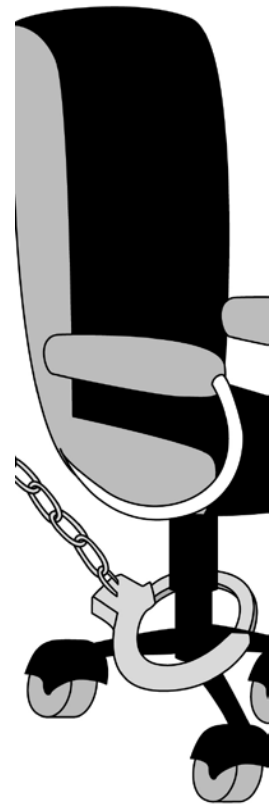


CORPORATE FRAUD

Ana Paula Paulino da Costa ana.costa@prof.bsp.edu.br
Professor at Business School São Paulo – Sao Paulo – SP, Brazil

Thomaz Wood Jr. thomaz.wood@fgv.br
Professor at Escola de Administração de Empresas de São Paulo, Fundação Getulio Vargas – Sao Paulo – SP, Brazil



INTRODUCTION

In the last few years, scandals involving corporate fraud have made headlines in the media. There have been dramatic cases such as those of Enron, Global Crossing and Bernard Madoff in the United States and Banco Santos, Boi Gordo and Daslu in Brazil which have been widely analyzed and debated. A search for the term ‘corporate fraud’ in Google that was carried out in 2012, yielded more than a million entries, which testifies to the popularity of this issue.

Corporate fraud can cause damage running into billions of dollars for investors, clients and suppliers. Apart from this, it can shake the confidence of clients, shareholders and investors

in particular companies and institutions, and have a damaging effect on society. Finally, fraud has led to increasing levels of operational control with adverse consequences on costs, and hence on the competitiveness of companies and entire industrial sectors.

The size and seriousness of the phenomenon has led several researchers to investigate this problem and search for explanations of its causes and constraints (e.g. BAUCUS, 1994; MACLEAN, 2008). It is a matter of a complex nature that entails financial, social, cultural and behavioral factors in a wide range of areas, such as Finance, Accountancy, Law and Organizational Studies and for this reason, researchers have tended

to investigate each case from an individual standpoint. The outcome of this is that a heterogeneous literature has been produced with a wide range of perspectives and analytical approaches.

In the field of Organizational Studies, the investigations of the subject have sought to answer questions regarding “when fraud occurs” and “why fraud occurs” (e.g. HILL and others, 1992; SCHNATTERLY, 2003). However, as Ashforth and others (2008) make clear, there seems to be a lack of studies that address the question of “how fraud occurs”.

In reality, before the question of how fraud occurs can be understood, it must be regarded as a process. An act of fraud is the outcome of coordinated activities

which take place over a period of time. An examination of it must include both the context in which the fraudulent practices occur and the ways in which the fraudsters pursue and carry out their schemes (see ACADEMY OF MANAGEMENT REVIEW, 2008). As well as this, the study of fraud should include substantive factors related to the activities that are put into effect and symbolic factors related to impression management, which are essential to keep the scheme in operation (MISANGYI, WEAVER, ELMS, 2008).

In Brazil, studies of corporative fraud have largely focused on issues regarding accounting standards (e.g. SANCHES, 2007), auditing procedures (e.g. ANTUNES, 1998; OLIVEIRA, 2005) and issues of criminal law (e.g. MOURA, 2007). Although acts of fraud have a considerable economic and symbolic effect, there are still very few studies that view executives as fraudsters and treat fraud as a process.

The aim of this article is to improve our understanding of the phenomenon of corporate fraud. We set out by raising the following question: what components should comprise a theoretical model that is able to explain how corporate fraud occurs? We seek to organize what is known about the matter in a systematic way and suggest employing an integrated theoretical model based on a procedural perspective.

