

**Corporate Scams- An Alarming Issue In India: Apparent Concerns,
Reviewing Corporate Governance Norms And Perceptions**

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Abstract

In this paper my objective was to observe the nature and perception of corporate fraud in India and its consequences in the business and economic systems, pinpointing the rising issues so that present legal as well as regulatory obligations can be re-evaluated and structured. This research is based on secondary data. But from where this research has been cited has collected data through an exploratory research, conducted through a combined mode of literature review, case studies, structured questionnaires from 346 companies who were sample for the study and 43 interviews were conducted with the corporate professionals, management, investors, government office and authorities having wide experience. During this process of my research and prior work of others, it was found that the regulatory system is weak, and there is a dire need to redefine the role of auditors. It was found that if proper care has been taken on part of auditor in every case, risk of occurrences of corporate frauds could be mitigated to a huge extent. Coordination among various regulatory authorities is poor, and after every scam, there is a blame game. Reporting of fraud and publication of fraud prevention policy is almost negligible in our country, if published these could help a great deal in prevention of frauds. Banks and financial institutions are unsuccessful in due diligence, and there is often a lack of professionalism on the board and the other executive levels in the company. This study and prior studies conducted by others points to the fact that fraud could be mitigated by realistic and cognizant action by the auditors, and corporate executives if they are willing to avoid perpetrating financial scam despite compulsion from investors, government securities regulators and external market fluctuations. This study points out the fact there should be compulsory publication of fraud prevention policy, special purpose corporate offence wings should be established, recognition of companies for improved corporate governance, fair execution of International Financial Reporting Standards in the companies, Thoughtful and prior attentiveness by banks and financial institutions, compulsory appointment of professionals by shareholders and fixation of responsibility on independent professionals, expertise of audit committee, and more powers to the regulators, especially Securities and Exchange Board of India.

Keywords: Regulating laws, Fraud detection and prevention, corporate scam, Fraud tendency.

Introduction

A corporation, being a body of various stakeholders at the micro and macro levels, must be fair and clear to its stakeholders in all its dealings (Ramachandran, 2008). In today's globalized environment, corporate organizations need to access resources and struggle in a universal marketplace to succeed. This fundamentally requires that it must embrace and display ethical conduct to grow and flourish in the long run. Recent decades have witnessed a sharp boost in the greed of individuals and organizations and have acquired an unavoidable presence in our lives and society. Corporate frauds and misconduct remains a stable feature posing a threat both from the macro and micro perspective of the economy. The liberalization process in budding economies has typically witnessed a series of scams almost with sickening regularity. Corporate fraud has become a global phenomenon with the improvement of commerce and technology. In recent years, fast-growing economies are witnessing an enormous rise in corporate frauds, rising grave questions in front of the academicians, researchers, and professionals on the worth of corporate governance mechanisms prevalent, present government regulation mechanisms and the role of corporate and individual ethics. Recently, several studies in finance, economics, and law literature have been conducted on the understanding of incentives and monitoring deterrents of corporate frauds and the loopholes in the government control systems. After every scam, the government and regulatory mechanism have been strengthened to shrink the number of frauds that enforce a check on the nexus between the company and professionals and between banks and bureaucrats, which may be accomplished through more disclosures, by putting and fixing responsibilities on each party involved in the fraud. Alike to other developing and some developed countries, India is in the clutch of scam, implying the call for a translucent, ethical and responsible corporate governance framework. The global financial crisis during the recent past, along with some of the large corporation failures and frauds, has credibly revealed that while the corporate governance superstructure in India is fairly durable (ICSI, 2007), certain loopholes may have their roots in the ethos of individual business entities. KPMG Survey of 2006, 2008 and 2010 reveal a sustained determination of corporate frauds and warn the presence of fraud risk in the business structures of large- and medium-sized organizations including banks. Corporate frauds have increased at a high pace in India (Vivian Bose Commission of Inquiry, 1963; KPMG, 2010). The Securities and Exchange Board of India (SEBI) introduced (Prohibition of Insider Trading) Regulations, 1992, which was later amended in 2002 but it does not have worldwide jurisdiction. SEBI should be vested more powers. It must achieve the nature of a criminal court to implement criminal sanctions against directors of foreign companies listed in the domestic exchange, who are vigorously involved in insider trading. Not just SEBI, we have a variety of regulations and laws dealing with a variety of fraud types and perspectives. Despite adopting corporate governance and with the existence of numerous legislations and regulatory authorities, corporate frauds have become widespread throughout the country. This paper endeavors to inspect the perception of corporate frauds in India and highlight the growing issues so that existing legal and regulatory obligations to report and publish fraud can be updated

