

ETHICS, CULTURES, FRAUD AND CORRUPTION – THE UNANSWERED QUESTIONS

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“All people are the same; only their habits differ.” (Confucius)

Abstract

The idea for the paper emanated from my concern regarding the absolute flood of unethical behaviour in recent times. Fraud and corruption in South Africa is rife and it seems that the average person has no control over what comes next. Considering the impacts of peoples’ background, social standing and culture, the paper considered the psychological processes through which learning of habits and mannerisms take place; and how it influences ethical behaviour. Valuable lessons are learnt, namely that culture, whether it being ethnical, organisational, family or religious, have a direct impact on a person’s ethical value system and subsequently on whether a person is inclined to partake in fraud and corrupt activities.

Fraud and corruption can cripple and destroy organisations and its auditors. Fraud and corruption are costly. The paper reports that it is ultimately the responsibility of executive management to manage fraud and associated risks – management must set the “Tone at the Top”. Managing ethics is costly, but ignoring it is fatal.

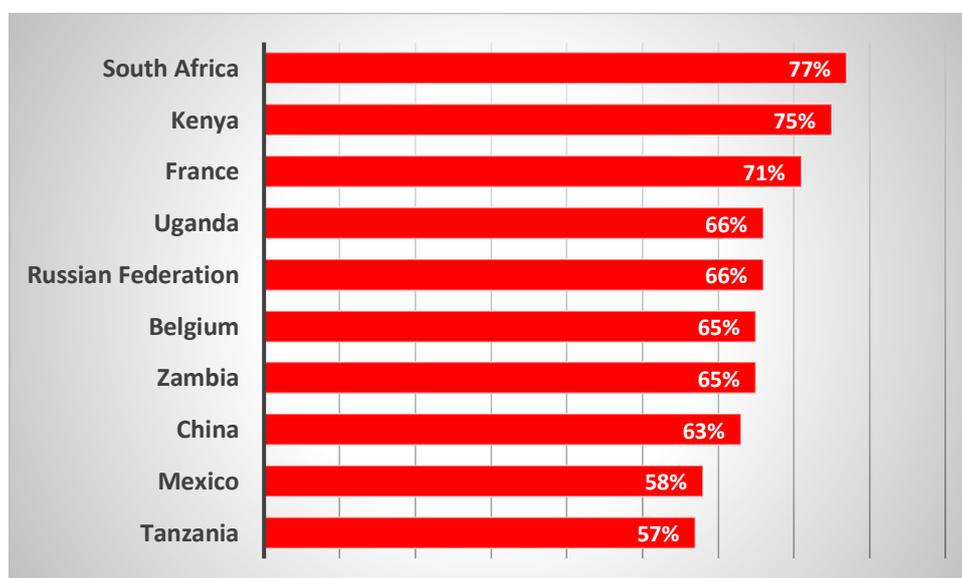
Although it is not the primary responsibility of auditors to detect and investigate fraud and corruption, the accounting profession needs to do introspection to determine what society expects of them. A mere audit opinion on annual financial statements does not satisfy the demands of society any more.

The question is apparently not whether fraud will occur in organisations, but rather when and that everybody must insist on doing the right thing – for the greater good.

Background and introduction

Fraud, corruption (collectively referred to as economic crime) and unethical behaviour are terms often mentioned in current media. More so, to report on incidents where such cases occurred instead of cases where it was prevented. In the business world today, many organisations suffer severe financial consequences as a result of the occurrence of fraud, corruption and other forms of commercial or economic crime (PwC 2018, ACFE 2018). A concerning phenomenon is the fact that a limited number of these intentional acts are discovered or reported, possibly attributable to the fact that it mostly costs more to investigate and prove fraud and corruption cases, than the actual amount of the monetary loss (Entrepreneur Staff 2019, LexisNexis Risk Solutions 2017).

In their annual Global Economic Crime and Fraud Survey, PwC (2018) reported that South Africa is the leader in the world with respect to the number of cases of economic crime reported (Figure 1 refers). What is *consoling* in a way is the fact that one does not only see developing countries under the top 10 countries. In the third place is France and seventh, Belgium – is it not ironic that one can use these as consolation?