The remainder of the text is structured as follows: first of all, there is an attempt to define the term corporate fraud. Following this, we bring together several factors related to fraud, in a systematic way at different levels of analysis. This leads us to outline

an integrated theoretical model. Finally, there is a discussion of the implications of the model for theory and administrative practice and recommendations of a research agenda for a further examination of the subject.

THE CONCEPT OF CORPORATE FRAUD

In generic terms, a fraud is “any kind of act that is cunning, deceitful, in bad faith and aimed at harming or swindling someone else or failing to fulfil a given duty” (HOUAISS, 2007). Jamal, Johnson and Berryman (1995) state that an act of corporate fraud occurs when the fraudsters find an opportunity and make a series of decisions with a view to obtaining benefits in an illegal way and creating an elaborate mise-en-scene to conceal these decisions and their effects.

In the scientific literature on fraud, one can find the most common factors that allow a working definition to be formed: the driving-force behind the fraudsters (BAUCUS, 1994); the presence of ‘sitting targets’ (MOURA, 2007); the absence or comparative lack of internal or external control (COHEN and FELSON, 1979); and social disorganization or the loss of social and moral values (BELKAOUI and PICUR, 2000; SCHNATTERLY, 2003).

On the basis of these statements and other common factors, we define corporate fraud as “a series of activities and illegal conduct carried out in a conscious or premeditated way by senior members of a business administration or organization, which follow each other in a way

that is designed to serve their own interests and are clearly intended to cheat a third party”.

FACTORS RELATED TO CORPORATE FRAUD

In the following section, there is a compilation of the components related to corporative fraud. This has been undertaken by making use of a classification of levels of analysis that has been adapted on the basis of the studies of Baucus (1994), and Ashforth and others (2008): 1) society, 2) regulatory framework, 3) sector of activities, 4) organization and 5) the individual

Society

The first component to be examined is society, with its culture, history and values, as well as the kinds of behavior that it tolerates or condemns. Different societies display different degrees of practice and tolerance regarding corrupt forms of behavior. Transparency International is a non-governmental organization which issues an annual index which is used for ranking the perception of corruption. The higher the position in the ranking, the stronger is the shared perception of an absence of deviant or corrupt practices. With a score of 3.8 (from a maximum of 10), Brazil is placed in 73rd position among 183 countries (TRANSPARENCY INTERNATIONAL, 2011), and is thus very far behind the “honest” nations in the world.

In particular social contexts, where there is an absence or breaking down of social norms, or anomie (DURKHEIM, 1983), an environment is established which

is conducive to corruption and perpetrating fraud. As is shown in the Strain Theory (MERTON, 1957), this condition may be accompanied by a combination of factors such as a desire to succeed, social projection and having illegitimate means at one's disposal to attain these objectives.

In effect, in both developed and developing countries there is social pressure on people to appear to be successful in their lives and work. In an analogous way, the opening up of markets which took place in Brazil in the 1980s increased the pressure on the performance of companies and, as a result, on their personnel (see ZAHRA, PRIEM, RASHEED, 2005).

Accompanying this, there seems to have been a blurring of the borderline between ethical and non-ethical behavior which originated in an educational system which ceased to roundly condemn the kind of practices that were unsuitable for conducting business (see ADLER, 2002). Significantly, a research study undertaken in the United States revealed that some MBA students are the most likely people to commit illegal acts (BRADSHAW, 2006).

The regulatory framework

The second component that needs to be examined is the regulatory framework. Some writers argue that fraud should be regarded as the outcome of the systematic corruption of capitalism, in so far as it is spread throughout the economy and involves both public and private organizations, social bodies and even religious institutions (BADAWI, 2005). Following this rationale, there are offers and demands for fraud embedded in

the economic system. In certain circumstances, these movements converge and this results in fraud (ASHFORTH and others, 2008). There are regulatory frameworks to combat these incidents (although they have other objectives too) and these are formed in different sectors and are responsible for laying down operational rules, systems of governance and degrees of transparency.

The more the market is deregulated, the greater the likelihood that standards will emerge in a spontaneous way; these may not necessarily be made explicit or followed to the letter but are practised and assimilated by society. Duran (2007) notes that, in markets that are unregulated, companies tend to become organized in a way that allows them to lay down rules as a protection against fraudulent acts.