to ensure compliance, consistency, and transparency of corporate operations that can promote the orderly growth and expansion of corporate sector in India.

We all are aware of big scams back on 1990s which include Harshad Mehta scam, C.R. Bhansali Scam, Virendra Rastogi Scam, UTI Scam, Ketan Parek, Dinesh Dalmia & Satyam scam. Recent ones are in form of bank loan defaulters such as Nirav Modi, Vijay Mallya, PNB scam, in general there is significant rise in these frauds in banking sector. Below are some data related to these scams.

Another eye-popping number

₹12,636 crore
LATEST SIZE OF PNB SCAM INVOLVING NIRAV MODI, MEHUL CHOKSI

₹1,251 crore
Worth fresh Letters of Understanding funneled to the Gitanjali group found by PNB

₹11,394 crore
Figure disclosed to the stock exchange earlier by PNB

2 Cases registered by CBI mentioning two different bunches of fake LoUs so far

0 Instruction to PNB from govt to compensate other lenders for losses tied to the fraud

8,670 Total loan fraud cases reported to RBI by PSBs in the last five financial years

\$9.58 bn Lost by India's nationalised banks in five years

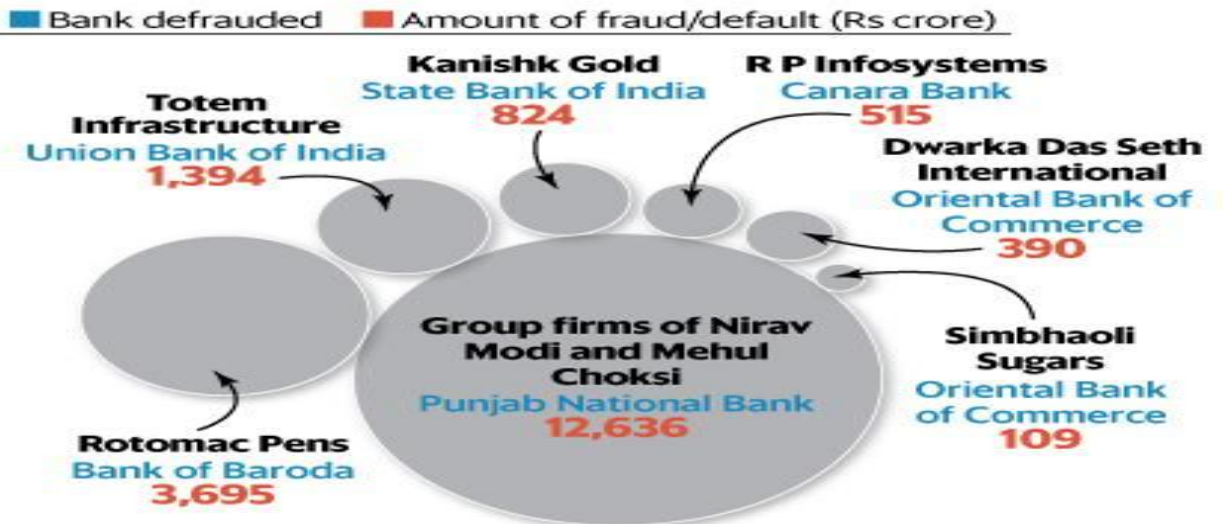
ED moves special court in Mumbai for NBW against Nirav Modi

