

## The Fraud Model in International Contexts: A Call to Include Societal-level Influences in the Model

Joshua K. Cieslewicz \*

### ABSTRACT

This study evaluates fraud in China from the perspective of Chinese Nationals using an explorative, qualitative approach. This study finds that in order to understand fraud in China, societal-level influences – including philosophical and religious tradition, culture, social norms, and societal conditions such as rule of law, political climate, and socioeconomic factors – must be taken into consideration. There are significant societal-level factors that influence fraud in China that have no direct equivalent in the United States, where the Fraud Triangle Model was originally developed. As societal-level factors vary across nations, an expanded version of the Fraud Triangle Model has been provided to enhance usability of the Fraud Triangle Model internationally. Fraud is a global problem, and the Fraud Triangle Model should adequately explain fraud in different societies and be well-suited for international use. Giving credence to societal-level fraud factors can increase the effectiveness of fraud risk evaluations performed by external auditors, internal auditors, audit committees, managerial accountants, and management around the world.

**Keywords:** Fraud, China, international, culture, society, fraud triangle.

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\* Joshua K. Cieslewicz is Assistant Professor at the Utah Valley University.

## **INTRODUCTION**

The primary purpose of this study was to obtain an understanding of fraud in China from the perspective of Chinese nationals. The qualitative Grounded Theory Methodology was utilized (Glaser and Strauss 1967; Strauss and Corbin 2007), which is well suited for exploratory research. Semi-structured interviews of Chinese nationals were performed. The semi-structured nature of the interviews permitted delving deeper into topics that arose in the course of the interviews. The interview data were transcribed and studied in light of what is understood about fraud from the Fraud Triangle Model and from accounting, cultural, sociological, and international business theories. During this process, additional interviews were performed to clarify the data and to substantiate findings. The data suggests that the Fraud Triangle Model, as commonly applied in the United States, does not make provision for all of the factors that influence fraud in China. Specifically, societal-level influences on fraud, which this study illustrates differ substantially between the United States and China, have been omitted from the Fraud Triangle Model. A recommendation is made that the Fraud Triangle Model be expanded so that it adequately supports understanding not only fraud in China, but in other societies as well.

The Fraud Triangle Model was developed within the United States and makes assumptions about fraud that are tied to characteristics of the United States society. The Fraud Triangle Model does not indicate that these assumptions about society were made. Yet, when attempting to apply the Fraud Triangle Model in explaining fraud in China, it is necessary that U.S.-centric assumptions about societal influences be identified, shed, and replaced with societal factors pertinent to China. The conclusion of this study is not that the Fraud Triangle needs to be replaced, but that it should be expanded to include societal-level influences in order to address international contexts.

Currently the Fraud Triangle Model accommodates organizational and psychological factors that influence fraud. Pressure and rationalization are primarily psychological factors. Opportunity refers to particular workplace factors that give rise to the opportunity to commit fraud and is an organizational factor. Wolfe and Hermanson (2004) recommended adding capability to the Model. With the right

capabilities, opportunities can be identified and taken advantage of. In this sense, capability modifies opportunity. Capability is an individual-level factor. Societal-level factors have been left out of the actual Model. Although in the literature it is sometimes taken for granted that societal-level influences on fraud exist, they have not been included in the Model. As will be discussed later, when societal-level factors have been discussed in the literature, they have been presumed to be those that are relevant to the United States.

This is consequential for those utilizing the model in practice. An accounting practitioner from the United States who learns Mandarin and relocates to China would discover that knowledge of fraud does not transfer seamlessly from one society to another. In other words, it is not enough to understand organizational and psychological factors. For the Fraud Model to be useful at the international level, it requires understanding societal differences and their impact on the existing Fraud Triangle Model factors. Factors including philosophical and religious tradition, culture, social norms, rule of law, socioeconomic conditions, and political status have effects on fraud.

China is currently the world's second largest economy, and many nations around the world are economically linked to China such that business decisions made in China have global repercussions. The decision in China to use melamine in the production of food products such as baby formula, chocolate, and pet food (Macartney 2008; Magnier 2007; Vause 2009) as well as to apply paint containing lead to toys distributed around the world (BBC 2007) illustrate the pervasive reach of China, as well as the importance of understanding intentional deception for gain in China. Academic institutions should likewise be concerned with understanding intentional deception in China, as exemplified by the expulsion by Newcastle University of students from China. The students had patronized enterprising businesses to prepare their applications which included forged degree and English proficiency documents (BBC 2008). Such surprising instances of fraud may be understood when the societal context in which they occur is understood.

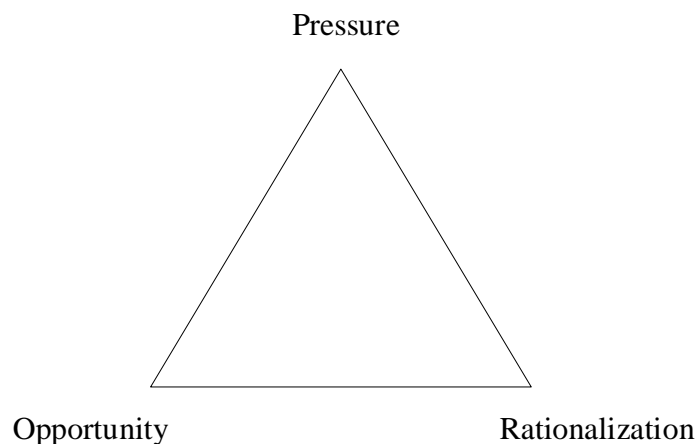
This study extends accounting research by providing an in-depth review of societal-level factors that influence fraud in China. It contributes to the literature on the Fraud Model by describing ways in which societal-level factors influence fraud. It also extends the usefulness of the Fraud Model internationally by adding societal-level factors to the model. In the next section, prior research on the Fraud Model, on fraud in China, and on societal differences is reviewed and research questions are stated. Research methods are then presented, followed by an analysis of results, and then by conclusions.

## **LITERATURE REVIEW**

### **Fraud Triangle Model**

The traditional Fraud Triangle Model as used in accounting (see, for instance: Albrecht et al. 1995 p. 19) indicates that for a person to perpetrate a fraud, he or she must perceive an opportunity; must feel pressure; and must rationalize (see Figure 1). This conceptual model is somewhat abbreviated, as review of the original work from which the Fraud Triangle Model arose demonstrates. The original research was performed by Cressey (1953), who developed the theory underlying the Fraud Triangle Model through interviewing prison inmates in the United States.

**Figure 1: The Fraud Triangle Model as based on Albrecht et al. (see works from 1980-2004).**



The first element required for fraud was originally described as “trusted persons . . . conceive of themselves as having a financial problem which is non-sharable” (Cressey 1953, 30). Cressey (1953) elaborated on this concept, indicating that “non-sharable” means that a person does not feel a financial problem can be shared with those with whom it could possibly be resolved. Cressey indicates the terminology of “problem” was purposefully selected to be very broad, and the adjective “financial” was selected to imply that the “problem” is interpreted by the perpetrator to be in some way addressable through finances. Financial problems include, for example, 1) pressure from debt, 2) expenditures in excess of income, 3) instances in which it is conceived that revenge for unfair treatment from an employer can be accomplished through fraud, and 4) the translation of other problems into monetary terms, such as determining that an upcoming divorce will necessitate funds to pay an attorney (Cressey 1953). Accordingly, pressures, incentives, or needs may lead to fraud as supported by Cressey’s research, although this component of fraud is usually simply described in the accounting literature as “pressure.” On this point SAS No. 99 is more complete, stating that people who commit fraud “have an incentive or are under pressure, which provides a reason to commit fraud” (AICPA 2002).

Cressey continued, “[trusted persons] are aware that this problem can be secretly resolved by violation of the position of financial trust” (1953, 30). This finding describes the condition that the violator has an opportunity. Wolfe and Hermanson (2004) recognized that while an opportunity may exist, for a person to carry out a fraud, he or she must also have sufficient capabilities to do so. An implication of this is that organizations should not only focus on reducing opportunity at the organizational level through internal controls. They should also consider whether those situated within the parameters of an opportunity have the capability to perpetrate a fraud. The massive fraud carried out by Bernie Madoff, which required someone with Mr. Madoff’s charisma, reputation, and skill (Arvedlund 2009), or capability, coupled with the right set of circumstances, or opportunity, provides an example of how opportunity and capability together lead to fraud.