Nonetheless, the regulatory framework is not always an effective means of preventing fraud. The Sarbanes-Oxley Act, enacted in 2002, after the corporate fraud scandals in the United States, was an attempt to tighten up controls by extending accountability to cover inappropriate practices and imposing stricter punishments on companies and their executives (ASHROTH and others, 2008; BORGERTH, 2007; GORNIK-TOMASZEWSKI and MCCARTHY, 2005). However, despite a notable increase in the degree of control, it remains an open question whether the system that was imposed has been effective in the prevention of corporate fraud. It can only be stated that the regulatory framework and in particular, the legislation for combating illegal acts, together with standards for improving the system of corporate

governance, have had a moderating influence on corporate fraud, albeit of a limited effect. In reality, the regulatory framework has not eliminated corporate fraud but only disrupted the behavior of the fraudsters and made it more difficult for them to pursue their activities - which means it might be a sophisticated hypothesis..

Sector activities

The characteristics of sector activities can help to restrain the occurrence of fraud and the most striking are culture, competitive pressure and the level of heterogeneity.

The scientific literature on corruption and corporate fraud has found cases in industry where there is a real culture of fraud, which means there is a greater likelihood of illegal acts (BAUCUS and NEAR, 1991). There are three points that support this observation: first of all, the perception that punishments for illegal acts are not strict enough when the cases occur in the industry itself (ZAHRA, PRIEM, RASHEED, 2005); second, the isomorphic process (DIMAGGIO and POWELL, 1983), or the gradual contamination of industry by fraudulent practices; and third, the existence of an incomplete regulatory framework that is outdated or vulnerable (DABOUD and others, 1995).

Another factor which can also be a contributory factor in fraud is competitive pressure, sometimes combined with the problem of a lack of resources or high costs. This situation can lead executives and businessmen to seek short-term results, occasionally by means of illegal expedients (see BAUCUS and NEAR, 1991).

In a similar way, heterogeneity

creates a favorable climate for fraud because it makes trading and management more complex and more difficult to understand and carry out (ZAHRA, PRIEM, RASHEED, 2005; PINTO, LEANA, PIL, 2008). This has a dual effect in enabling fraud to be practised more easily: on the one hand, it puts pressure on people and makes it harder for them to achieve good results, and on the other, it creates opportunities that can be exploited by fraudsters.

Organization

The fourth component that must be taken into account is the organization, the principal locus of corporate fraud and the place where the misdemeanour is planned and carried out. The scientific literature which addresses the question of fraud in organizations tends to look at the internal control systems (see SCHNATTERLY, 2003). The existence of these systems is supposedly to provide a suitable level of operational control, monitor risks and ensure the business runs smoothly. However, Ashforth and others (2008) and Westphal and Graebner (2010) state that very often these systems only play a ceremonial role and just form a part of the list of good management practices, without having any real preventive effect. In the following section, these systems will be examined but an attempt will be made to consider them in broader terms. We begin with the question of cultural organization. Finally, we will address the question of control systems per se, including both internal and external systems.

Organizational culture plays an important role in offering guidance to people's behavior and thus can

moderate the extent of fraud. At the heart of organizational culture, there are values and assumptions about what is right and wrong (SCHEIN, 2009). These values and assumptions govern the decision-making in the organization. The organizational culture can both restrain fraud by strengthening the values that underpin ethical behavior (STANSBURY and BARRY, 2007; TREVINO and others, 1999) and encourage it by supporting attitudes that are linked to unethical behavior (ASHFORTH and ANAND, 2003). Anand, Ashforth and Joshi (2004) state that Enron, WorldCom and Parmalat resorted to cultural mechanisms that involved the whole company in the fraud process.