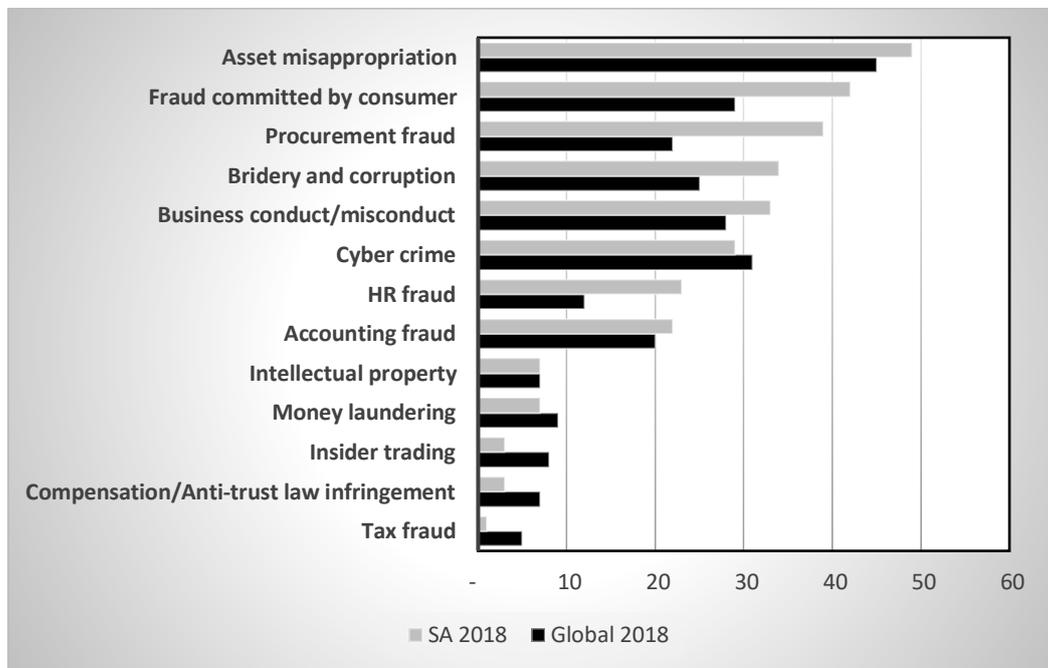


(Source: PwC 2018)

Figure 1: Top 10 countries in the world reporting the most economic crime

In addition, with regard to the types of fraud reported (refer Figure 2), asset misappropriation, fraud committed by consumers, procurement fraud, bribery, corruption, and business

conduct/misconduct, are the top five types of fraud that people engage in (PwC 2018). Asset misappropriation is the economic crime type reported most in the world (around 45%) and in South Africa (around 49%). In South Africa, more than a third of the economic crimes reported are bribery and corruption, compared to around 25% globally.



(Source: PwC 2018)

Figure 2: Types of economic crime reported

Considering the concerning statistics revealed, the paper is outlined by first, defining and contextualising ethics in relation to culture, with reference to value systems; second, economic crimes (fraud and corruption) in relation to corporate governance is defined and contextualised; and third, the paper presents closing arguments with concluding remarks.

In an attempt to understanding the reasons why some people engage in irregular or unacceptable activities or behaviour, in the context of economic crimes such as fraud and corruption, the next section briefly interrogates the possibility that *culture* could contribute to a person's inclination to engage in such activity.

Cultures

When considering Albert Bandura's *social learning theory* (Grusec 1992) the propensity to partake in criminal activity stems from similar psychological processes through which any person learns habits, mannerisms or behaviour – through repeated exposure or continuous observation. It thus begs the question whether criminal behaviour could be directly associated with, or attributed to a person's background, ethnicity, religion, childhood, living conditions, and/or a person's gender or sexual orientation – what behaviours or habits a person in his/her daily life are/were exposed to (Cowen *et al.* 1992).