Punjab National Bank appoints A K Pradhan as Group Chief Risk Officer

Source: Google

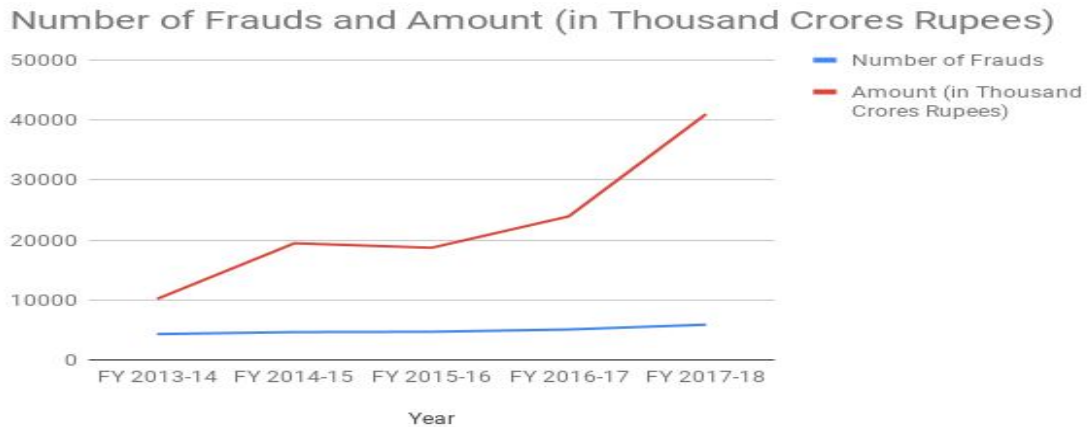
LOAN FRAUD CASES PILE UP

The number of loan fraud cases has been piling up after the RBI directed banks to file complaints against erring companies.



*Data based on CBI FIRs for the last two months
Source: Google

Source: CBI FIRs



Source: Google

Corporate fraud types and propensities

Fraud is the use of forged representations to achieve unjust benefits and criminal deception. The Internal Resources Service, Department of the USA of the Treasury, explains a corporate fraud as a disobedience of the Internal Revenue Code and related statutes devoted by large, publicly-traded corporations and/or by their senior executives (IRIS, 2010). Corporate fraud, theoretically,

is broad and encompasses a diversity of criminal and civil violations. Also, corporate frauds have progressively become very complex (Sutherland, 1949).

A typical fraud triangle often quoted in the literature has three major elements:

- (1) **Opportunity** – Sometimes defined as a perceived opportunity, which explains the method of committing crimes or frauds
- (2) **Motivation** – The strain or “need” that a person feels which could also be a apparent financial need, whereby a person strongly desires material goods but does not have money or means to acquire them; and
- (3) **Rationalization** – The technique and intellectual method by which an individual can come to an understanding in their mind and to validate any act or acts that they take part in.

Some of the factors and circumstances that permit an individual to have the opportunity include – the knowledge of the weaknesses of the company’s internal control systems, right to access the accounting records or assets, lack of or poor administration, unethical “Tone at the Top” and trust that the person will not get trapped (Fraud Risk, 2009). After having an opportunity and with the motive components of the fraud triangle having met, many need to and do rationalize their activities as the last and concluding step in the fraud triangle. Some do not need to rationalize their actions, and they know what they are doing, and no matter what the purpose, they do not need to attempt to veil their criminal activity from their soul (ACFE, 2007). Rationalization can alleviate their guilt and offer the culprits with the final requirement of the fraud triangle. Quoted factors for rationalization includes poor compensation, no or less appreciation, requirement of more money, etc. Duffield & Grabosky (2001) define fraud as an act concerning deception (for example intentional misrepresentation of the truth or distortion or concealment of a material fact) to attain an unfair benefit over another and to secure something of value or deprive another of a right. It happens when an executor communicates forged statements with the intent of defrauding a victim out of property or something of value (Vasiu and Vasiu, 2004).

Fraud can be classified into following types:

- Financial reporting fraud;
- Misappropriation of tangible assets, intangible assets or proprietary business Opportunities; and
- Corruption, including bribery, gratuities, money laundering, and embezzlement.