The systems of corporate governance have undergone a huge development and dissemination in recent decades. Today they are regarded as an important source of the prevention of fraud committed by senior management (SCHNATTERLY, 2003). However, even if the Board of Directors is able to follow the list of good practices, this will not ensure their effectiveness in preventing corporate fraud (ABBOTT, PARK, PARKER, 2000; PERSONS, 2006). In some cases, the structure and organizational procedures can be employed to exempt the senior executives from responsibility for misdemeanours (PINTO, LEANA, PIL, 2008).

The control systems can be subdivided into different categories: legal and regulatory sanctions, social sanctions, norms and procedures, rewards, monitoring of ethical behavior and self-control (see LANGE, 2008). Each of these has different features and capabilities, which are expressed in

a way that depends on the nature of each organizational locus. We will examine them one by one:

- Control by legal and regulatory sanctions exists to curb fraud. However, its dissuasive powers are restricted because punishments are rarely proportional to the size of the organization or the gains obtained from fraud. Thus, its effects are considerably reduced, when it is taken into account by some authors that this is a factor that can encourage corruption.
- The sources of control by social sanctions or judgements from outside are mainly the media, class associations and risk rating agencies. These bodies exert an influence on the behavior of managers because they have the power to expose to the public at large, offences that are committed by an organization and its personnel. However, the organizations can mitigate the effects of this type of exposure by proactively investing in seals and certificates of approval, taking social action or managing any crisis that occurs.
- Control through norms and procedures is found in every kind of organization. This system is particularly important in large organizations which have several departments and a decentralized management. The challenge for the organization is to maintain a suitable level of control while, at the same time, ensuring a degree of freedom for business transactions. This is needed to be able to act in a flexible way in unstable or competitive markets. Nonetheless, this balancing act,

which is difficult to achieve, leads to shortcomings and imperfections which can be taken advantage of by those who perpetrate fraud. (ZAHRA, PRIEM, RASHEED, 2005; HAMDANI and KLEMENT, 2008).

- Control by a system of rewards consisting of salaries, bonuses, variable remunerations, share options, benefits and other features, is a strategic measure for organizations. It allows the results achieved by an organization to be linked to the gains of the personnel responsible for bringing this about. However, the complexity of a company's management and the activities of interest groups who seek to profit from exceptional financial gains, can lead to distortions in the system (DELVES, 2004).
- Control through monitoring of ethical behavior consists of ethical codes, procedures and internal standards which are drawn up to encourage people to oppose corrupt practices and denounce any misdemeanours (GIOIA, 1992). However, in attempting to codify behavior that is desirable or undesirable, the monitoring system can lead professionals to overlook unforeseen situations (LANGE, 2008). It also restricts the capacity of the personnel to tackle the problem of ethical ambiguity and thus lead to a deterioration of competence (STANSBURY and BARRY, 2007).
- However, many organizations inculcate implicit internal standards and 'vicious' values that are characterized by a search for results at whatever

cost and a permissive attitude with regard to deviant behavior. (LANGE, 2008).

The individual

The fifth component to be taken into account comprises individuals. These are obviously the perpetrators of fraudulent acts. However, their rationale and behavior are influenced by their environment and by an organizational culture. Apart from acting as an incentive for corrupt behavior, these environments and unethical organizational cultures endow it with a degree of legitimacy (BUTTERFIELD, TREVIN, WEAVER, 2000). This situation induces people to become involved in deviant practices even though they cannot obtain any personal advantage from doing so (ASHFORTH and others, 2008).

An analysis of the current scientific literature shows that the studies on corporate fraud that are centred on the individual, follow two paths. The first is concerned with the personal willingness to carry out a fraudulent act. The second refers to the cognitive attachment of the individual to the fraudulent system.

The willingness of the individual to carry out a fraudulent act can generally be attributed to various factors, among which the following are prominent: a lack of integrity and sense of moral identity, the difficulty of exercising self-control (which leads to a strong propensity to take risks), a low level of cognitive moral development and psychopathological behavior (ASHFORTH and others, 2008). The historical background of an individual and an organization can

provide valuable information about deviant behavior. If there has been an example of deviant behavior in the past, this will probably be repeated (DABOUD and others, 1995)

The cognitive attachment of the individual to the fraudulent system can be explained by the Theory of Differential Association (SUTHERLAND, 1940). According to this theory, criminal behavior in the individual can undergo a series of stages: learning the skills needed to practise fraud, establishing the situations where these techniques can be employed, and assimilating and accepting ideas that can give legitimacy to crime.