The last condition described by Cressey, “[individuals] are able to apply to their own conduct in that situation verbalizations which enable them to adjust their conceptions of themselves as trusted persons with their conceptions of themselves as users of the entrusted funds or property” (Cressey 1953, 30) is represented in the traditional Fraud Triangle Model as rationalization. However, it is questionable whether repeat offenders must rationalize anew each time they commit a new fraud. This is reflected in SAS No. 99 (AICPA 2002), which indicates that this component of fraud may be met by someone with an “attitude, character, or set of ethical values that allow them to knowingly and intentionally commit a dishonest act” (2002, paragraph 7). These factors are at the level of the individual, and again societal-level factors are absent.

The pioneering, seminal research on fraud by Cressey (1953; Sutherland and Cressey 1974) and Albrecht et al. (Albrecht et al. 2008; Albrecht et al. 2004; Albrecht and Albrecht 2002; Albrecht and David 2001; Albrecht 1996a, 1996b; Albrecht et al. 1995; Stice et al. 1991; Albrecht 1988; Albrecht and Schmoldt 1988; Albrecht et al. 1982; Romney et al. 1980) focused on individual and organizational-level factors. This may be because for their research, societal context did not change. As they examined fraud in the United States, societal context was a constant, a static part of the background. Societal factors are either ignored or are tied to the United States.

Albrecht et al. (1982) discussed social factors of the United States, yet did not discuss how societal factors vary internationally and that there are significant societal-level differences that alter how the Fraud Triangle components apply in other societies. Societal-level factors were not included in the Model, yet these factors vary dramatically around the world, just as individual-level factors vary from person to person and organizational-level factors vary from organization to organization. They indicated “Social forces resulting in increased fraud include: 1) failure to prosecute, 2) larger business, 3) ostracism of the whistle-blower, 4) more computers, 5) failure of the criminal justice system, 6) lack of honesty training, 7) welfarism, 8) inflation” (1982). It would appear that many of these suggestions are bound to the United States of the early 1980’s. Others are restricted more to the United States in general.

For example, “failure to prosecute” tends to take particular forms in the United States, such as a district attorney not pursuing charges or a company failing to report a fraud. But in China, failure to prosecute has markedly different connotations. In some societies, bribes may be paid to secure a release of a prisoner, and for this reason there is a failure to prosecute. Albrecht et al. do at one point mention bribes as one reason that fraud perpetrators may go free, but do not further address such a dilemma, one that is prevalent in many parts of the world (Husted 1999) and that alters the perceived risks associated with committing fraud, perceptions of the opportunity to commit fraud, and appropriateness of approaches to mitigating fraud. Leaving societal-level factors out of the Fraud Model implies they either do not influence fraud or are not found to vary around the world and can be considered constant. It further suggests that fraud in the United States, if instead exposed to societal-level factors from Africa or Asia, would be unchanged. Leaving societal-level factors out of the Fraud Model provides an incomplete picture of fraud.

Recommended solutions to fraud also appear to be intended for the United States (Albrecht et al. 1982). A selection of the suggested solutions follow: “Society and organizations within society can reduce fraud by : 1) prosecuting fraud perpetrators . . . 5) publicizing the discipline given fraud perpetrators . . . 15) giving convicted fraud perpetrators stiffer penalties commensurate with the dollar loss involved in the crime . . . 16) speeding up the judicial process to make fraud prosecution more cost-beneficial” (1982 p. 196). In comparison to the United States, China excels at these particular points, especially when saving face for the nation becomes important. White collar criminals can be executed with very short trials, with the results being highly publicized, and with relatively low cost. Consider, for example, the execution of the head of China’s food and drug safety agency for taking bribes from pharmaceutical companies (Magnier 2007) as well as the death sentences resulting from the use of melamine in the production of food items (Vause 2009). Albrecht et al. intended these specific recommendations for the United States in consideration of its lengthy and often unsuccessful prosecution of white collar criminals, as opposed to implying that China should further shorten its prosecution periods

and accelerate the penalties for white collar criminals. There also seems to be a cultural assumption underlying the list of recommendations – that of right to fair trial, an assumption that is not shared within China. Solutions to fraud that have been mentioned demand modification or even replacement in other societies. Societal differences are consequential when discussing fraud, but the current Fraud Model does not call for consideration of such differences.

The Fraud Triangle Model is not the only accounting model developed within the United States that fails to call into consideration societal-level factors. In speaking of the Internal Control Framework (COSO 1992), Hughes, Louwers, and Reynolds (2008) expressed that “the entity’s control environment is most often viewed as relatively self-contained. In other words, whatever occurs within the company’s control environment happens without reference to any external environment” (2008 p. 116). They stressed the importance, within the United States in the case of their research, of recognizing and considering societal-level assumptions that have bearing on the Internal Control Framework. Oversight of the import of societal-level factors has occurred in both the Internal Control Framework and the Fraud Triangle Model.

In summary, while excellent work has been done in evaluating fraud within the United States, international implications have been insufficiently addressed. Certain conclusions about fraud in the United States seem to exhibit inadequate fit for other parts of the world because of differences in societal-level factors. As such, the below research question follows:

***Research Question 1: Can the Fraud Triangle Model be used to explain fraud in different societies, namely China and the United States, without taking into account differences in societal-level factors? Alternatively, do societal-level factors need to be taken into account to adequately explain fraud in different societies?***



## **Fraud in China**

Studies of CPA firms in China have expressed there are problems with collusion in the auditing domain. In an archival study, Wang, Wong, and Xia found that Chinese state-owned enterprises were more likely to hire small, local auditors. They found that as national regulatory and economic institutions improved, the tendency of these state owned enterprises to hire small, local auditors increased. After investigating and eliminating several possible alternative explanations, the authors suggested that the state-owned enterprises might make this choice to more easily secure needed audit opinions through collusion (Wang et al. 2008). Such a conclusion warrants explanation, given research in the United States has not reached similar conclusions. A clear explanation as to why collusion might be to blame for this finding in China was beyond the scope of the study and research methodology employed. A qualitative study is better suited to provide this type of in-depth explanation.

Yunwei expressed that audit reports in China may be affected by governmental influence, thus impairing the independence of audit firms (Yunwei 2000). Earlier, DeFond, Wong, and Li (1999) found that modified opinions increased nine-fold after China adopted auditing standards based on International Auditing Standards. This was followed by a reduction in market share among large auditors who presumably have more at stake and are more likely to issue modified reports should conditions warrant them. Shafer (2008) found that auditors working for local firms in China – relative to those working for international firms – considered suspect actions to be relatively more ethical and represented that they were more likely to commit such actions. Based on these studies, it appears that small, local firms in China are relatively more likely to collude with clients, and that there is a flight to such CPA firms when regulation stiffens. Again, an in-depth, qualitative examination of aspects of Chinese society that assist in explaining these quantitative findings is needed.

Wong-On-Wing and Liu (2007) found that the Chinese in China, in comparison to Americans, pay more attention to situational factors and are less likely to interpret observed fraudulent behavior as fraudulent and to agree to punish those involved. This seems to imply that fraud is more likely to be

overlooked in China than in the United States and that the Chinese are less likely to report a bribe when one is discovered.

Significant efforts to improve the audit institution in China have been made, such as the adoption of standards largely consistent with international auditing standards in 1995 and the separation of audit firms from governmental control in 1998 (Lin and Chan 2000). An auditing firm cleansing took place between 1997-1999 in which the Chinese Ministry of Finance revoked 360 accounting firm licenses and reprimanded another 1187 firms, thus punishing 42 percent of all accounting firms (Yunwei 2000). Bringing independence to the auditing profession has been challenging in China. The current study seeks to understand what characteristics of the Chinese society may have caused this to be the case.