From the previous reasoning, it seems that what was learned in past endeavours influences a person's behaviour – both positively and negatively. Gleaned from this argument (based on Bandura's 'social learning theory') is that if a person is constantly exposed to good and psychologically healthy activities and habits, in a stable and 'good' environment, it is more likely that such a person result in being a 'good' person – acceptable to the *greater society*. This same argument would thus hold true if a person is exposed to opposite habits, activities or behaviour – the person could end up being a bad person or even a criminal with unacceptable ethical behaviour.

In defining ethical standards and norms, it is important to consider the impact of different cultures associated with a particular setting within which these standards and norms are developed (Cohen *et al.* 1992). This is important as likewise assumptions of individuals and their beliefs result in an unconscious behaviour – a culture (Schein 1989). Culture is generally observed on three levels, namely ethical, national, and organisational (Schein 1989). As asserted by Hofstede (1980) culture on a national level can be defined as “the collective mental programming of the mind which distinguishes the members of on human group from another” and that ethical diversity is related to cultural diversity. Cultural difference between global regions, such as Western Europe and the United States of America (USA), resulted in differing fundamentals of their respective codes of ethics. For example, Western European codes of ethics are founded on principles of co-determination, responsibility and a sense of belonging, while the USA codes are founded on equity and fairness principles (Schlegelmilch & Houston 1989).

Observations by Hofstede (1980) revealed societal differences relative to cultural dimensions: power distance, individualism, masculinity and uncertainty avoidance. *Power distance*, refers to situations where more powerful individuals' 'power' is acceptable although a measure of inequality exists. According to the *individualism* concept (as opposed to collectivist), individuals are members of one or more "in-groups", (for example organisational, family or a clan) which they cannot release or detach themselves from. The individual's relation and association with the "in-group" is assumed to safeguard his/her personal interests, resulting in an expectation of loyalty. The *masculinity* principle refers to the extent that members of a society expect [male] members to be 'assertive', 'ambitious', 'competitive', 'striving for success', respecting everything that is strong, fast and big (Vitell *et al.* 1993).

The *uncertainty avoidance* concept relates to aspects that are unstructured, unclear, and/or unpredictable, resulting in the members of a particular culture to be unhappy or uneasy with the situation (Vitelli & Endler 1993). A higher the level of *uncertainty avoidance* would result in cultures being more aggressive, involved, active, emotional, demanding comfort and intolerant.

It is thus clear that the culture with which a person is associated, will determine a person's behaviour when confronted with a particular situation. Where a person is confronted to choose between partaking and not partaking in criminal activity, the culture of that person would play an important role – thus affecting the persons ethical behaviour. According to Christie *et al.* (2003) culture is a significant determinant of ethical attitudes of business managers. The cultural forms that might have an impact on ethical behaviour, especially in respect of business activities, include societal, religious, family, organisational and ethnical culture. As these cultures could have an impact on ethical behaviour, ethics as it relates to economic and/or business activities is defined and contextualised next.

Ethics defined and contextualised

Doing business, or conducting of business activities, involve human actions and interventions. These actions and interventions are carried out, mainly through being required to make

decisions by individuals or groups of individuals such as a manager, teams or a board of directors of a company. The decisions are influenced by an understanding of what good ethical behaviour is. Because individual persons are involved in all decision making, the ethical values of each individual could substantially influence the decision.

Van Vuuren (2019) states that: "... organisations are reluctant to manage their ethics performance". In his attempts to find reasons for this phenomenon, Van Vuuren (2019) states that the reluctance could be attributable to a false sense of trust or faith that people have in one another – believing that people are ethical or that they are unethical. Various scholars provide definitions of ethics and some with underlying theories were presented around this phenomenon. In their attempts to define ethics, scholars used both the terms *ethics* and *morals* – in combination or separately. (Kretzschmar, *et al.* 2014; Rossouw & van Vuuren 2015). All attempts to define ethics, include reference to 'what is good or right in human interaction'. From these definitions, three distinct concepts emanated: self, good and others (Kretzschmar *et al.* 2014; Rossouw & van Vuuren 2015).