Fraud recognition and control

Researchers have projected various measures to diminish the intensity of fraud. These are generally classified into governance structures, amendments in the legal and reporting systems

and self-correction exercise within the organization. Corporate frauds often are easy to commit, but anticipation and prevention of these frauds is not an easy task (Seetharaman *et al.*, 2004). Reiss and Tony (1993) suggested that in order to prevent fraud, often one has to rely on the government to frame laws and rules which will lead the activities of organizations in order to set up techniques for their enforcement or compliance. Mesquita *et al.* (2004) found that these governance structures influence performance in the organizations and compensation packages are used for giving rewards to management and stockholders. Some other authors like Guttentag *et al.* (2008) pointed out on the need for additional disclosures which significantly reduces fraud. Baer (2008) is of the opinion that corporate frauds should be presumed as the type of crime that can be deterred. From the point of view of an organization, alertness and innovativeness can help in prevention of fraud (Coburn, 2006). Coburn (2006) also suggested ways to carry out an effective investigation in the organization and the relevant steps that needs to be considered if an investigation is undertaken. Employees who spill the beans at work on serious fraud and unprofessional conduct out of concern for public interest are to be afforded new protection against reprisals and unfair dismissal (Sarker, 1995). Li (2010) conducted a study on same issue i.e., corporate financial fraud and detection and used an empirical structure that models the strategies of interdependence between fraud & detection and accounts for the possibility that some fraud may remain undetected. Erickson's (2011) work on the same revealed that these lawsuits did not aim various types of corporate wrongs. On the other hand, these lawsuits often target the same suspected misconduct, the same defendants and the same corporate wrongs. Study of Dyck *et al.*'s (2007) on the effectiveness of external control mechanisms in detecting corporate fraud points that monetary incentives for detecting frauds against the government influence, detection without increasing frivolous suits is questionable, suggesting gains from extending such incentives to corporate frauds more generally. Business failures and frauds in the USA, several other scams in Russia and the Asian crisis (1997) put forward the corporate governance issues in the forefront in the developing countries and transition economies. Bonner *et al.* (1998) investigation suggests that certain types of financial reporting fraud results in higher chances of litigation against independent auditors. Study carried by Khanna (1996) contends that corporate civil liability avoids the unwanted characteristics of corporate criminal liability. Studies of Mutyala and Himachalam (2011) found that the current corporate scams and frauds that have come to light in recent times have brought about a transform and have necessitated substantial external regulations apart from the internal controls and regulations. Hence, corporate governance issues are of paramount significance for the business community internationally and international financial institutions. ACFE (2007) mentioned that social issue of corporate scams and espionage within the workplace and corporate atmosphere can have a devastating impact on the business entity in which these corporate frauds are happening. Alinsky (1984) in his study examined that organizations are a complex system designed by the humans to fulfill a definite purpose. Lack of proper administration is one causative factor to internal fraud and espionage. If an employee is in an environment in which there is little or no supervision then this makes it less of a threat to take part in fraud against the organization because they feel they will not be detected (Liska and Messner, 1999). Power is a key social concept in organizational situations. Advancement in information technology has also induced fraud to a very noticeable extent. Vasu and Vasu (2004) in their study proposed taxonomy of IT fraud concerning the

perpetration platform and method. For Internet or cyber fraud, Baker (1999, 2002) categorized fraud as: fraud in securities sales and trading, fraud in electronic commerce and fraud by Internet companies. MacInnes *et al.* (2005) categorized five major causes of IT fraud:

- (1) Incentives of criminals;
- (2) Characteristics of victims;
- (3) The role of technology;
- (4) The role of enforcement; and
- (5) System-related factors.