Efforts to improve the accounting institution in general in China have also been made, as evidenced by the adoption of standards based on International Financial Reporting Standards in 2006 (ICAEW 2008). The need for improvements is clear. In-Mu, Daqing, Donghui and Wu (2005) provide an example as to why this is the case. Their study demonstrated that when a regulation was enacted which required a return on equity (ROE) in excess of 10 percent for three years in order to qualify for stock rights offers, the number of firms claiming to meet this threshold jumped threefold despite declining economic conditions (i.e., 1996-1998). China has tenaciously churned through vast accounting improvements, yet problems persist. This study seeks to explain why problems with fraud, particularly with bribery and collusion, persist in China despite persistent and publicized efforts to curb them. Taking the perspective that this is more than an individual-level or organizational-level problem, the below research question follows:

***Research Question 2: What challenges related to fraud prevail in China that may be different from those faced in the United States?***

### **Societal Differences**

Before proceeding further, it may be helpful to point out that this study has no intention of singling China out as being worse than other nations when it comes to fraud. Clearly no nation is

immune from problems with fraud. The United States, for example, has repeatedly experienced massive corporate failures due to intentional deceit masterminded by executives. China was chosen for this study because of its rising status in the world and the importance of its economy to the world.

There is evidence that ethics are not better or worse with U.S. or Chinese managers (Shafer et al. 2007). A more wide-scale study – *Culture, Leadership, and Organizations: The Globe study of 62 Societies* – indicated that individuals across different societies consistently value strong ethics of their business leaders (House et al. 2004). Several studies have demonstrated that ethical perceptions *differ* across societies rather than demonstrating that some societies are more or less ethical than others (Cohen et al. 1992, 1993, 1995, 1996). Fraud occurs throughout the world (Apostolou and Crumbley 2007). The current study does not suggest that fraud is more prevalent in China than elsewhere. Rather, China provides a point of comparison that illustrates that societal settings in which fraud occurs differ remarkably, and that societal differences impact fraud across societies.

Societal factors also affect what a society will interpret as effective measures to reduce fraud, such that what one nation views as important in controlling fraud may not be viewed as important in another nation. Thus, whereas the United States created the Sarbanes-Oxley Act, other nations may come up with different solutions better suited to the particular society they are created for.

Different societies have, over time, arrived at different solutions (from an anthropological perspective) for maintaining order, for cooking meals, and for interacting with relatives. Likewise, they have developed different preferences or values in relation to business (Hofstede 1980; Trompenaars 1998; House et al. 2004), including accounting (Gray 1988). Even the types of counterproductive workplace behaviors that emerge most prominently have been shown to differ by society (Yang and Diefendorff 2009). This study seeks to understand whether fraud likewise is subject to societal-level influences, which differ across societies. In doing so, the following research question is pursued:

*Research Question 3: How can existing academic lenses – such as culture, social norms, philosophical tradition, and social capital – enhance understanding of the influence of societal-level factors on fraud?*

## METHODOLOGY

This study is a qualitative, exploratory study focused on understanding business corruption and fraud in China from the perspective of the Chinese instead of from what is currently understood about this topic in the West. As found in the literature review, studies have extended U.S. research into China and arrived at findings that have proven difficult to explain with Western theory. Accordingly, the assumption behind this study is that Western experience may or may not be prepared to explain phenomena in the East. The approach taken was to first seek to understand fraud and corruption in China through exploratory, qualitative research rather than to develop hypotheses relying on Western theories and quantitatively test the hypotheses.

Given this goal, the inductive Grounded Theory Methodology was followed (Glaser and Strauss 1967; Strauss and Corbin 2007). This method involves both semi-structured interviews and observations and provides that explanations emerge through the course of a study. The semi-structured nature of the interviews allows for further exploration and understanding of ideas encountered during the interviews and is appropriate for qualitative, exploratory research. With this methodology, if ideas are encountered that cannot be explained by existing theory, recommendations are made to augment the relevant theory. The recommendations are supported with qualitative interview data and a discussion of relevant research and related theories.

### Participants

Chinese nationals were interviewed. The interviews lasted on average about an hour and were audio recorded and transcribed, a process which took several hours for each interview. Of the eleven original interviewees, six had work experience in China. One of these was a professor from China, three

were graduate students, and two were upper division students. The remaining five were upper division business students who had learned about business in China from their parents who live and conduct business in China. Using subjects who were removed from China assisted in allowing for free discussion on sensitive issues about China. Students were given extra credit for their participation. Several of the subjects seemed to benefit from the interviews in that they expressed appreciation for having the opportunity to think about their society in ways they had previously taken for granted.

In addition to these hour-long interviews there were eleven brief interviews. These were performed to clarify data or verify findings. Two of these involved students previously interviewed, seven involved professors from China, and two involved business professionals from China.

### **Procedure**

As discussed above, semi structured interviews were conducted. Once transcribed, the interview data were reviewed and categorized in accordance with Richards (2005). The categorized data were then considered in light of existing accounting, cultural, sociological, and international business theories. It was during this process of analyzing the data from the original interviews that the briefer interviews were conducted in order to make certain that the original interview data were correctly understood and that conclusions drawn from the data appropriately represented the Chinese perspective. In many instances existing theory assisted in understanding the data and satisfactorily explained it. In other cases, existing theory fell short of explaining the data. When using this qualitative research methodology, these shortfalls are of the most interest as they identify potential areas in which existing theory may need to be expanded upon or revised.

### **ANALYSIS**

Whereas quantitative studies provide statistical results, this qualitative study provides illustrative interview data that describes societal-level factors that influence fraud in China. The goal is to provide insight into a different way of viewing fraud, from the Chinese perspective, as well as to discuss the data

from accounting, cultural, sociological, and international business theory perspectives in order to further enhance understanding of fraud in China. Based on the qualitative interview data and insights from existing theories, propositions for future research are presented. Finally, based on the findings, an expanded Fraud Triangle Model is presented.

### **Understanding “*Guanxi*,” or Relationships**

Interviewees, when asked to describe business in China, either immediately brought up *guanxi*, or when asked specifically about relationships in business, explained the nature of and importance of relationships in business in a similar way. One research participant explained that, “[Business in China is] very interactive, a lot of relationships between people. A majority of the things are based on building relationships.”

From the viewpoint of translation, there are terms in Chinese that have no equivalent concept in English (Schaffer and Riordan 2003; Brislin 1986). The word “*guanxi*” is an example. The semantic meaning of “*guanxi*” that is not easily explained to Westerners is at the core of one of the major societal-level influences on fraud in China. “*Guanxi*” is often translated as “networking,” yet this translation is inadequate. Westerners often assume the meanings of “*guanxi*” and “networking” are the same and assume they understand “*guanxi*” and thus overlook the complications, the depth of meaning, and the potency of *guanxi* (Fu and Liu 2008 p. 248).

The composition of the characters comprising “*guanxi*” carries insights into the concept of *guanxi*. In Chinese there are traditional characters, which can be very complex, and the simplified characters, which are now commonly used in China. The traditional character for “*gaun*” has the “door” radical around the perimeter (see Figure 2). This part of the “*guan*” character, when combined with the remainder of the character, expresses a closed door. This connotes the idea that some people are within closed doors with whom a relationship is honored, while others are without the doors and without a relationship to those inside. The traditional character for “*xi*” implies tying up and extending

relationships (Luo 2000). Together, they convey a complicated concept that has no direct equivalent translation into English.