Considering the various definitions of ethics, it is clear that defining ethics is about more than just right and wrong. As previously explained, multifaceted thoughts impact on peoples' perceptions on what is right and wrong; as well as reasons why something is regarded as right or wrong (Bishop, 2013). In addition, Collins (2011) reference six business ethical theories underlying his definition of ethics that relate to ethical decision making, namely: egoism, social group relativism; cultural relativism, utilitarianism, deontology and virtue ethics. These theories are useful when one has to determine whether a decision or action can be regarded as ethical or unethical. However, from the context of this paper, three of the six theories are most applicable. The three are:

- Utilitarianism – ethical consequence. The application of this theory relates to whether the result or consequence of an action, is best for the greater good;
- Deontology – reason/s for taking a particular decision where the reason has reference to individual rights rather than the greater good; and
- Virtue ethics – characteristics (traits and habits) that could result in a good, happy and meaningful life.

Based on the focus of this paper, ethics and ethical behaviour in the economic environment, business ethics emanated as a “new field of study” (Engelbrecht 2012). However, the field of study has grown almost exponentially (Arnold, *et al.* 2006; Engelbrecht 2012). Naude (2006) cautions that business ethics could contribute to “sharpening the teeth of the tiger” – reassuring the morality of organisations while pervading wrongs flourish vehemently. Previous arguments on how a person’s ethical values are determined are applicable in terms of business ethics too. The culture within an organisation will have an impact on the behaviour of those associated with a particular organisation or business. Businesses develop and enforce values and slogans that are ‘drilled’ (rightly or wrongly) into all of its employees’ and stakeholders’ conscious awareness – in an attempt to create a particular *corporate* or *business culture* – and in doing so, stimulating a person’s development or growth into specific ethical behaviour.

One can thus deduce that it is the ‘tone at the top’ that determines the general ethical consciousness and behaviour of individuals and groups associated with the organisation – resulting in an almost tangible ambiance. Just think of the ambiance that one experience when walking into a bank, hospital, church or school. When referring to the ‘tone at the top’ one immediately thinks of senior management and the board of directors – those responsible for giving direction in an organisation (Schwartz, *et al.* 2005). The board of directors and therefore directors individually, play an important role in determining [setting] the ethical climate and culture of an organisation. It is thus primarily the responsibility of the directors or senior management to ensure sound ethical behaviour throughout their organisation. In exercising their duties in relation to development of an organisational code of ethics, Schwartz, *et al.* (2005) propose six ethical values as the foundation of the code, namely: honesty; integrity; loyalty; responsibility; fairness; and citizenship.

The code of ethics of the organisation serves as one of the ‘tools’ of the board to ensure good corporate governance. Corporate scandals throughout the world have made regulators and business leadership aware of the importance of improved control and management of their organisations. Since 1994, the King Committee on Corporate Governance in South Africa have developed the King Reports on Corporate Governance, with the most recent version thereof

the King IV Report on Corporate Governance for South Africa (Rossouw, *et al.* 2002; Tshipa, *et al.* 2018).

In spite of legislation and governance codes, increasing occurrences of fraud and corruption are reported annually (Christensen 2019). To provide context of fraud and corruption as it relates to the context of this paper, the next section provides explanations and clarifications on what these two concepts entail.

Fraud and corruption

Fraud constitutes “a wrongful or criminal deception *intended* to result in financial or personal gain for the perpetrator” (Coetzee, *et al.* 2019). Fraud is further categorised as either employee fraud (commonly known as blue-collar crime) or management fraud (also referred to as white-collar crime). Unfortunately, the majority of people in society are ill informed about the detail of what exactly fraud is, what actually happened, or led to the instances of fraud and/or corruption in these