Deviant practices can be explained by a failure to recognize the moral nature of situations (BUTTERFIELD, TREVIN, WEAVER, 2000), the routine character of cognitive deviation (ASHFORTH and ANAND, 2003), the way behavior is suited to rationalized ideologies (Anand, Ashforth, Joshi, 2004) and the use of cognitive roadmaps that tend to dispense with an ethical dimension (GOIA, 1992). These processes and practices make fraudulent practices seem natural so that they become cognitively acceptable to the individual who commits or is involved in them.

AN INTEGRATED THEORETICAL MODEL

At this stage of the study, we will compile the various components that surround the system of corporate fraud: society, the regulatory framework, the sector of activities, the organization and the individual, by determining the shortcomings and features that

allow fraudulent acts to occur. In this section, an attempt is made to combine these components with a view to forming an integrated theoretical model which, on the basis of a procedural perspective, can explain how fraud occurs.

As a point of departure, we draw on the work of Baucus (1994) who distinguished between three groups of situational factors that precede fraud: pressure, opportunity and a willingness to be involved in fraud. Pressure is the outcome of a competitive climate, a legal and regulatory environment and organizational factors. Opportunity arises from a competitive climate, a legal and regulatory environment and organizational factors as well. Willingness is the result of features of the environment and again, organizational factors.

The model of Baucus (1994) only applies to the antecedents of fraud, and is able to answer the question “why does fraud occur?” We believe that before the whole phenomenon can be understood, it is necessary to provide a more comprehensive model. This can be achieved by turning to the work of MacLean (2008), who introduced a moderating variable related to culture and organizational identity. As a result, he endowed his model with the rationale of symbolic interactionism where deviant behavior is constructed socially and embedded in the organizational culture, or in more precise terms, in the schemes that are shared by professionals within a determined organizational environment.

In an attempt to make further advances, we also resort to the work of Misangyi, Weaver and Elms (2008). These authors explore in greater depth the path opened up

for investigation by MacLean (2008), by outlining in detail the question of the cognitive procedures and the shared schemes. In examining the symbolic dimension, they pave the way to explaining how fraud occurs.

We seek to combine the studies mentioned above of Baucus (1994), MacLean (2008) and Misangyi, Weaver and Elms (2008) since they can be regarded as making contributions to a single evolutionary pattern. The first of these studies provides an understanding of the origins of fraud by laying stress on antecedent factors. The two following add to an understanding of the creation of meanings (symbolic resources) for fraudulent practices (substantive resources) at different levels of analysis.

On the basis of a procedural perspective, it can be stated that corporate fraud occurs on account of certain antecedent conditions (which have already been explored in the literature) and the activities of fraudsters. These follow three stages:

- The first stage is the conception of fraud which is understood as meaning the identification of an opportunity for illegal gain, as well as the identification of substantive and symbolic resources to carry out the intended fraud
- The second stage is introducing the fraudulent scheme which includes employing substantive and symbolic resources and neutralizing the internal and external systems of control; and
- The third stage is the support given to the fraudulent scheme which involves its administration and print management, both for

the internal and external public. In reality, print management seems to be a critical factor in the success of corporate fraud. It is the application of techniques for manipulating images and the senses in a way that allows the illusion to be created of suitability and solidity over long periods and it conceals the existence of illegal acts.

In this way, an integrated theoretical model that is capable of explaining how corporate fraud occurs, must rely on the following features: first of all, the environmental components – society, the regulatory framework and the sector of activities; second, the organization, the locus of fraud, and the individual or fraudster; and third the three stages mentioned above – the conception, the introduction and the support of corporate fraud. In other words, an understanding of how corporate fraud occurs, must take account of all these features and components, on the basis of an integrated and procedural perspective.

