

A Critical Review of Fraud Discourse – a Case Study of Pakistan

Mr. Attique ur Rahman
Deputy Director, SAI Pakistan



Abstract

Corruption is a form of fraud. Fraud is deception intended to achieve monetary or personal gains. The threat of fraud is increasing exponentially with an estimated loss of GBP 3.2 trillion in the previous year alone. Similarly, public sector corruption has been one of the major issues in Pakistan. The previous premier of Pakistan was ousted on charges of corruption and the incumbent premier's primary manifesto was eradication of corruption. Therefore, this study preferred to take a very topical and an issue of national and global worth. To control fraud a significant thrust of the fraud-related research has been the development of frameworks to prevent fraud. The dominant discourse in this regard is the so-called “fraud triangle” that got entrenched in the professional auditing standards across globe. Contrary to the dominant notion of the fraud triangle, there is a limited study to understand and deter fraud. This study also takes the less trodden path but also takes the fraud triangle (opportunity, pressure and rationalization) as a unit of analysis to explore its validity in the context of corruption in Pakistan's public sector. The study collects primary data from researcher's observation and interviews of civil servants of Pakistan, and secondary data from case studies of corruption highlighted by media and investigated by Pakistan's prime accountability agency, National Accountability Bureau (NAB). The data triangulation reveals that corruption in Pakistan's public sector is motivated by opportunity only while pressure and rationalization elements of the fraud triangle get

irrelevant overtime. Moreover, the study unfolds that the corruption was committed through collusion, and collusion is beyond the scope of the fraud triangle which is a unidirectional and individualistic model. Similarly, the fraud triangle does not take into consideration historical, socio-political and cultural aspect while dealing with fraud. This study contradicts the dominant view about the validity of the fraud triangle in dealing corruption cases in Pakistan's public sector. The study raises question marks about the validity and generalizability of the fraud triangle. The critical approach of the study shows that how multifaceted, interrelated, and complex nature of fraud is, which makes the fraud triangle unlikely to be presented as a valid model in context of corruption in Pakistan's public sector. The author believes that a holistic cross-disciplinary research to understand and deter the complex phenomenon of fraud in general and corruption in specific is the need of the hour.

1. Introduction

Corruption is a form of fraud, most common and one of the costliest occupational fraud around the globe (ACFE, Report to the Nations, 2018). Fraud is a form of deception intended to achieve monetary or personal gains (Action Fraud, 2018). The threat of fraud is increasing exponentially especially in the complex businesses run with digitalized processes. The financial cost of fraud has been estimated GBP 3.2 trillion globally by the Centre of Counter Fraud Studies, University of Portsmouth, UK (Gee and Button, 2018). Among

various categories of fraud that an organisation could be threatened with, corruption falling under the occupational fraud category (ACFE's Fraud Tree, see fig 2) is the largest and most prevalent one (ACFE, 2018). The occupational fraud is a form of fraud that is committed against an organization from within by its own employees who were entrusted to take care of its assets and resources. The occupational fraud caused a financial loss of over USD 7 Trillion in 125 countries between 2016 and 2017. While, corruption in the public sector caused a financial loss of GBP 40.4 Billion in the UK alone in a single year of 2017 (Gee and Button, 2018).

Corruption is a global phenomenon. In South Asia comprising Pakistan, India and Bangladesh corruption is a leading occupational fraud across the globe i.e., 62% followed by non-cash, billing,

expense reimbursement etc. While sub-saharan Africa, United States, Western Europe are also victims of corruption as a most common occupational fraud weighing at 49%, 30% and 36% respectively (ACFE; Report to the Nation, 2018). Nevertheless, Corruption is the biggest occupational fraud in Pakistan, than anywhere in the world as shown in the Fig 1. Among total corruption cases, 50% of them were committed in the government and public administration. (ACFE; Report to the Nation, 2018). The former Prime Minister of Pakistan, Mr Sharif was ousted from his office on charges of corruption. While the incumbent Premier, Mr Imran Khan's political manifesto and then his maiden speech to the nation focused on measures to eradicate corruption (DAWN, 2018). Therefore, this topical issue garners profound importance to get the attention of the current study.