**Figure 2: The first two characters are the simplified Chinese characters comprising “*guanxi*.” The latter two characters are the traditional Chinese characters for “*guanxi*.” The first of the traditional characters, or the third character below from left to right, is “*guan*.” It has the “door” radical around it, which looks like a “P” and then a backwards “P,” both with extra lines through them. This part of the “*guan*” character, when combined with the part that might be described as being between the doors, expresses a closed door. This connotes the idea that some people are within closed doors with whom a relationship is honored, while others may be without the doors and without a relationship with those inside the doors. The second traditional character, or the last one to the right, is “*xi*.” “*Xi*” implies tying up and extending relationships (Luo 2000). Together, they express a complicated concept that has no direct equivalent translation into English. The first two characters, which are simplified characters, also carry the full connotations of “*guanxi*,” as understood by the Chinese, even if the characters have been simplified and to the Western eye may appear to be very different from the last two traditional characters.**

Simplified

Traditional

关系 關係

*Guanxi* is so important to business in China that international business researchers have suggested the concepts of personal and position power originating in the West should be complemented with the concept of relational power from the East (Fu and Liu 2008). The roots of this emphasis on relationships are deep and are embedded in Confucianism, which emphasizes an individual’s relationships with others (Bian and Ang 1997). This emphasis is a part of the Chinese culture. Culture has been described as the “collective programming of the mind which distinguishes the members of one human group from another” (Hofstede 1984 p. 21). Outsiders, having not grown up in China and been subjected to the

Chinese “programming,” must come to appreciate *guanxi* in order to make sense of many aspects of business in China. Given the rising prominence of China in the world, it seems important to do so.

It is extremely important to the Chinese to maintain their connections, or *guanxi*. This importance is punctuated by considering what happens to people with poor *guanxi* as explained by one interviewee: “You probably will be able to move up, but you don't know if there's anybody that dislikes you that comes out on your way, that will kind of, mmm, kind of, sabotage your career (laughs). You never know.”

An illustration of the emphasis placed on relationships in China is that while in the West a successful businessperson is likely to be described as wealthy, in China such a person is spoken of as being “well connected” (Chen 2001 p. 45). As such, *guanxi* is a form of social capital. Social capital refers to the value inherent in one's relationships (Bourdieu 1986). With regards to this type of capital, “mutual acquaintance and recognition provide credentials which entitle people to various kinds of credit” (Luo 2000 p. 41). The Chinese go to great efforts to acquire this capital, being well aware of the importance of this type of capital in China. Bourdieu explained the value of social capital, which is well understood by the population in China: “The volume of the social capital possessed by a given agent . . . depends on the size of the network of connections he can effectively mobilize and on the volume of the capital (economic, cultural, or symbolic) possessed in his own right by each of those to whom he is connected” (Bourdieu 1986 p. 249).

An observation relayed by one of the participants underscores the difference between the American and the Chinese perspective on business relationships. The participant had an American brother-in-law. She expressed surprise at finding how little he would go out to dinner with coworkers. In China, employee-to-employee relationships are actively fostered by “hanging out” with each other. “You have to develop a very good relationship with [other employees]. Like, maybe hang out with them more, take them out for dinner, over holidays give them gifts, ask them about their family, and just do whatever you can to make the other person comfortable with you.” And foot the bill, too. Restaurants and karaoke



bars are very important to people's careers in China, and this is regardless of one's level within a company.

The importance of relationships is also evident in the approach taken to identifying new business partners. Whereas Westerners tend to be more concerned with getting down to business and discussing contracts, the East Asian approach to accepting a new business partner is to converse about sometimes seemingly irrelevant topics until it becomes clear that the other party is of the preferable type. Once a relationship of trust is established, business can follow. Relationships are so important that oral understandings are more important than written contracts. When disagreements arise, courts are usually avoided. "In the business world . . . agreements are based on personal honor and courts of law are viewed as arbitrary and are to be avoided in seeking resolution of business disputes" (Wank 2000 p. 275). Long-term business relationships with trusted partners are preferred. Such relationships are more likely to survive short-term gyrations as partners understand each other's challenges and work to their mutual health.

To reiterate, this study does not intend to equate *guanxi* with fraud. They are not one and the same. They are not synonymous. *Guanxi* itself is innocuous, though it is generally associated with admirable elements of the Chinese culture. Yet if one is to understand fraud in China, this important aspect of Chinese culture must be taken into consideration. For example, if one highly values relationships, one might be more likely to 1) to find a way to fraudulently assist someone with whom a trusted relationship is maintained, 2) assist someone in questionable activity if doing so may strengthen or create a desired relationship, or 3) have a relationship either within or without the organization that could make it possible to commit a fraud without detection. These conditions are complicated by the nature of communication in China. The Chinese in China are generally more indirect or "high-context" in their communication (Hall 1976). With regards to fraud, this lends itself to approaching a topic without directly explaining what one is getting at, or to feeling out opportunities to commit fraud without being overt. These two factors – the focus on relationships and indirect communication – make it relatively

more likely that more than one individual is involved in fraud, thus increasing the propensity for collusion. As a single fraud involving collusion by definition involves more people than a fraud isolated to one individual, the effect on society of a single fraud may be greater. *Guanxi* and a propensity for indirect communication, both of which are characteristics of Chinese society, introduce a new layer of complexity to fraud not contemplated by the Fraud Triangle Model.

It is difficult to square this pervasive preoccupation with relationships in China with findings from Albrecht et al.'s seminal work on the Fraud Triangle that has a clear focus on the United States. Indications of this focus include terminology, such as "Wall Street expectation" (Albrecht et al. 2004), reliance on statistics tied to data from the United States, and explicit reference to the United States (see, for example, Albrecht et al. 2008; Albrecht and David 2001). Quality research was performed, yet the research focused on the United States, and this limited the scope of the findings.

The following quote from Albrecht et al. (1995) emphasizes this. The part of the quotation in parenthesis is from the original text: "... collusive fraud is usually slower to develop (it takes time to get to know others well enough to collude and to "trust" that they will cooperate rather than blow the whistle)" (1995 p. 267). Given the continual energy the Chinese put into developing and maintaining relationships, it seems unlikely that this finding applies to China in the same way as it does in the United States. It also seems questionable that the same statistics apply for China as for the United States, such as the finding by the Association of Certified Fraud Examiners (ACFE 2008) that about 65 percent of frauds are committed without collusion.

The ACFE 2008 report also notes that in the United States, the median loss of frauds involving collusion is more than four times higher than other frauds. The ACFE's 2008 report focuses on the United States. The 2010 report from the ACFE (2010), while it considers data from around the world, does not provide similar descriptive statistics on collusion.

**Proposition 1:** Fraud in China, compared with fraud in the United States, is more likely to involve collusion due to an emphasis on *guanxi*.

**Proposition 2:** Fraud in China, compared with fraud in the United States, is more likely to involve collusion due to a societal tendency to favor indirect communication.

**Proposition 3:** Societal-level factors influence both the relative prevalence of collusive fraud in a given society as well as the way in which a collusive fraud is likely to come about in a given society.

**Proposition 4:** As societal-level factors differ society by society, fraud in different societies will be influenced by different societal-level factors. In instances in which societies have similar societal-level factors, fraud may be influenced by a particular societal-level factor to differing degrees.

### **Reciprocity and *Guanxi***

Principles of reciprocity are respected to varying degrees throughout the world. For example, in the former Soviet Union, the best goods were not obtained through waiting in line; rather, the best goods were obtained through connections. One had to extend favors to those in positions to distribute goods in order to be remembered when desirable goods became available (Neidhart 2003 p. 183). In China, principles of reciprocity are important aspects of *guanxi*.

The reciprocal nature of *guanxi* can be calculative, but is not necessarily so. One interviewee responded to a question about whether or not his willingness to step in and assist with a project assigned to another would depend upon if that person had previously been helpful to him.

No, but I would see how much I have to work [to provide] that help. If it doesn't hurt what I am doing I would be willing to [help] even though he hasn't helped me before because that's how we build relationships. Sometimes I don't look for returns I just help some other guys and maybe they will help me in the future, I don't know. But at least he doesn't hate me if I help him.

One example provided by interviewees illustrates the importance of reciprocity in Chinese thought. Many Chinese have shrines in their homes, or the homes of their relatives, honoring ancestors. Special holidays call for elaborate worship: “During July 14<sup>th</sup> on the Chinese calendar – the old one – the people believe the ghost door opens and the ghosts come out. And the people will burn paper houses and

money and things for them. And leave some food.” Another interviewee explained the sometimes-daily ritual of *baisan*: “They get pictures. Then they have the [fragrance or incense sticks] that they burn in front of the picture. At my home [the picture] is just some words. It says the name of a [legendary figure]. Powerful people that can have power to protect the person who does Baisan.” These relationships involve the burning of paper money, houses, and other objects representing material items with the belief that the items burned may then be used by the dead. Those involved in this ritual hope for reciprocating assistance from their ancestors who are beyond the grave. This example related to worship suggests that expectations of reciprocity are deeply embedded in Chinese society.