Studies prove that corporate fraud occurrences have a direct connection to audit quality, standards, and practices. Study of Ramos (2003) provides an extensive and methodical explanation, as well as execution guidance and practice tips for Statement of Auditing Standard Number 99 (Consideration of Fraud in a Financial Statement Audit) fraud standard. Durtschi *et al.* (2004) propounded Benford's Law, a helpful digital investigative process used by the auditors to identify fraud. Non-financial measures were effective in helping auditors to assess fraud (Brazel *et al.*, 2009). Owusu-Ansah *et al.* (2002) investigated the efficacy of 56 standard audit methods in detecting fraud. Auditors were also found to be affected by the format of the justification memorandum (supporting, balanced and component) in detection of fraud (Agoglia *et al.*, 2003). Brainstorming sessions were found to help auditors to improve fraud assessments (Brazel *et al.*, 2010; Hoffman and Zimelman, 2009). Hunton and Gold (2010) argued that those auditors who used most frequently used brainstorming procedure in practice (open discussion) create a lower number of fraud risks identified than those auditors who used the nominal group and round-robin brainstorming procedures.

Literature, generally, points out the fact that corporate frauds assume different forms, and the persons viewing frauds carry varying perceptions. A lot of studies contribute to the fact that corporate decision-makers have a strong inducement to commit fraud, knowing the fact that legal action taken will not have substance or may not be applicable. In India, there is a variety of laws dealing with frauds; however, frauds are still rising in India. Corporate frauds carry a large impact on various stakeholders. Recognition and avoidance of frauds is a national issue. The prevention of fraud is important for the corporate image of the national economy, and an efficient mechanism must exist to identify and stop the continuation of the frauds and strict prosecution should be in place. We therefore examine the nature and types of corporate frauds and their consequences and analyze the perception of companies concerning factors inducing corporate frauds, views on regulatory framework and fraud prevention mechanisms.

Objectives:

Following were the research propositions which triggered me to take up this study:

- Whether the corporate perception on the relative importance of fraud types is the same across various company types or not.
- Is publication of fraud prevention policy statement is uniform across all the companies or not.

Methodology:

As already stated, this paper is based on secondary data collected from research papers and internet, paper which is the main base of my research included a survey of literature on the corporate frauds *inter-alia* covering the nature, fraud types, inducements, motivations, detection and control mechanisms and roles of auditors, boards, etc. In this light, they had developed a questionnaire to analyze the perception of the corporate world in India and substantiate the results with arguments. They had conducted a sample survey of the corporate professionals, management, investors, government offices and authorities having wide experience on the issue of corporate frauds through a well-structured questionnaire judgmentally administered to 400 respondents through personal interviews, as well as mailed questionnaire methods and web survey, namely, www.surveymonkey.com, during the period from July 2010 to January 2013. Out of 400 respondents, 346 were selected for the study. My approach while conducting this issue was exploratory in nature. I had gathered data from various research papers; governments issued reports and recent studies. The survey questionnaire primarily used by the researcher whose study I've cited included enquiries about following:

- Status of the organization;
- Corporate frauds ranking according to prominence;
- Organizations policy and practice for preventing frauds;
- Views on factors behind corporate frauds;
- The position of corporate frauds in India, the role and performance of Indian companies in the prevention of corporate frauds; and
- Consequences of corporate frauds.

As already mentioned, this paper has used secondary data; primary work included some unstructured interviews (43) at the offices of government agencies like Company Law Board, Serious Fraud Investigation Office, Registrar of Companies, SEBI etc. Descriptive statistics and observation is used to describe the result.

Results

In my study it was found that the results of corporate perception on types of corporate frauds and organization policy and prevention mechanism in India differs and is presented as:

Corporate frauds types and inducements

Corporate frauds have been classified into four major groups, namely, Bribery, Misappropriation of Assets (MOA), Corporate Espionage, Procedural Frauds and Financial Statement Frauds (FSFs) and are rated by the respondents on a scale of 1-5 in the order of prominence.

