle (FT) and theory of planned behavior (TPB)

Elements of the “fraud triangle”
- Attitudes (Attitude, character, set of ethical values)/Rationalizations
- Incentives/pressures
- Opportunities

Elements of the extended “theory of planned behavior”
- Attitude toward fraud
- Subjective norms
- Perceived behavioral control
- Moral obligation

Intention to engage in fraud
Fraud

Influence
Possible influence

Adapted from Ajzen (1991).
Table 1: Case studies of corporate scandals

This table presents a detailed analysis of the behavioral motivations of 39 corporate scandals. The components are classified according to the combined theory (FT/TPB): Incentives-pressures, opportunities, attitudes/rationalizations (this latter component being subdivided into four separate components taken from the TPB: attitude, subjective norms, perceived behavioral control and moral obligation). The paragraph mentioned after some of the components refer to SAS 99 and ISA 240 (see Appendices 1 and 2). If a component is covered by ISA 240 but not by SAS 99, it is underlined. If a component is covered neither by SAS 99 nor ISA 240, it is displayed in italics. FFR stands for “Fraudulent Financial Reporting” while “MA” represents a “Misappropriation of Assets”. We mention after the company’s name the type of fraud. FFR is present in all the cases under study.

<table>
<thead>
<tr>
<th>#</th>
<th>Companies</th>
<th>Incentives/Pressures (1)</th>
<th>Opportunities (2)</th>
<th>Attitudes/Rationalizations</th>
<th>Subjective norms (4)</th>
<th>Perceived behavioral control (5)</th>
<th>Moral obligation (6)</th>
</tr>
</thead>
</table>
| 1  | Adelphia Communications (FFR – MA) | To meet Wall Street expectations (§ 2.1).                                                | Family link (§ 2.1).                                                            | To meet Wall Street expectations (§ 5).  
Personal enrichment (§ 9).  
To maintain a high leaving standard, greed, “To have the funds to support his lifestyle”.  
Managers’ personality: “Mass market retailer of the year 2001”...  
According to him, he acted for the good of the company, and the good of the Company was also his good.                                                                                                                                                                                                                                             |                                |                                                                                               | Sees himself as someone very generous and helpful. Money used to help people.                                                                                                                                  |
| 2  | Ahold (FFR)                        | Ambition for the group: to build an empire. Fixation on growth. Compete with Wal Mart (§ 1.1). Launched mergers => debts => to hide (§ 2.2) Stock options (§ 3.2) | Relationship with the distributors (§ 1.2).                                        | Stock options (§ 4)  
Greed  
Company’s success and CEO’s personal success: reputation at stake  
Managers’ personality: “Mass market retailer of the year 2001”...  
According to him, he acted for the good of the company, and the good of the Company was also his good.                                                                                                                                                                                                                                             |                                |                                                                                               |                                                                                  |
| 3  | AIG (American International Group) (FFR) | Pressure from the financial market which was criticizing the decline in AIG’s reserves (§ 2.1) Important shareholder and share price (§ 3.1) Stock options (§ 3.2) | Complex transactions (§ 1.4).                                                     | Stock options (§ 4)  
Obsessed by the daily fluctuations in the company’s stock price (§ 4)  
Company’s success = CEO’s personal success - Reputation – Pride - “Imperial chief executive” - The market would lose faith in the company without him.  
Managers’ personality: tyrannical, nobody dared to oppose him.                                                                                                                                                                                                                                                                                                         |                                |                                                                                               |                                                                                  |