“In this era of unparalleled public scrutiny, today’s organisations face a perfect storm of fraud related risks – internal, external, regulatory and reputational.” (PwC 2018)

organisations. Many of the fraud or corruption cases appear on television news broadcasts providing a brief and limited commentary. Contributing to the dearth of information to society regarding fraud and corruption cases are the journalists who collect the information for news broadcasts – they only highlight the *sensational* news events, those events that will draw the attention of the curious minds of people. Any fraud case seem to be sensational, possibly for the same reason that people want to see what happened when they drive past a collision scene in traffic – human curiosity. Shocked at first about what they saw, but soon carries on driving, forgetting about the collision scene and its potential consequences. Similarly, most business executives have forgotten what has happened with Enron and its auditors, Arthur Andersen following the revelation of the financial statement fraud that occurred. Jeffrey Skilling (CEO of Enron) was sentenced to 24 years in prison (Briefings Magazine 2017); Enron totally collapsed; the fifth of the “Big 5” accounting and auditing firms, Arthur Andersen collapsed; thousands of people lost their jobs; and people and businesses lost millions of dollars – the fraud resulted in dire consequences.

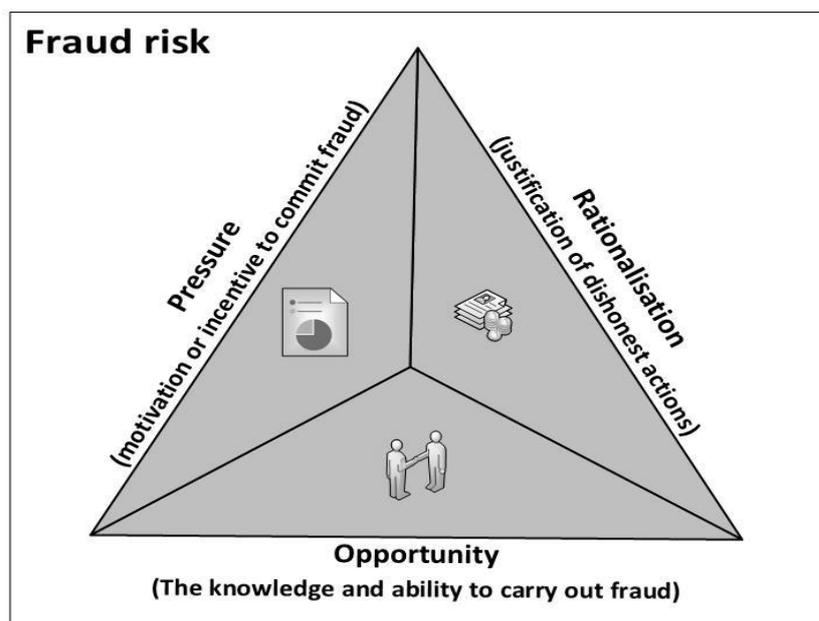
Business executives all over the world duly noted the consequences of the Enron scandal and have forgotten all about it as, subsequent to Enron, a further number of financial scandals, with similar dire consequences, were revealed. Table 1 shows the 10 worst accounting scandals of all time, as reported by Accounting Degree Review (2019). Some concerning observations are, first that in all the cases *executive management* are responsible for the frauds (white-collar crime) and second, that large accounting and auditing firms – the “Big 5 [4]” – were the auditors.