Table- 1: Ranking of types of Frauds

Fraud Type	1(Rank)	2(Rank)	3(Rank)	4(Rank)	5(Rank)
Bribery	60	29	44	19	4
MOA	-	74	29	39	14
Corporate Espionage	38	18	45	47	8
Procedural Frauds	-	24	55	27	50
Financial Statement Frauds	66	-	35	43	12

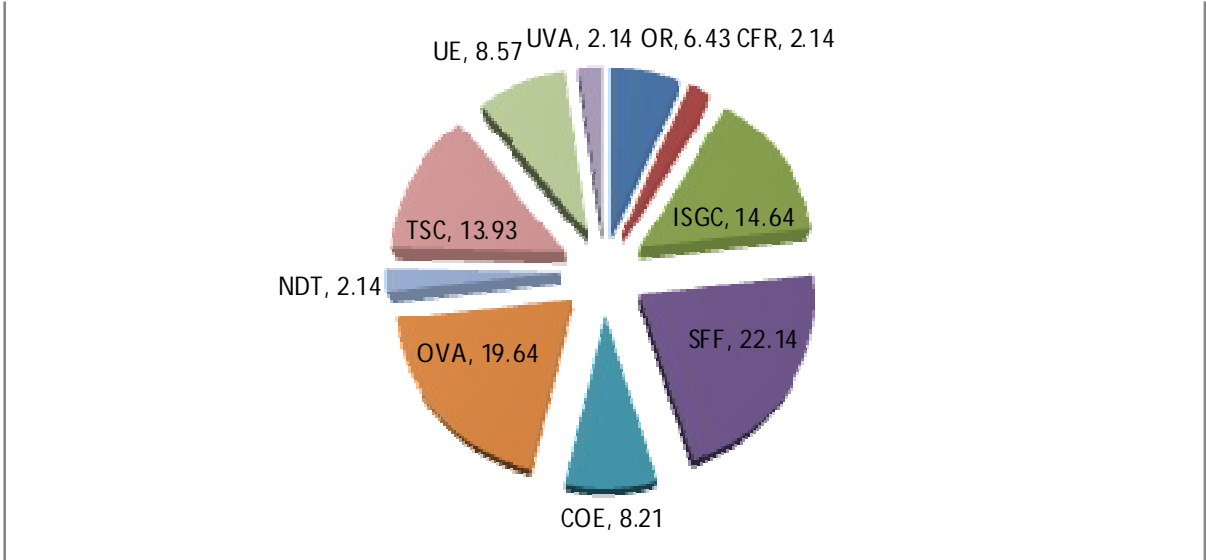
Source: Emerald insight

A large number of respondents ranked MOA as the most prominent type of fraud followed by FSF and bribery. The results confirm the fact that MOA and FSF are affecting investors and banks and financial institutions, which manipulate the market valuation of securities for investors and the manipulation of stock for banks and financial institutions. MOA may promote insider trading, as well as manipulate stocks for funding, while FSFs are committed to give rosy pictures to the investors like in the Satyam scam.

Bribery hampers the corporate image in the long run, which affects the business and its stakeholders. Large differences of opinion are obtained for FSF across capital clusters. Small companies, having capital between INR5-10 crores and relatively large companies above INR25 crores of paid-up capital believe that FSFs are the most prominent types of corporate frauds. For example, Satyam Computer chairman made a nexus with the statutory auditor of the company to audit the untrue financial statements.

Also, as per the provisions of the Companies Act, 1956, the appointment of Company Secretary and Managing Director is mandatory as soon as the paid-up capital of the company rises to INR5 crores. Furthermore, to maximize borrowings from the bank or financial institutions, the company management, with the help of unscrupulous professionals, prepares untrue financial statements, such as manipulation of stocks and false valuation of fixed assets, to reflect a rosy picture of the company and not accounting for provisions and actual liabilities, including statutory dues shown as contingent liabilities or disputed liabilities. This calls for a surveillance mechanism required when any organization being a company enters into the early stages of its capital cluster.