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<th>Companies</th>
<th>Incentives/Pressures (1)</th>
<th>Opportunities (2)</th>
<th>Attitudes/Rationalizations</th>
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<tr>
<td>4</td>
<td>AOL (FFR)</td>
<td>Growth. To be able to buy the “giant” Time Warner (§ 1.1) Pressure of the financial</td>
<td>Use of estimates (§ 1.3)</td>
<td>Attitude (toward the fraud) (3)</td>
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<td>market: considered advertising revenues as important to measure the performance (§ 2.1)</td>
<td>Stock options (§ 4).</td>
<td>Subjective norms (4)</td>
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<td>Share price (§ 3.1) Stock options (§ 3.2)</td>
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<td>Perceived behavioral control (5)</td>
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<td>Moral obligation (6)</td>
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<td>Chairman: Narcissist person.</td>
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<td>5</td>
<td>Bristol-Myers</td>
<td>To keep pace with rivals by reporting double-digit profit growth (§ 1.1) To meet</td>
<td>“Channel stuffing” (sales to</td>
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<td></td>
<td>Squibb (FFR)</td>
<td>internal sales and earnings targets and analysts’ earnings estimates (§ 2.1, 4) Stock</td>
<td>wholesalers) (1.2)</td>
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<td>price (§ 3.1) Stock options, compensation bonus (§ 3.2)</td>
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<td>6</td>
<td>Cendant (FFR - MA)</td>
<td>To make the merger with HFS possible (§ 1.1). Stock options (§ 3.2).</td>
<td>Auditor located far away (§ 2.2).</td>
<td>Personal enrichment: payment of their living expenses (planes, golf). Too high living</td>
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<td>7</td>
<td>Computer associates (FFR)</td>
<td>Pressure to present strong growth figures (§ 2.1). Stock options (§ 3.2).</td>
<td>Domination of management by a small</td>
<td>Awards received for the best managed company. “Software titan”.</td>
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<td>group (§ 2.1).</td>
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<td>Donation to and promotion of charitable causes. Built day-care centers for their children in CA offices</td>
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<td>#</td>
<td>Companies</td>
<td>Incentives/Pressures</td>
<td>Opportunities (2)</td>
<td>Attitudes/Rationalizations</td>
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<td>8.</td>
<td>CMS Energy (FFR)</td>
<td>Performance-based compensation, year-end bonus (§ 3.2)</td>
<td>“Round-trip” trades (§ 1.1).</td>
<td><em>Personal enrichment:</em> boosting the revenues to increase year-end bonuses.</td>
</tr>
<tr>
<td>10</td>
<td>Delphi (FFR)</td>
<td>To hide the bad financial state (§ 1).</td>
<td>Several executives involved (§ 2.1).</td>
<td><em>Greed</em> (performance-based salary).</td>
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<td>To fund pension obligations.</td>
<td>Auditor’s failure (§ 2.2).</td>
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<td>To hide a dispute with General Motors</td>
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<td>To meet analyst earnings expectations (§ 2.1).</td>
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<td>Increase of stock price and sale of stocks (§ 3.1).</td>
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<td>Performance-based salary (stock options, incentives (§ 3.2).</td>
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<td>11</td>
<td>Dollar General (FFR)</td>
<td>Growth (§ 2.1).</td>
<td>Direct involvement of the CEO in preparing the company’s financial results (§ 2.1).</td>
<td><em>Image of “marketing genius”</em>.</td>
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<td>Stock options (§ 3.2).</td>
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<td>Donation to endow a program on moral leadership at a University.</td>
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<tr>
<td>12</td>
<td>Duke Energy (FFR)</td>
<td>Performance-based compensation, year-end bonus (§ 3.2)</td>
<td>“Round-trip” trades (§ 1.1).</td>
<td><em>Personal enrichment:</em> manipulation to maximize the size of the year-end bonuses and other performance-based compensation</td>
</tr>
<tr>
<td>#</td>
<td>Companies</td>