The principle of reciprocity is also reflected within families in that parents go to great efforts and sacrifice in raising children and providing education opportunities for them with the expectation that their children will take care of them in their old age. Rest homes are not an option. Children are expected to care for their aging parents.

Yet reciprocity is not always idyllic<sup>1</sup>. Bribery, kickbacks, and other types of covert payments are subsets of fraud that harness principles of reciprocity and that depend upon secrecy and trust within relationships. The audit research in China reviewed earlier suggests that collusion is problematic in the auditing profession. The current study suggests that this may be due in part to strong societal acceptance of reciprocal relationships being manifested in client-auditor relationships.

The business environment in China is marked by a preoccupation with relationships and expectations for reciprocity within those relationships. These influences may alter one’s sense of the need to reciprocate, or one’s rationalization of fraud. They may also alter one’s perception as to whether or not

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<sup>1</sup> Gift giving is a prevalent social custom in China in all areas of life: in family and in significant relationships, as well as in dealing with political authorities, social institutions and business people. For all this, from an ethical perspective, it still may be difficult to know when it is proper to give or receive a gift, what sort or amount of a gift is appropriate, or what social obligations gift giving imposes. Those unfamiliar with Chinese culture may make the easy association of gifts with bribes and allege that the Chinese are promiscuously corrupt in their business practices. Such an easy assessment is, however, incorrect. The cultural and moral differences between gift giving, bribery, and corruption have been assessed, and helpful guidelines are available for managing business relations in China (see Steidlmeier 1999).

a particular act is fraudulent in the first place. The current Fraud Triangle Model does not factor in these societal influences on fraud.

**Proposition 5:** In China, principles of reciprocity characterize the society. Principles of reciprocity will influence pressure to commit a fraud, incentives for committing fraud, as well as needs that prompt the perpetration of fraud. Principles of reciprocity will also influence rationalization for committing fraud.

### **The Strains of Advancing Materialism on Traditional Chinese Values**

From a very early age, most Chinese nationals become aware of the need to do better than others in school. They must work hard to pass tests to go on in education in order to get a well-paying job so the family will be better off and so parents will be taken care of in their old age. The need to succeed financially is imprinted on the minds of children from an early age. The interviewees described an amazing work ethic. One woman who had worked for an accounting firm said, “[In] China it is just get the job done no matter if it is eleven or one a.m. in the morning. They get the thing done.” Another explained it in other terms. While working on a particularly busy project for several weeks, for seven days a week “I only slept about five hours every day and the rest of the time at work.” She described her work in terms of any time she was not sleeping. Another individual explained people generally work six or seven days a week, and then he said, “Usually you go to work at eight in the morning and you don't finish until seven at night. Sometimes you even [are] forced to work overtime.” Clearly this definition of overtime differs dramatically from some places in the world. When asked about the main responsibilities of fathers, one woman responded monolithically, “Money.” Obtaining money is a central concern, compounded, as the participants explained, by competition resulting from a large population.

The value placed on relationships in China may lead to increased pressure to perform financially. For example, an interviewee explained that she is a single child, and her husband is a single child because of the one-child policy in China. Traditionally, the eldest male has the responsibility to care of the parents, but in the case of this couple, they fully expect to have to care for all four of their combined

parents. This situation is quite common in China now. The children take their responsibility to care for their parents seriously; to do otherwise is to lose face. An interviewee explained, "I really don't know how to deal with it but I know that's my responsibility. It will be hard but I have to do it anyway."

Parents and children are honor-bound in a reciprocal relationship in which parents go to extremes to support children in educational pursuits and children grow up and are expected to care for parents.

The challenges associated with the expectation that one provide for parents has become exacerbated as the once more egalitarian-oriented society has become subjected to the possibilities of socioeconomic stratification (Madsen 2000 p. 315). Chinese nationals may now seek to differentiate themselves economically or materialistically from others. Simultaneously, memories of the socialist ideology of equality may embellish social pressure to maintain parity with others (Davis 2000), and may further provide pressure for perpetuating fraud.

The opening of China to a market economy has brought increased appreciation for material wealth and comfort (Madsen 2000 p. 315) and associated increases in financial pressures and expectations. A growing economy has also brought opportunity to capitalize on relationships and key positions, sometimes in ways that are suspect. The Fraud Triangle Model, as currently constituted, does not facilitate consideration of these societal-level factors that alter the landscape in which the Fraud Triangle Model must be applied.

**Proposition 6:** Pressures, needs, and incentives to commit fraud are influenced by societal assumptions such as those about individual, family, employer, and governmental responsibilities; perceptions of needs and what is an appropriate standard of living; and what is considered to be of value in a given society.

**Proposition 7:** Societal-level factors influence rationalizations for fraud. As these factors differ across societies, effects on fraud will also differ across societies. Societal values from which fraud perpetrators must set their own set of values apart from also differ across societies, leading to different effects on fraud.

**Proposition 8:** Societal-level factors influence pressures, incentives, and needs that lead to fraud. Societal-level factors which influence pressures, incentives, and needs, or the relative strength of their influence, will differ across societies.

### Trust and Secrecy

Interviewees were asked what the most important attributes on the job are. In answering, one respondent described elements essential for *guanxi*: “You need to be reliable, so people can trust you. And keep my personal secrets.” Another interviewee elaborated on secrecy: “In China, there is more secrecy to the role of relationships. In China, the role of relationships is more secret. There are many, many decisions that are made based on relationships that are a result of private conversations.”

In the United States, trust is often reinforced by signing a contract, which it is presumed will be enforceable. In China, trust is developed through cultivating *guanxi*. It is not assumed that individuals at large are trustworthy. Professors visiting from China who were interviewed provided an illustration of this. When asked why experimental accounting research has been very slow to take hold in China, they provided an unexpected answer. Reviewers do not trust that experimental data has not been fabricated. To apply the Fraud Model, there are pressures and incentives to publish and there is opportunity and capability. All that is missing is rationalization. In addition, a blind review process is very much opposed to principles of *guanxi* in that reviewers are not supposed to know if they have an established relationship with the author or not. Thus, even the publishing paradigm as viewed through the Fraud Triangle Model is influenced by societal-level factors.

Whereas in many Western nations written agreements are king, oral agreements are more commonplace in East Asia. The emphasis has not been on sophisticated written contracts. Strong relationships are valued partly because trust is paramount as the legal system is generally not thought to be reliable in resolving disputes. The specifics of oral contracts are also difficult to discover, allowing for secrecy.

Albrecht et al. commented that “frauds that involve collusion are more difficult to detect” (1995 p. 267), although societal-level factors impacting this concept, as well as the associated implications for use of the Fraud Triangle Model internationally, were not addressed. One such complication found at the international level is exemplified in China, where accountants have had to become adept at hiding transactions. As one subject explained, “Perhaps less often now than 10 years ago, but most companies used to keep 3 sets of books: tax, actual, and financial. The difference being that the tax and financial books were not accurate. Chinese businesses also tend to keep soft money off the books. It is understood that unless you use such money to bribe people, you will most likely not be able to proceed from point A to point B - someone will not assist you.” China is emerging from a place in which this approach to accounting was typical. Part of one’s job as an accountant would thus be to collude with management against the government and other outsiders. It would seem that such familiarity with collusion and secrecy within a company could also breed collusion of varieties unwanted by employers, resulting in fraud against the company itself. Such societal-level tendencies may alter how the traditional Fraud Model functions from one society to another, such as from the United States to China. This is not implied or accommodated by the current Fraud Model.

**Proposition 9:** Expectations for secrecy verses openness within a society influence whether individuals would be more or less likely to engage in a collusive fraud.

Expectations for secrecy verses openness will moderate how an opportunity is perceived across societies.