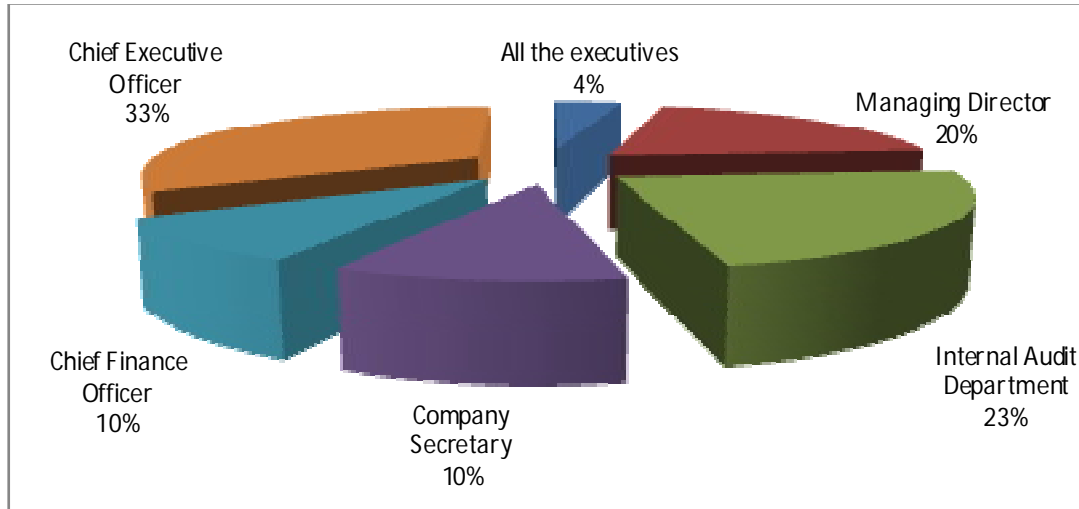
Figure-1: Financial Statements Fraud Types



Source: Emerald Insight

Notes: OR (overstating revenue); CFR (creating fictitious revenue); ISGC (investment in shares of group companies beyond FMV); SFF (siphoning of funds to off-shore entities); COE (capitalisation of operating expenses); OVA (overstating value of assets); NDT (non-disclosure of transactions); TSC (transaction between sister concerns); UE (understating expenses); UVA (understating value of assets)

Figure-2: Fraud Responsibility



Source: Emerald Insight

Study found out that 19.64 percent of the respondents indicated the overstating the value of assets as a form of FSF. The basic type of over-valuation assets is cash in hand, stock and debtors and revaluation of fixed assets. This type of practice is adopted by a corporate to mobilize more and more financial resources of the Companies Act, 1956 to remove such delinquent managerial personnel from the Board of such companies in larger public interest.

Table-2: Capital Clusters & Type of Fraud

Type of Fraud	F-ratios
Bribery	7.818
Misappropriation of Assets	<i>9.105</i>
Corporate espionage	7.122
Procedural frauds	<i>14.292</i>
Financial statements Frauds	<i>19.831</i>

Source: Emerald insight

Note: Italic numbers shoe the significant F-values.

This study suggests the rotation of auditors because this table shows large difference of opinion for financial statements fraud across capital clusters. Small companies, having between INR5-10 Crores and relatively large companies above INR 25 crore of paid-up capital believe that financial statements frauds are most prominent type of corporate frauds.

Furthermore for bribery, F-ratio was highly significant across respondents differentiated on the basis of role. CEOs & MDs have given highest ranking to the prominence of bribery. Hence, appointment of rational independent directors on the board with a significant say is of outmost necessity in corporations in India.