<td>Incentives/Pressures (1)</td>
<td>Opportunities (2)</td>
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<td>16</td>
<td>Freddie Mac (FFR)</td>
<td>To meet analysts’ expectations (reduction of earnings) - Appearance of sustained, predictable growth (§ 2.1). Stock options (§ 3.2).</td>
<td>Conflict of interest for the auditor (charity). Corporate culture which encourages fraud to approximate analysts’ forecasts.</td>
<td>Stock options (§ 4). Personnel ambition (to become the CEO).</td>
</tr>
<tr>
<td>#</td>
<td>Companies</td>
<td>Incentives/Pressures (1)</td>
<td>Opportunities (2)</td>
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<td>17</td>
<td>Global crossing</td>
<td>Sustainability of the firm (§ 1).</td>
<td>Swap of network capacity (§ 1.1, 1.2).</td>
<td><strong>Attitude (toward the fraud)</strong> (3): Consulting and real estate fees. Confusion between company’s assets and his own’s. (§ 9). <strong>Subjective norms</strong> (4): Greed, ambition: to build an empire (“the Emperor of Greed”). <strong>Perceived behavioral control</strong> (5): Chairman is bright, aggressive and has a huge ego. “Roman emperor”.</td>
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<td>(FFR - MA)</td>
<td>To meet securities analysts estimates (§ 2.1). Sale of shares (§ 3.1).</td>
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<td>Sales of shares (§ 3.1).</td>
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<td>Sales of shares (§ 3.1).</td>
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<td>Salaries based on earnings (§ 3.2).</td>
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<td>21</td>
<td>Homestore.com (FFR)</td>
<td>Revenue growth (advertising revenue) (§ 2.1).</td>
<td>“Round-trip” transactions (§ 1.1). Fraud hidden to auditors.</td>
<td><strong>Attitude (toward the fraud)</strong> (3): Greed (sale of shares). <strong>Subjective norms</strong> (4): CEO’s power, ambition (the CEO embodied the company). <strong>Perceived behavioral control</strong> (5): Admired head of a fast-growing software company. <strong>Moral obligation</strong> (6): The CEO funneled his own money to the company accounts in an attempt to cover fake sales.</td>
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<td>Contract with AOL Sale of shares (§ 3.1).</td>
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<td>22</td>
<td>HPL Technologies (FFR)</td>
<td>Growth in revenues. To be able to make an IPO. Collapsing markets of Silicon Valley and the world of high tech.</td>
<td>Auditor’s failure.</td>
<td><strong>Attitude (toward the fraud)</strong> (3): Auditor’s failure. <strong>Subjective norms</strong> (4): Auditor’s failure. <strong>Perceived behavioral control</strong> (5): Admired head of a fast-growing software company. <strong>Moral obligation</strong> (6): The CEO funneled his own money to the company accounts in an attempt to cover fake sales.</td>
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<td>23</td>
<td>Im Clone Systems (FFR)</td>
<td>Sales of shares (insider trading) (§ 3.1).</td>
<td>Family link.</td>
<td>Personal enrichment. Standard of living to maintain. To pay debts (secured by the stocks). Insider trading for himself and his family. Protect the wealth of his family and friends.</td>
</tr>
<tr>
<td>24</td>
<td>K-Mart (FFR - MA)</td>
<td>Competition with Wal-Mart (price war) (§ 1.1). Survival (weight of debts). Performance-based bonuses, stock options (§ 3.2).</td>
<td>Junior executives were demoted or transferred when they refused to make unrealistic forecasts.</td>
<td>Personal enrichment (personal air travel), loans to themselves. (§ 9).</td>
</tr>
<tr>
<td>25</td>
<td>Lucent (FFR)</td>
<td>Internal sales target. External sales target (§ 2.1). Bonus on sales (§ 3.2). Keep their job</td>
<td>Deficient internal control.</td>
<td>Personal enrichment: bonuses on each sale they achieved. Career: So as to keep their jobs and/or to be promoted, by meeting the internal sales targets.</td>
</tr>
<tr>
<td>26</td>
<td>Merck (FFR)</td>
<td>To make the Company look successful. Growth in revenues. To ease the IPO of a subsidiary.</td>
<td>Auditor’s failure.</td>
<td>No apparent personal interest.</td>
</tr>
<tr>
<td>27</td>
<td>MicroStrategy (FFR)</td>
<td>To boost the firm’s share price.</td>
<td>Total control of the company.</td>
<td>Personal problems (alcohol). CEO’s ego. Impressed by wealth.</td>
</tr>
<tr>
<td>#</td>
<td>Companies</td>
<td>Incentives/Pressures (1)</td>
<td>Opportunities (2)</td>
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<td>30</td>
<td>Phar-Mor (FFR - MA)</td>
<td>To restore the Company’s profitability.</td>