### **Roles and Relationships versus Rule of Law**

It would be difficult for fraud research focused on the American context to adequately contemplate fraud in the environment of China. In the United States it is presumed that there should be “liberty and justice for all,” as is reiterated every time American citizens recite their Pledge of Allegiance. The rule of law, following a borrowed tradition initiated long before by Socrates (Licht et al. 2007), is expected to reign. In contrast, in China, Confucian concepts of roles are fundamental to society. These



roles are reinforced by social norms. These social norms are powerful influences in Chinese society that act to preserve harmony, a central object of Chinese society (Kim and Nam 1998). This contrast in the two societies is evidenced by their respective rule of law rankings as found in the World Bank Worldwide Governance Indicators (Kaufmann et al. 2008). Overtime different societies have adopted different approaches to solving societal problems.

Laws in China are viewed as being flexible, depending on the particular law and the current political environment. Attitudes towards law carry over into attitudes towards policies in business. Interviewees explained that company policies are not rigid in China. A scenario was posed to an interviewee in which an employee needed a favor from human resources due to a personal problem. The interviewee explained how *guanxi* would overcome company policy:

In China, it would happen, because you will get what you want if you have the relationship. It all depends on how risky it is for someone - for the HR person. She can make some exception just for you, because you have been nice to her, or because you did her a favor before. But it also depends on how close you are. Like if I was in HR and I just happened to know this lady just three months ago, then I would say, no, I'm so sorry, I can't help you. *But if she was my friend from grade school* (emphasized), then I would say, 'Well, I don't know, I can ask, I mean,' and see if there are other opportunities or ways for her.

These types of comments encountered in the interviews suggested that business owners must have a different approach to dealing with intentional deception by employees than strategies employed in the United States. The interviewees provided a stock answer to such inquiry. They explained that the typical approach to finding employment in China is to go to work in a company where a relative or friend of a relative works. This sentiment was repeated again and again. When probed about how companies feel about hiring related people, answers such as the following were given:

If my mother wants to hire somebody she will ask some friends if they have some people that can help her. They must [then] ask some people or family. [The successful candidate] must have some relationship because you can trust her then, and if she does some bad thing we still can catch her. We don't like always go to the courts you know in China. Do not go to the law. We think go to the courts is not good.

Research participants noted that foreign companies do not hire in this fashion, yet Chinese companies predominantly do. This approach to relying on trusted relationships to fill positions further accentuates the differences in societal solutions to the problem of fraud. Albrecht et al. found that “Generally it is people we ‘trust’ and ‘have confidence in’ who can and do commit frauds” (1995 p. 267). This is less true in China where the societal force of face as well as the appreciation for *guanxi* comes into play and assists in restraining trusted relatives and friends from perpetrating fraud. In China, if one loses his or her *guanxi*, one may simultaneously lose face and place in society.

Albrecht et al. acknowledged that the need to rely on people is inherent in business, and they recommended businesses “carefully select people of high integrity” (1982 p. 146), but the hiring of trusted individuals as a control to prevent fraud is criticized, which seems appropriate for the United States. In an interesting twist, the rationale in China for hiring relatives and friends of relatives does not rest on this rationale of seeking individuals of integrity. As expressed by interviewees, there is a need to be able to have some leverage on an individual through relationships, or *guanxi*. Again, this approach would not necessarily be expected to work in a more individualistic societal context such as is found in the United States.

Several interviewees commented on the legal system in China. Participants explained that in form, top government officials in China are elected by representatives from all of the provinces, and that in theory these representatives represent the Chinese people. There apparently is a disconnect in this process, however, as explained by the interviewees. The Chinese people at large do not know who represents them at the conferences, they don’t know who the candidates are for the president and other top government positions, and they do not know why the leaders become the leaders. With this background, an interviewee explained how law is viewed in China:

Law is [considered] a very important thing, but sometimes [the common people of China] feel like it is a little unfair thing because the law is for ordinary people. For very powerful persons the law is not that big of a deal. Because they have lots of relationships at high levels, [they] know a lot of people at high levels and maybe just a phone call thing. If your son did something bad then you just call someone. Oh it's my friend, it's my college classmate and we know each other for 20

years. Just call him and maybe he's the one in charge of such kind of stuff and he just calls somebody at a lower level and [says] okay, you don't have to worry about this person, it's okay. It's done. I think that's the beauty of power in China. [It] seems unfair, [if] I don't know somebody at a high level. But if I really know somebody at a high level, I probably like this kind of world. I think that's another [problem]. If the president really wants to eliminate that kind of stuff, all these relationships make it hard for him just to go forward.

This quote provides additional insights into fraud in China. It suggests that solutions to fraud that rely on rule of law within a society, which tends to be emphasized in the United States, may not be the best solutions to fraud in other nations when societal-level factors are taken into consideration. Existing fraud prevention strategies are incomplete and sometimes inappropriate for the case of China. By not incorporating societal-level factors, the Fraud Triangle Model may be interpreted to suggest that these are not as consequential as other factors that influence fraud (e.g., rationalization, pressure, opportunity) yet without taking into consideration these societal-level factors, one is not able to adequately understand and address fraud in China.

**Proposition 10:** Fraud prevention strategies may rely on characteristics, or take for granted certain characteristics, of the society for which they are developed. Because of such societal-level factors, solutions to fraud in one nation may not be advisable for adoption in another nation.

Another interviewee commented:

I will also say the legal system doesn't really work very well because a lot of things also are based on relationships. So say like for example if I did something unlawful, that I got arrested. Then my parents would find and see if they have any friends that have any friends that work in the police station or anything that can get me out of it. Or do I have any friends that will happen to know someone that would help me to get away with it. So normally if you give them a bribe or know someone then they just let you go.

Another interviewee responded to the question of what she would do if faced with going to jail rather matter of factly, "If you have relationship then you should be fine. You give them money." Note that the relationship typically precedes the giving of money. Part of the process seems to be knowing who to bribe, and having some level of trust with that person. The Chinese seem to be skilled at putting

together a string of relationships that ultimately includes someone with the authority to accomplish what they need done. This may involve the payment of a bribe.

This has consequences for companies. When a company resorts to aggressively cutting corners, paying bribes, or otherwise circumventing safe, legal, and conventional business practices, competitors may be put under pressure to likewise practice deceit to remain competitive. This scenario is made more severe when companies may be able to pay political connections to make legal recourse attempted by their competitors hopeless. This scene is further complicated as the line between fraud and *guanxi* can be less than clear, such that some acts that would be considered fraudulent in the United States would not be interpreted as fraudulent in China.

**Proposition 11:** Acts that would be considered fraudulent in one society may not necessarily be considered unacceptable in another due to societal-level influences on business practices.

#### ***Guanxi*'s Impact on Fraud as Informed by Aspects of Culture and Social Norms**

From a cultural perspective, relationships in China tend to be particularistic (Trompenaars 1998) such that those with whom one has or desires to have a connection with are favored over others. Individuals from societies with more universalistic orientations, in which rules are assumed to apply to everyone fairly equally, tend to be puzzled by what is easily interpreted as unequal or unfair treatment governed more by relationships than by law. Of course relationship-related business practices exist worldwide. However, a difference between nations such as the United States, that rank relatively high on individualism and low on collectivism (Hofstede 1980), and China, which is a more collectivistic society, is that in China developing these relationships is both a preoccupation and pervasive norm (Chen 2001 p. 46).

Social norms are expectations that regulate behavior. They are reinforced or sanctioned by the group for whom they have relevance (Horne 2001). Underlying social norms is the premise that we do not act as purely isolated, independent thinkers unaffected by outside influences (Hechter 2001). As

social beings, we are influenced by tacit rules, peers, the observed actions of others, and personal standards internalized from our social experiences – we are influenced by social norms (Cialdini and Trost 1998). Coffee (2001) suggested that the impact of social norms may be greatest when law is the weakest. Wated and Sanchez (2005) indicated bribery is an endemic problem where strong social networks have developed as substitutes for developing government institutions. For China, these factors are further influenced by strong historical roots to Confucianism. Confucianism stresses fulfilling ones' obligations in relationships, or observing social norms, rather than giving priority to rule of law. If one is to understand fraud in China, this fundamental shift in thinking related to assumptions about society must be undertaken. To assist in this, the Fraud Model needs to be revised to accommodate the impact of societal-level factors.