Table 1: The 10 worst accounting scandals of all time

Scandal	Year	Damage	Fraudster/s and their position	Auditors
Waste management Scandal	1998	\$1.7 billion fake earnings	Dean L. Buntrock (CEO/Founder/Chairman)	Arthur Andersen
Enron scandal	2001	Shareholders lost \$74 billion	Jeff Skilling (CEO); Ken Lay (former CEO)	Arthur Andersen
Worldcom Scandal	2002	Inflated assets by up to \$11 billion Investors lost \$180 billion	Bernie Ebbers (CEO)	Arthur Andersen
Tyco Scandal	2002	CFO and CEO stole \$500 million	Dennis Kozlowski (CEO); Mark Swartz (CFO)	PwC paid \$225 mil to investors.
Healthsouth Scandal	2003	Inflated earnings - \$1.4 billion	Richard Scrushy (CEO) main player	E&Y settled for \$107 mil.
Freddie Mac Scandal	2003	\$5 billion earnings misstated	David Glenn (President/ COO); Lelend Brendsel (Chairman/CEO)	PwC settles law suit
American Insurance Group Scandal	2005	Accounting fraud \$3.9 billion.	Hank Greenbag (CEO) Paid \$9.9 million settlement	PwC
Lehman Brothers Scandal	2008	Hid over \$50 billion in loans as sales	Lehman executives; AND Ernst & Young	E&Y
Bernie Madoff Scandal	2008	Ponzi scheme - \$64.8 billion	Bernie Madoff; David Friehling; (accountant); Frank Dipascalli	E&Y held liable for losses.
Saytam Computers Ltd. Scandal	2009	Falsly boosted revenue by \$1.5 billion.	Ramalinga Raju (Founder/Chairman)	PwC 2-year India audit ban

(Source: Accounting Degree Review 2019)

All the accounting scandals listed in Table 1 were reported on television news all over the world, but it did not deter the subsequent fraudsters – why not? This question relates to the psychology of fraud – why do people commit fraud? Coetzee *et al.* (2019) mentions two main reasons why organisational fraud occurs. Apart from internal factors such as culture and background, as mentioned and discussed previously, external factors or reasons are first, an *unfair expectation and pressure* on individuals to do *whatever it takes* to achieve targets or profits; and second, personal gain. The latter is also attributable to personal greed. A third factor that contributes to fraud occurrence is opportunity. These factors resulted in the presentation of the fraud triangle. Figure 2 illustrates the fraud triangle. It shows how the three factors [elements] are interrelated in peoples’ reasoning and justification for committing fraud.



(Source: Coetzee *et al.* 2019)

Figure 2: Fraud triangle

A further ‘cancer’ in the business environment is *corruption*. I compare corruption to cancer. If it is detected timeously, it can be managed or mitigated, however, if not detected timeously, the cancer [corruption] will spread throughout the body [organisation] to a point where it is likely to cripple, destroy or *kill* the body [organisation]. Although fraud and corruption refer to similar types of irregular actions, semantic differences exist. Different to fraud, corrupt

activities include bribery, kickbacks, commission and other irregular gains. Corruption is committed without leaving an audit trail – it occurs informally, unstructured and secretly.

A multitude of scholarly research on why people commit fraud and/or corruption exists (Coetzee, *et al.* 2019). These studies revealed a few common psychological characteristics of fraudsters, namely:

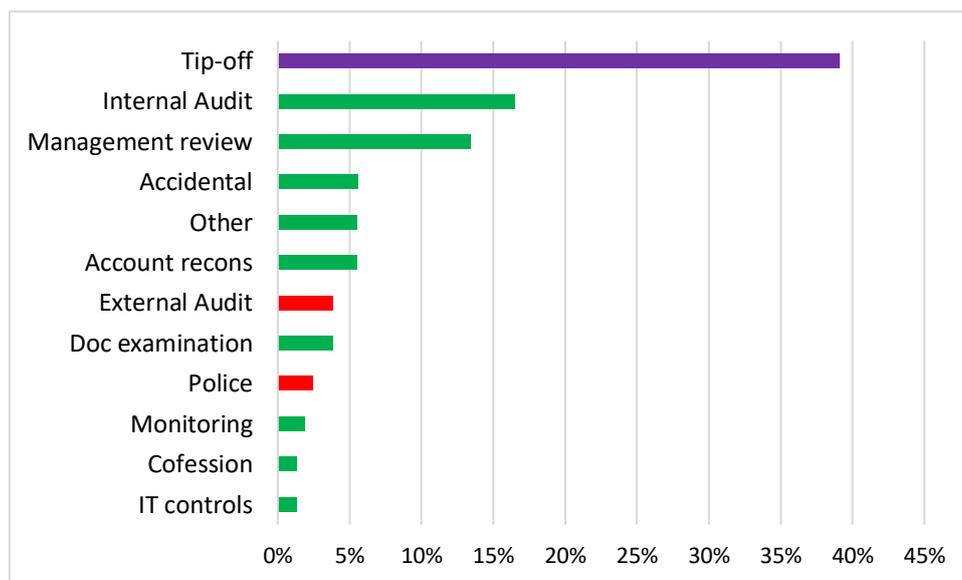
- They are able to work on their own and are independent;
- They are highly intelligent and skilled and are able to beat an internal control system;
- Their communication skills enable them to reason themselves out of a situation when they are confronted;
- They do not deceive themselves in performing their normal day-to-day tasks and during dealings with their colleagues – they have a strong self-esteem.
- Their own justifications will only fail them once their irregular activities are actually uncovered.