<td>Very little oversight inside the company. Auditor’s failure.</td>
<td>Personal enrichment (home, jet, car….) (§ 9). <em>Passion for sports (funding of a basketball team).</em></td>
</tr>
<tr>
<td>32</td>
<td>Reliant Energy (FFR)</td>
<td>Ambition for the company: make the company one of the best energy traders. Enron’s influence (energy market).</td>
<td>Round-trip trades (§ 1.1). New field, new market (no one knew what the size of the market).</td>
<td><em>Executive’s career and image of competence.</em></td>
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<td>Family link (§ 2.1).</td>
<td>High standard living (helicopter). Real estate transaction with the family. Ambition and competence.</td>
<td>Martin Grass was bullying his employees and partners.</td>
</tr>
<tr>
<td>33</td>
<td>Rite Aid Corporation (FFR)</td>
<td>To do better than his father. =&gt; mergers =&gt; high debt. Rite Aid as a powerful retail company. Sale of shares (§ 3.1). Salaries based on performance (§ 3.2).</td>
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<tr>
<td>36</td>
<td>Ullico (FFR)</td>
<td>Stock options (insider trading) (§ 3.1).</td>
<td>Many executives and directors involved.</td>
<td>Personal enrichment with sale of shares.</td>
</tr>
<tr>
<td>38</td>
<td>WorldCom (FFR)</td>
<td>Company’s performance (§ 2.1). Ever growing revenue and income (§ 2.1). To meet analysts’ forecast (§ 2.1). To maintain the share price.</td>
<td>Management hides the truth.</td>
<td>Personal enrichment (shares of the company) (§ 4). Complicity between the CEO and the CFO.</td>
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<td>Attitude (toward the fraud) (3)</td>
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<tr>
<td>39</td>
<td>Xerox (FFR)</td>
<td>Earnings target ($2.1). To boost the firm’s share price. Increase in compensation (including stock options) ($3.1, 3.2).</td>
<td>Auditor’s failure. Opposition within the board.</td>
<td>Personal enrichment (shares of the company) ($4).</td>
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<tr>
<td>Elements of the TPB</td>
<td>Items</td>
<td>Companies involved (anecdotal evidence)</td>
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<tr>
<td>Attitude toward the fraud</td>
<td>To maintain a high living standard</td>
<td>Adelphia Communications, Cendant, Computer Associates, Datek Online, HealthSouth, ImClone Systems, Phar-Mor, Rite Aid Corporation, Tyco, Harken Energy, Qwest</td>
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<td>sometimes linked to a passion for sports</td>
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<td>Reputation at stake</td>
<td>(company’s success = personal success)</td>
<td>Ahold, AIG, Network Associates, Qwest</td>
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<td>Perceived behavioral control</td>
<td>Prize received</td>
<td>Ahold, Computer Associates</td>
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<td></td>
<td>or superlative:</td>
<td>- Youngest chief executive (Bristol-Myers Squibb)</td>
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<td></td>
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<td>- Marketing genius (Dollar General)</td>
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<td>- Admired head of a fast-growing company, very rich and very young manager (Datek Online)</td>
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<td>- Highest-paid CEO (HealthSouth)</td>
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<td>- Worldwide recognition (Sunbeam)</td>
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<td>- Financial wizard (CFO of WorldCom)</td>
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<td></td>
<td>Personality</td>
<td>- Tyrannical/autocratic (AIG, Enron, HealthSouth, Network Associates, Rite Aid Corporation, Sunbeam, WorldCom)</td>
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<td>- Narcissistic (AOL)</td>
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<td>- Encourages hero worship of executives (Phar-Mor)</td>
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<td>- Personal ambition - career (Freddie Mac, Homestore.com, Reliant Energy, Waste Management) or for the firm (Global Crossing, Qwest)</td>
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<td>- Alcoholic (MicroStrategy)</td>
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<td>Moral obligation</td>
<td>Charitable causes</td>
<td>Adelphia Communications, Computer Associates, Enron, Freddie Mac, HealthSouth, and WorldCom</td>
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<td>Action for the good of the company</td>
<td>Ahold</td>
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