*Guanxi* is implicitly governed by social norms. The violation of these social norms destroys harmony and is often described as causing one to lose face (Kim and Nam 1998). If one is in a particular role, it is the job of others to support that individual in performing that role rather than to seek opportunity to disparage and surpass. Hierarchy is respected, a characteristic of Chinese society that again has roots in Confucianism (House et al. 2004 p. 523), and which is reflected in what Hofstede described as high power distance (1980). Respect for hierarchy in relationships provides order to Chinese society, whereas law is more important in providing order in the United States. The strict hierarchy, the unified effort that supports this hierarchy, and the real sense of shame that is felt when one fails to either live up to the expectations inherent in his or her roles, or to support others in fulfilling their role obligations, are powerful forces in China that set the Chinese society apart from the society of the United States.

Someone from the United States who is not very familiar with Chinese culture might be surprised to find that meeting certain expectations of others may trump respecting certain laws, policies, and other formal measures assumed to ensure fairness in the United States. In Chinese society, *guanxi* principles carry weight in their own right. Consequently, there are situations that would be interpreted as collusive fraud in the United States, but which in China might be questionable to be labeled as such, given the

expectation of respecting hierarchy and making allowances for *guanxi*. This suggests that the boundaries of fraud may differ between societies, a possibility not interpretable through application of the current Fraud Triangle Model.

**Proposition 12:** Fraud, when viewed from the perspective of different societies, has subtle differences tied to the culture and social norms of the society.

### **The Fraud Model in International Contexts**

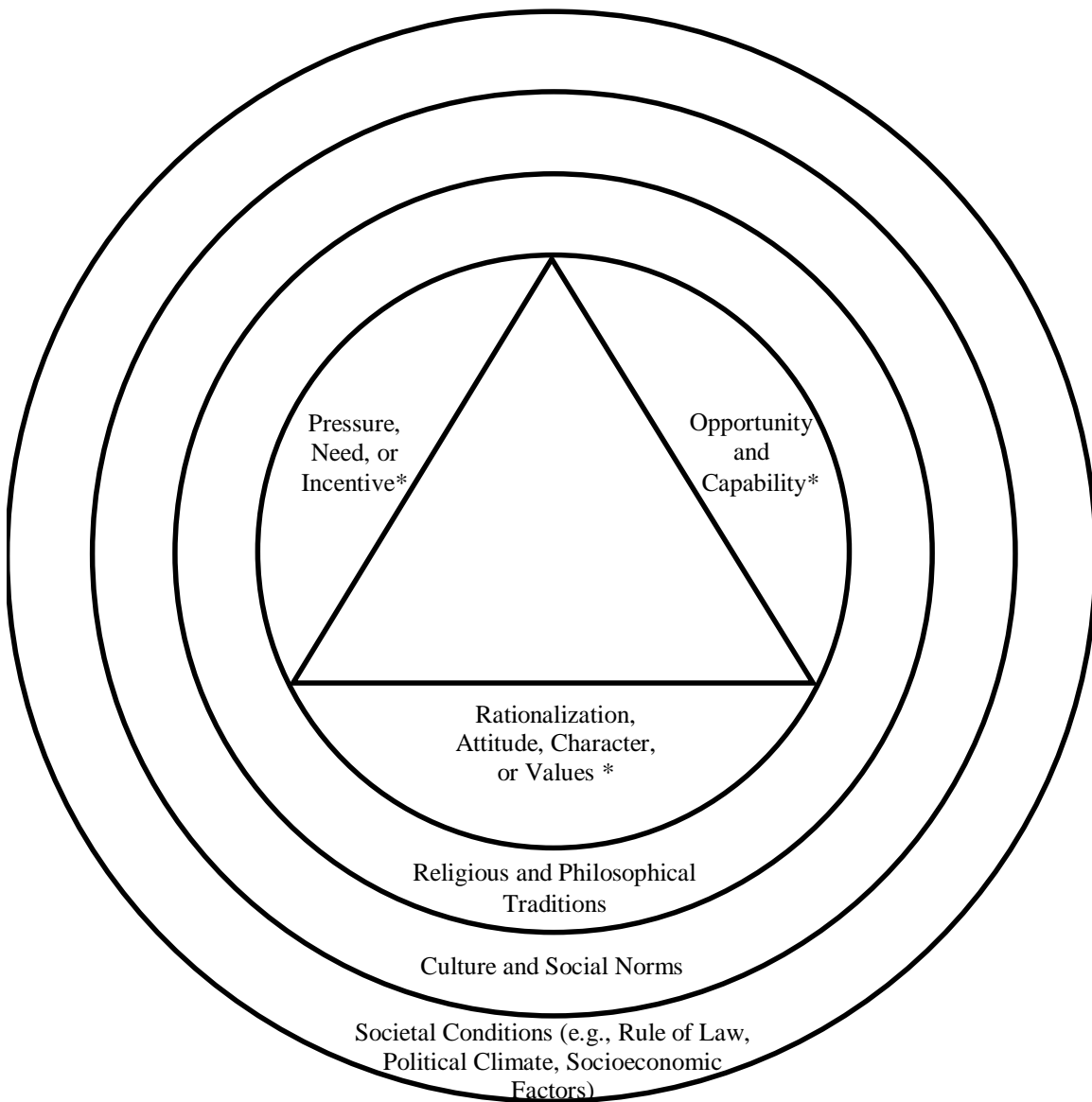
The review of the Fraud Triangle literature found earlier in this paper suggests that the seminal, pioneering research in the United States on fraud assumed societal-level influences are, or at least treated them as, a constant. In the United States, there was one general set of societal-level influences on fraud, making it seem as if societal-level influences were ubiquitous and fixed. As business has become more and more international, this approach to understanding fraud needs updating.

An understanding of societal-level influences on fraud is crucial to directors and managers charged with considering the risk of fraud on organizations that cross boundaries, a situation that is becoming more and more common. Auditors would also do well to look closer at their own societal assumptions that may color their understanding of fraud and its influences. In the United States, SAS No. 99 (AICPA 2002), reemphasized in PCAOB reviews (2007), calls for the exercise of professional judgment in ensuring that the right input is considered when evaluating fraud risks. To fully consider fraud risks, societal-level factors must be considered. For instance, if a business has operations in China, *guanxi* must be understood and its import appreciated. For audits, Asare and Wright (2004) found that consulting fraud experts has positive results. The current study suggests that an *international* fraud expert should be consulted when dealing with international contexts. To do otherwise is to risk performing an audit without adequate understanding of the company and the environment in which it operates in.

This study illustrates that societal-level influences on fraud can alter opportunities; pressures, incentives, and needs; and rationalizations. Societal-level influences can also alter what is considered to be fraud, as well as how fraud can best be addressed in a society. The current Fraud Model does not

facilitate recognition of societal-level influences on fraud and thus does not assist in comparing risks from society to society. The Fraud Model should be expanded to explicitly incorporate societal-level fraud factors and thus make the fraud model more appropriate for use at an international level. A revised model incorporating the findings from this study is included as Figure 3.

**Figure 3: The Fraud Triangle in International Contexts.** The traditional Fraud Model, which incorporated individual-level and organizational-level influences on fraud, is expanded to include societal-level influences on fraud. These include religious and philosophical traditions, culture and social norms, and societal conditions such as rule of law, political climate, and socioeconomic factors. Societal-level influences impact the traditional components of the fraud triangle. For example, in a given society pressure may be heightened for reasons inconsequential in other societies, opportunities may be interpreted differently, and rationalization may be heavily influenced by culture and tradition. Societal-level factors may also alter perceptions of what is fraudulent and what is not and what is considered acceptable business practice. The tendency for fraud to take on a particular structure or form (e.g., collusion) may also vary based on societal influences, as may the types of fraud likely to be committed.



\*Components of the Fraud Model as developed by prior research (see Cressey (1953), Albrecht et al. (1980-2008), AICPA (2002), and Wolfe and Hermanson (2004)). The current study expands the Fraud Model by adding societal-level influences on fraud that must be taken into consideration when using the Fraud Model internationally.