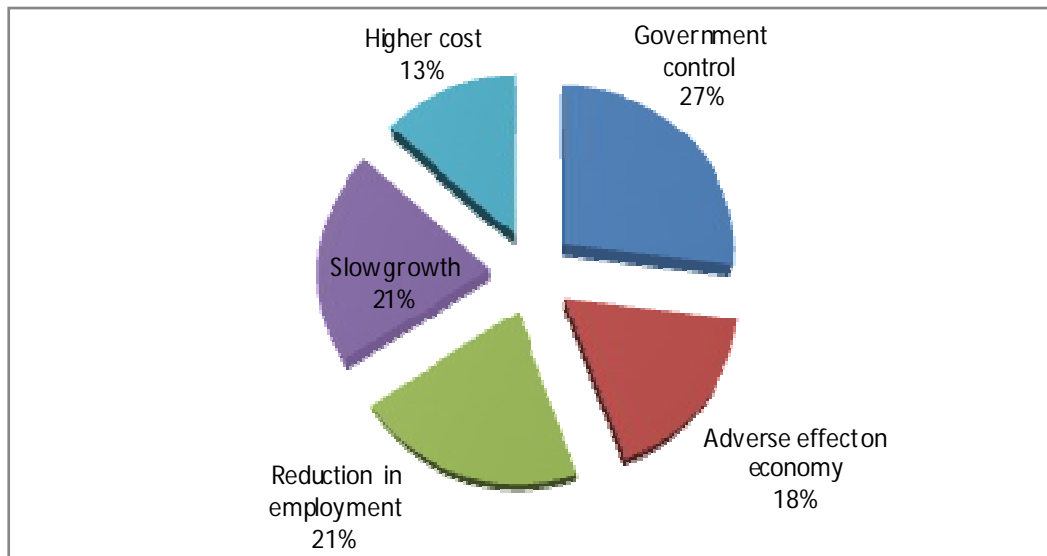
Table-3: Policy documentation v/s publication

Opinions	Publicizes policy statement	Does not publicizes policy statement	Not aware of publications
Have a policy statement	32	0	8
Don't have a policy statement	27	52	0
Not aware of policy statement	8	0	29

Source: Emerald insight

This study found out that there is dire need for publication and reporting of suspected frauds through a well- structured mechanism.

Figure-3: Consequences of Fraud on Economy



Source: Emerald insight

This study found out that these scams affect a country in numerous ways, which has been depicted in the above figure.

Key findings of my research are that about 58% respondents believed that fraud incidents are likely to rise in next upcoming years. Top three reasons identified are: Lack of efficient control, Diminishing ethical values & Senior Managements override of control.

Conclusion

Corporate frauds are on the rise globally and in India, and therefore detection and prevention are of prime concern of everybody, be it the government or the shareholder. Efforts are being made by all concerned to prevent such corporate frauds and alleviate the pain and agony of small investors and shareholders. The analysis shows that bribery, FSFs, MOA and procedural frauds are major categories of frauds prevalent in the corporate sector, which affects the corporate image, brand, and profitability of a company. The inducements for such frauds are the mobilization of more and more resources through banks and financial institutions and also through the general public by issuing equity shares and public deposits. Regulatory mechanism is a failure, which is evident from the formulation and publication of fraud reporting and prevention of document formulation and publication.

The complexity of corporate fraud (which is the handiwork of a select few) comes bare only when the complete edifice of a company has collapsed. Sudden surprises that a company has created the gullible investors and that the directors of the company have gone underground shakes the confidence of all the stakeholders. Shareholders feel helpless before a large corporate fraud. This shakes up the confidence of all the stakeholders, and the shareholders are helpless before a corporate mammoth. Such corporate fraud strips of the large taxes that the government could have earned, it strips off the valuable savings of the investors and the National Wealth has a negative plunge and everybody seems bewildered. It was found that there is an urgent need for consistency of publication standards of fraud prevention policies all over. The detection of corporate frauds, many times, becomes difficult, as the financial statements are fabricated or the balance sheet is camouflaged and also the frauds are never a part of the directors' report. Statutory disclosures also present statements on such a disguised balance sheet; hence, there appears to be a close and strong nexus between the perpetrators of the fraud and the unscrupulous professionals, making the fraud invisible till the lid blows off. This profanity of corporate fraud has a silver lining in the cloud, as it has three simple methods, which can be evolved to deter the perpetrators of the white-collar crime, its timely detection, and punishment of the accused and the delinquent persons. Results indicate that rotation of statutory auditors and compulsory appointment of qualified internal auditors can help to prevent or minimize fraud.

Note

- Cash received but not accounted for – CRAR;
- Cash paid but not correctly shown – CPCS;
- Misappropriation of inventory – MOI;
- Misappropriation of other assets – MOA.
- Financial statements fraud- FSF.

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