In addition, the Association of Certified Fraud Examiners (ACFE 2018) in their discussion on the profile of a fraudster, asserted that a person that would typically consider committing a fraud is:

- male and middle-aged;
- on managerial level within the organisation; and
- someone who has authority and power as a result of the seniority he holds in the organisation.

So, who is responsible for managing the risk of fraud and corruption in the organisation? Too many organisations – and society – are of the opinion that the *assurance providers* (internal and external auditors) are responsible for preventing and detecting fraud. This misunderstanding could be a contributing factor to the high occurrence of fraud and corruption. Do the directors and senior management not [intentionally] neglect their legal responsibility by assuming a false sense of assurance while placing too much (unfair) reliance on the auditors? Another question that emanates from these observations is whether society do not have faith in the leadership and executive management of organisations and that society therefor demands some form of comforting (assurance) that their investment or stake

in an organisation, is in good and capable hands (CICA 1988). An expectation gap thus exists. Society expects of auditors to provide them with comfort, while auditors are in fact unable to provide sufficient comfort through audit opinions that all *seem* well in an organisation. As soon as an organisation uncovers and reports a fraud or corrupt activities, society will immediately ask: *where were the auditors? Why did the auditors not detect the fraud during their audit engagement?* Statistics reported by ACFE (2018) (refer Figure 3) reveal that during 2016, external auditors detected *less than 5%* of occupational frauds and internal auditors approximately 16%. The vast majority of occupational frauds were detected by means of tip-offs (almost 40%). Again, this leaves the question whether the assurance providers are doing enough, or are they sufficiently sensitised to detect irregular activities during their various assurance engagements. However, it is reassuring that internal mechanisms or activities in organisations detected most (10 out of 13) occupational crimes.



(Source: ACFE 2018)

Figure 3: Initial detection of occupational frauds

Fraud *investigation* (also known as forensic accounting) is a highly specialised skill. Limited attention is given to this skill in the education and training syllabi of auditors – both internal and external. Professional bodies in their competency frameworks and professional standards expect of their members (auditors) to have an awareness level of competence of fraud (Labuschagne 2014). The professional standards do not require of auditors to have a high competence level for fraud investigations.

Thus, is it fair to frown upon the auditors if they did not detect fraud? If so, professional bodies and auditors need to pay close attention to the desires and demands of society, that society expects more assurance from auditors than a mere “audit opinion on annual financial statements”.

As explained previously, the prevention and detection of fraud and other irregularities is primarily the responsibility of management. In South Africa, the Companies Act, No. 78 of 2008, enacts that directors are responsible to the shareholders to manage fraud and corruption risks. Although the duty to manage fraud risk is delegated to senior management in the organisation, the governing body or board of directors will ultimately remain *responsible*. The role and responsibilities of audit committees as one of the components of good corporate governance, is often overlooked or excused when fraud and corruption is revealed. According to Business Daily (2018) “... audit committees are identified as effective means for corporate governance that reduce the potential for fraudulent financial reporting”. A concept of combined assurance saw light as a consequence of these anomalies. In terms of combined assurance, the board, external auditors, internal auditors and the audit committee form the four pillars of corporate governance (Coetzee, *et al.* 2019) thus resulting in a shared responsibility for managing, preventing and detecting acts of irregular activity such as fraud and corruption.