## CONCLUSIONS

This study uses the case of China, in contrast with the United States, to illustrate that societal-level factors influence fraud and that societal-level factors can vary greatly from one society to another. The traditional Fraud Model does not explicitly recognize, nor does the Model itself accommodate, consideration of such societal-level differences. In this study, the traditional Fraud Model is extended to explicitly incorporate societal-level fraud factors and thus make the fraud model more appropriate for use at an international level.

In providing insight into societal-level influences on fraud in China, this study provides an in-depth discussion of potential explanations for findings from earlier quantitative studies (for example, see: Wang et al. 2008; DeFond et al. 1999; In-Mu et al. 2005) that have identified problems with collusion in the auditing profession in China.

Societal-level influences on fraud in China have their roots in China's past. The philosophical tradition initiated by Confucius emphasizes relationships and roles. Principles of reciprocity traditionally have also been very important in China, and are evidenced in traditional folk religions and in expectations for gift giving. A cultural expression of this traditional emphasis on relationships and reciprocity that is a fundamental part of business in China is *guanxi*. *Guanxi* is characterized by secrecy and trust. *Guanxi* has many positive connotations, but in relation to fraud it can mean that individuals may resort to questionable means to assist someone with whom a trusted relationship is maintained or desired, and that strong relationships – both within and across organizations – abound that could make it possible to collude without detection.

The cultural importance of *guanxi*, along with social norms pertaining to *guanxi*, combine with societal conditions in China, including a relatively low expectation for rule of law, to make China more prone to fraud involving collusion. Socioeconomic conditions in China are improving, tightening pressure to enhance one's material station in life. This is exasperated by expectations that children care for their aging parents. This commendable, ingrained aspect of Chinese society has become complicated

as the one-child policy has resulted in couples needing to provide for four aging parents. The Fraud Triangle Model, originally prepared for and embedded in the societal context of the United States, faces this very different set of societal influences in China. These societal-level factors influence pressure, opportunity and capability, and rationalization for fraud. They also lead to a different set of societal values that individuals must reconcile with their own values when contemplating committing a fraud. This all takes place in a society where the boundary between *guanxi*-related practices and the definition of fraud are blurred. This situation is not common to the United States, where most people do not even understand what *guanxi* is and where there is not even a satisfactory translation for the concept. The Fraud Triangle Model needs to be updated in order to accommodate such societal-level fraud factors that are needed in the Model to adequately explain fraud across different societies.

To reemphasize, this study does not intend to imply that certain facets of societies should automatically be equated with fraud. This is no more appropriate than stating that someone who has opportunities and incentives to engage in fraud will automatically commit fraud. Rather, this study utilizes the case of China to demonstrate that different societal contexts are consequential, just as differences at the organizational and individual levels are. For a Fraud Model to be appropriate for use at the international level, it must take into consideration societal-level influences on fraud.

## APPENDIX 1 – LIMITATIONS OF THE FRAUD MODEL

The construct of fraud has limitations with ramifications for the Fraud Model. These limitations became apparent while considering fraud in the societal context of China.

In some situations it may be inappropriate to attach connotations of fraud to someone's decision to intentionally deceive others to accomplish some end – such as procuring medical care for a loved one or to meet some other basic need (Rest et al. 1999; Rest 1979) – that is necessitated by undue pressure or rigidity on the part of others. In a nation where a medication is available but is withheld because of the societal structure of the health care system, many have wondered about the ethics of *failing* to secure a medication for a family member if a reasonable, non-violent means is available to do so. Also in extreme scenarios in which someone is put under great duress by colluders to comply with their schemes, and societal factors such as high power distance and respect for hierarchy come into play, there seems to be inadequate ground to conclude that a fraud has occurred, at least by the individual so abused.

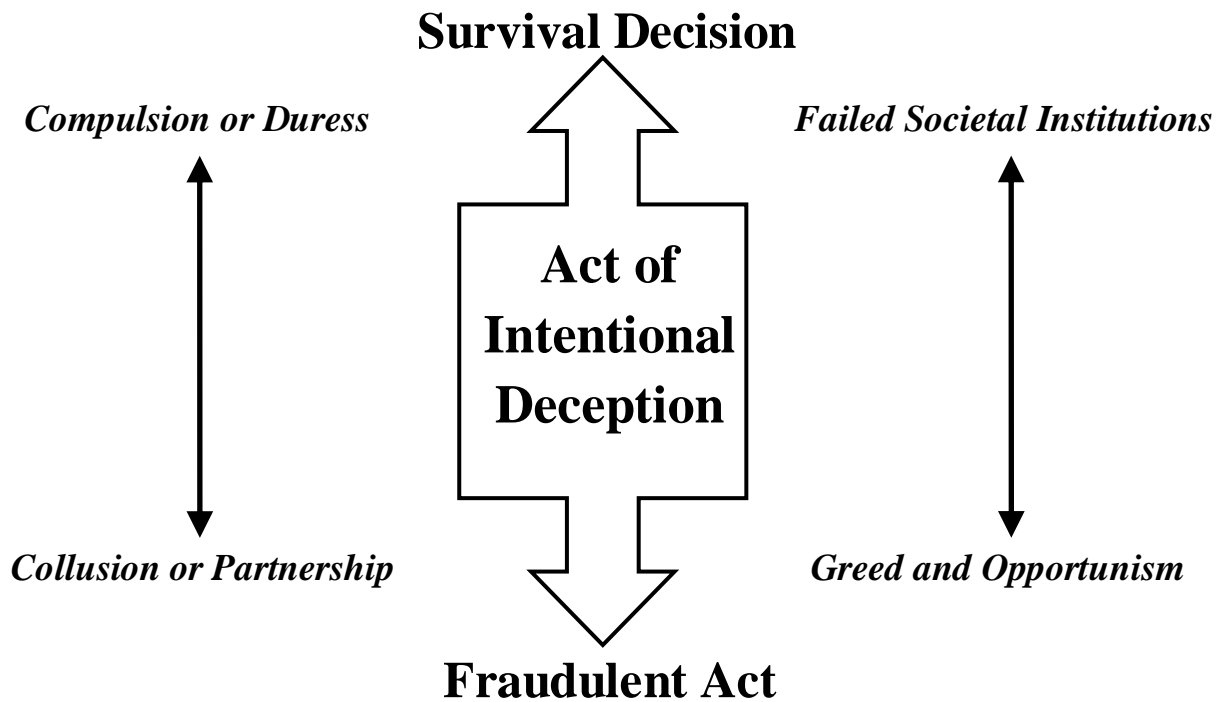
When someone is coerced to collude, the Fraud Model collapses such that there is neither rationalization nor opportunity, only compulsion to comply. Those desiring one's participation in a fraud may be in a position – or may have as part of their *guanxi* others who are in positions — to remove one from one's job or to cause harm to one's life or family. One of the interviewees in this study described such a case involving a relative, and another described a situation involving a business partner.

In a different scenario in which some vital need motivates one to perpetrate a fraud, the structure of the Model holds up, but the meaning of the act committed changes. The literature on ethical reasoning would suggest that a higher level of ethical reasoning has been deployed (Ponemon 1992; Rest 1979) and the nature of the act has changed from a fraudulent act to what may be considered a survival decision. Clearly this represents an extreme situation, but it does represent a potential boundary of the construct of fraud.

The difference between cases that are clearly fraud and those that may extend beyond the boundaries of the fraud construct can be represented on continuums as represented in Figure 4.

**Figure 4: In evaluating acts of intentional deception for gain, it is not enough to consider whether the act was performed for gain and if the act was intentional. It is also important to consider circumstances influencing *why* an act was performed, especially when evaluating fraud internationally, where societal-level influences on fraud can differ substantially. The fraud construct may be viewed on continuums. Compulsion or duress on one end of a continuum can render an act of intentional deception a survival decision, while collusion or partnership on the other end of the same continuum may render an otherwise similar act to be fraudulent. Likewise, less-than-successful societal institutions may induce acts of intentional deception that may be termed survival decisions, whereas at the opposite end of the continuum an otherwise similar act may be a result of greed and opportunism and constitute a fraudulent act.**

## Limitations of the Fraud Model



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