CONCLUSION

In this article, we have sought to add to the understanding of the phenomenon of corporate fraud and encourage new research studies in this field. The following question was raised: what components are needed to form a theoretical model that is able to explain how corporate fraud occurs? In finding an answer, our aim has been to systematize the knowledge on this matter and identify the elements of

a theoretical model which is based on a procedural perspective. In this final section, we suggest how this study has added to theory and practice and we set out an agenda for further research in this area.

Making a contribution to the theory in Organizational Studies

We believe that this study makes two significant additions to theory. In the first place, it draws attention to an important phenomenon that has had a big impact and which could be of interest to other researchers in the field of Organizational Studies. As has been stated, there have been very few scientific studies in Brazil on corporate fraud and some of these have been conducted in other fields of knowledge such as Law, Finance and Accountancy.

In the second place, this study has sought to advance knowledge about corporate fraud on the basis of what has been undertaken in previous studies and allow an understanding of how fraud occurs. We believe that the integrated theoretical model which has been set out here, will be of assistance in the analysis of real cases.

Making a contribution to administrative practice

With regard to administrative practices, in our view there are three outcomes of this study. In the first place, it draws attention to the wide range of variables involved in corporate fraud, at different levels of analysis and shows how it must be treated as a complex phenomenon. As a result, this study suggests that the prevention

or detection of fraud does not have any simple solution.

In the second place, it shows the limitations of systems of prevention and control which have been included as good management practices. Clearly, the adoption of modern systems of governance, ethical codes and compliance audit procedures must be welcome. However, they cannot be taken at their face value. An in-depth investigation is needed to make sure that they are well planned and are fulfilling their role. It is also necessary for the standardization, regulation and inspection bodies to improve their systems and go beyond simply checking the information supplied by companies.

In the third place, this study highlights the use of symbolic resources in carrying out fraudulent schemes and supporting corporate fraud. In effect, the symbolic dimension seems to be an essential part of the process. Without the introduction of certain cultural signs and the management of external images, a good deal of fraud would probably never come to fruition.

In our view, this research study can be useful for two distinct publics: executives interested in strengthening systems of corporate control and managers of regulatory bodies that seek to operate more robust monitoring practices in their area of activity. We believe that by adopting an integrated approach, we can help prevent fraudulent activities and detect their implementation in its early stages.

An agenda for further research

As is evident from our research, there have been scientific studies

on corporate fraud and related topics for at least two decades. In recent years, as a result of the outbreak of major scandals, there seems to have been an increase in academic interest (see ACADEMY OF MANAGEMENT REVIEW, 2008). In the teaching and research of management, there is currently a real concern with ethical issues, business sustainability and corporate social responsibility. The question of corporate fraud is closely bound up with this concern. On the other hand, there is still an inadequate understanding of the phenomenon.

In view of this, some possible lines of research are outlined here. First of all, undertaking case studies which allow more in-depth analyses to be conducted on how the different variables interact to bring about fraudulent schemes. Second, undertaking more detailed studies on the use of symbolic resources to support fraud both within the organization – through the manipulation of cultural traits – and outside the organization – through manipulating images. Third, undertaking analyses on the effectiveness of preventive measures, such as systems of corporate governance, internal systems of control and cultural interventions, aimed at spreading ‘virtuous’ values and an understanding of ethical conduct. And fourth, undertaking an investigation into the failings in the systems of prevention and external monitoring, which can offer guidance to executives of companies and managers of regulatory bodies about how to improve them.

Finally, we would like to express our belief that studies on corporate fraud can be useful not

only to illuminate the phenomenon in itself but also to show how, in a general way, corporations operate. Although there have been a large number of scandals resulting from corporate fraud, they still represent rare events given the number of companies in operation. Nonetheless, it can be assumed that a much larger number of companies operate in restricted conditions and although they may not cross the line of legality, they still employ dubious practices that are similar to those used in the fraudulent schemes. We hope that this study will encourage other researchers to explore this subject further, fill in any gaps and add to the investigation.

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