A further challenge that organisations face in respect of fraud and corruption, is that it normally costs as much as twice the monetary value of the fraud to investigate the case. “The cost of proactively preventing fraud diminishes in comparison to the costs that are incurred to prosecute it” (Entrepreneur Staff 2019). Around 20% of organisations in South African had to spend “between **twice and ten times** as much on investigations as the original amount lost” (Entrepreneur Staff 2019). Similar results are reported for fraud investigations in the United States of America (USA) where about \$2.26 is spent on investigations compared to \$1.00 of fraud.

World-wide, the number of economic crime cases reported is growing, for example in the United Kingdom *75% more fraud cases were reported in 2018* compared to the preceding year

(KPMG 2018). Over time scholars have identified specific trends and appearances by which organisational fraud is characterised (Coetzee, *et al.* 2019), these are briefly outlined:

- The higher the level of authority of the fraudster, the greater the fraud loss;
- The longer employed, the greater the fraud loss;
- Fraud losses caused by men are greater than the losses caused by women;
- The higher the age of the fraudster, the bigger the fraud loss;
- The higher the educational level of the employee, the higher the fraud loss;
- Larger fraud losses (in terms of monetary value) are experienced in the purchasing, upper management and marketing departments;
- A higher frequency of fraud cases are reported in the accounting, upper management and sales departments; and
- Fraud perpetrators are mostly first time offenders.

It is concerning that it can be deduced that, as was seen from earlier discussions in this paper, fraudsters go through a psychological process of *learning* to commit fraud; and the more experience they gain over time, the more *brutal* and *arrogant* their fraudulent behaviour becomes. Factors that reportedly influence the magnitude or severity of economic crimes are: level of authority; length of time employed; gender; age; and level of education. It seems that an increase in the value of these factors, result in greater fraud losses [consequence] – a direct relationship.

Attempting to make sense of all the findings and revelations in the paper thus far, the next section provides a summary of the paper as well as concluding remarks.

Summary and conclusion

Can auditors be trusted? Do auditors have integrity? Do auditors understand and live the values of their profession? Can business leaders be trusted? Can government be trusted? Is it attributable to the African cultures that we have more corruption in South Africa? Is it because the African Value System is different to that of the rest of the world?

These are typical and uneasy questions that one needs to ask when considering what has, in recent years, unfolded in South Africa and globally – especially insofar as economic crimes (fraud and corruption) are concerned. Although the answers to some of these questions are not yet provided, we saw that certain behaviours and habits are learned through constant exposure to behaviours; that cultural habits do have an impact on how people behave ethically – a psychological learning process takes place. Business executives and boards set the “tone at the top” in the organisations (Schwartz, *et al.* 2005). Employees see and learn – almost like the proverbial and axiomatic “monkey see, monkey do”. Like when children see what their parents do and learn – natural psychological learning takes place from a very early age in a person’s life, or professional career, and mannerisms, habits and cultures are formed.

We learned that occupational crimes follow patterns and that specific similar characteristics are present in most of the occupational crimes detected and investigated. We also saw that the assurance providers are not the best defense against fraud and corruption in the organisation; and that auditors are not adequately skilled to detect and investigate fraud. In most cases it is just not worth spending money on investigating fraud as it will cost more to investigate a fraud case than what the actual loss from fraud amounts to.

From the deliberations and arguments presented in this paper, I am not convinced that organisations’ executive management and society realise or contemplate the devastating consequences of unethical behaviour. The following questions/thoughts are left unanswered in my mind:

- Do people understand ethics and ethical behaviour?
- Why do people in my organisation commit fraud?
- When will they commit fraud – not will they commit fraud?
- Who will commit fraud in my organisation?
- How will they commit fraud?
- How much will it cost my organisation?
- Will my organisation survive the fraud/corruption?

It is not a matter of whether an organisation is victim to commercial crime, it is a matter of *whether* or *when* it will be detected. In spite of the almost depressing statistics, it is now time

to start insisting on doing the right thing. To manage ethics is costly, but consequences [and losses] of fraud and corruption is disastrous and dreadful.

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