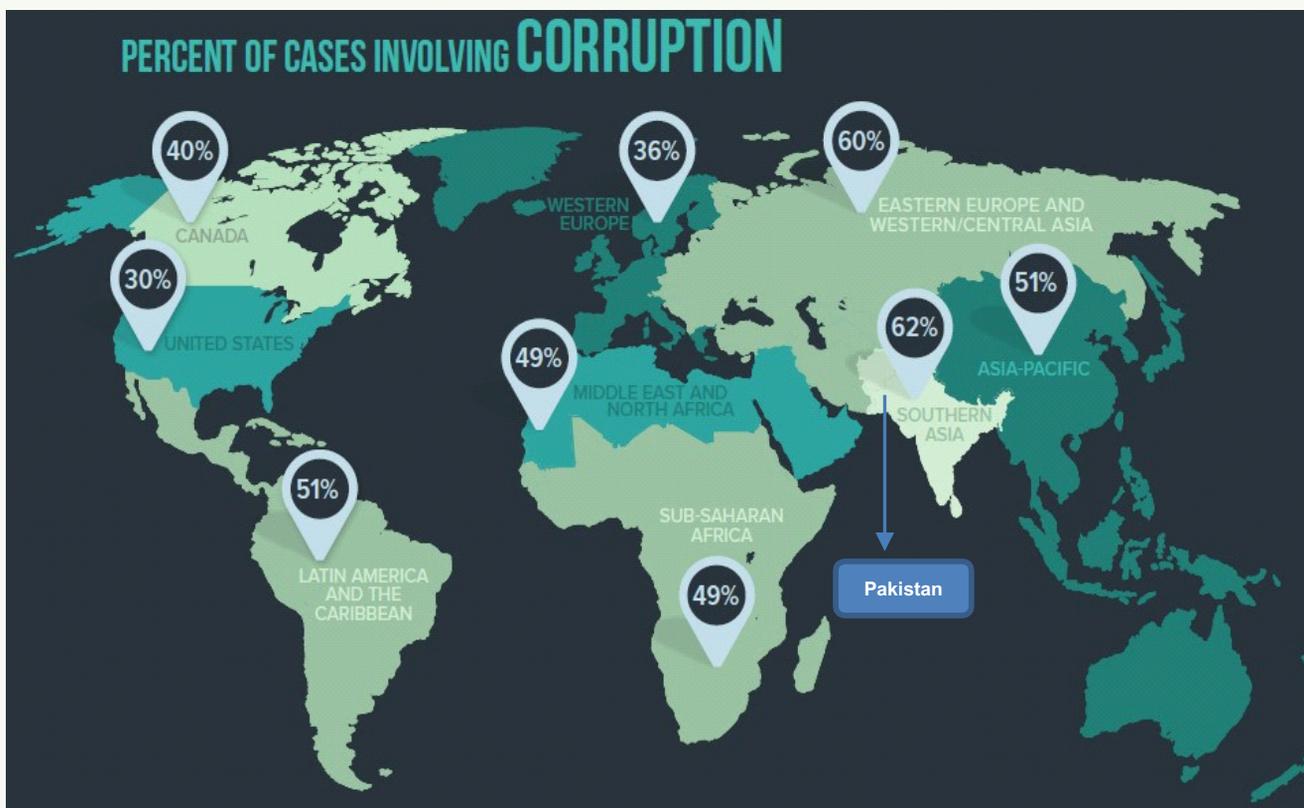


Fig.1: Percent of cases involving corruption (Source: ACFE; Report to the Nations, 2018)

2. Development of Frameworks to Prevent Fraud

A significant thrust of the fraud-related research has been the development of frameworks to prevent fraud. The dominant discourse in this regard is the so-called “fraud triangle” which is entrenched in the professional auditing standards across globe (IAASB, 2009; PCAOB, 2005), the USA (AICPA) (2002), SAS No. 99; Australia (ASA, 240) and International Auditing Standards (ISA 240). Similarly, Smith and Crumbly (2009) found in their comprehensive review that fraud triangle is most taught framework in the fraud examination and forensic accounting courses in the United States, the United Kingdom, Hong Kong and Lebanon.

Contrary to the dominant notion of the fraud triangle, (Morales et al., (2014) studied the genealogy of the fraud triangle and illuminated that the fraud triangle is usually credited to the study of Donald Cressey, an American sociologist, but it has been transitioned from Cressey's original work. The term 'fraud triangle' was coined decades after Cressey's work on embezzlement by Joseph Wells, an agent of Federal Bureau of Investigation, and member of Certified Public Accountant (CPA) who later founded the ACFE. The fraud triangle represents fraud as an 'individual act' for personal enrichment and demands effective internal controls and monitoring of individuals in an organization. “The fraud triangle Fraud is thus constituted as a problem at the confluence of the individual and the organization; it is certainly not represented as a social, political, or historical problem” (Morales et al., 2014, p.178). Similarly, Free (2015) in his work of “looking through the fraud triangle” expressed his concerns on the over-simplified and individualized nature of fraud triangle:

Recent research in accounting has made important strides in understanding the individual drivers of fraudulent behavior. However, the fraud field is at

risk of becoming seduced by over-simplified, individual-oriented models that, by definition, are unable to capture the complex notion of fraud in practice. In short, the complex and varied nature of fraud means that much work remains to be done to paint a more complete canvas (Free, 2015).

There is burgeoning number of scholarly concerns refuting the overly ambitious claim about the fraud triangle as the sole basis of fraud investigation and prevention, and as the valid model for dealing with fraud (Morales et al., 2014; Power, 2013). As Morales et al. (2014) illustrated that the applicability of the fraud triangle is an apolitical and a base to deal fraud. Nevertheless, Donegan and Ganon (2008) appreciated scholars to raise questions about its relevance and extent of its influence where it may not be applicable

3. Literature Review

The review dilates the precursors of the fraud triangle (opportunity, pressure, rationalization) and a brief over view of other fraud theories. This section will conclude with the critique on the fraud triangle.

3.1. Fraud Triangle

Wolfe and Hermanson (2004) explain that Sutherland's White-Collar Crimes theory (1940) and Cressey's Fraud Triangle theory (1950) reflect Auguste Comte and Emile Durkheim's (1893) rationality of positive thinking. To understand the essential components of a crime, Wolfe and Hermanson (2004) appreciate the concept of Durkheim (1893) wherein the later argues to identify characteristics identical in various crimes encompassing a variety of social conditions. They further dilate the findings to understanding wider perspective leading to explore rational explanation of social dealings and may help to establish fundamental principles determining the objective reality of social facts (Durkheim, 1894). To reveal objective reality, Sutherland (1940) proposed that

perpetrators of white-collar crimes have some common traits including elements of respectability and high social status in a society (Free, 2015). In its continuation, (Free, 2015) adds that Cressey (1950) identified three fundamentals i.e., opportunity, pressure, and rationalization as precursors for a respectable and high-class person to get motivated to commit a fraud. The presence of

all three precursors will stimulate a person to perpetrate a fraud. If any of the components is missing, fraud will not be committed (Cressey, 1953). Cressey's finding was later termed as Fraud Triangle by Wells the founder of ACFE (Krancher et al. 2011). To get clear understanding of the fraud triangle, analysis of each leg of the triangle will facilitate to unfold the framework.

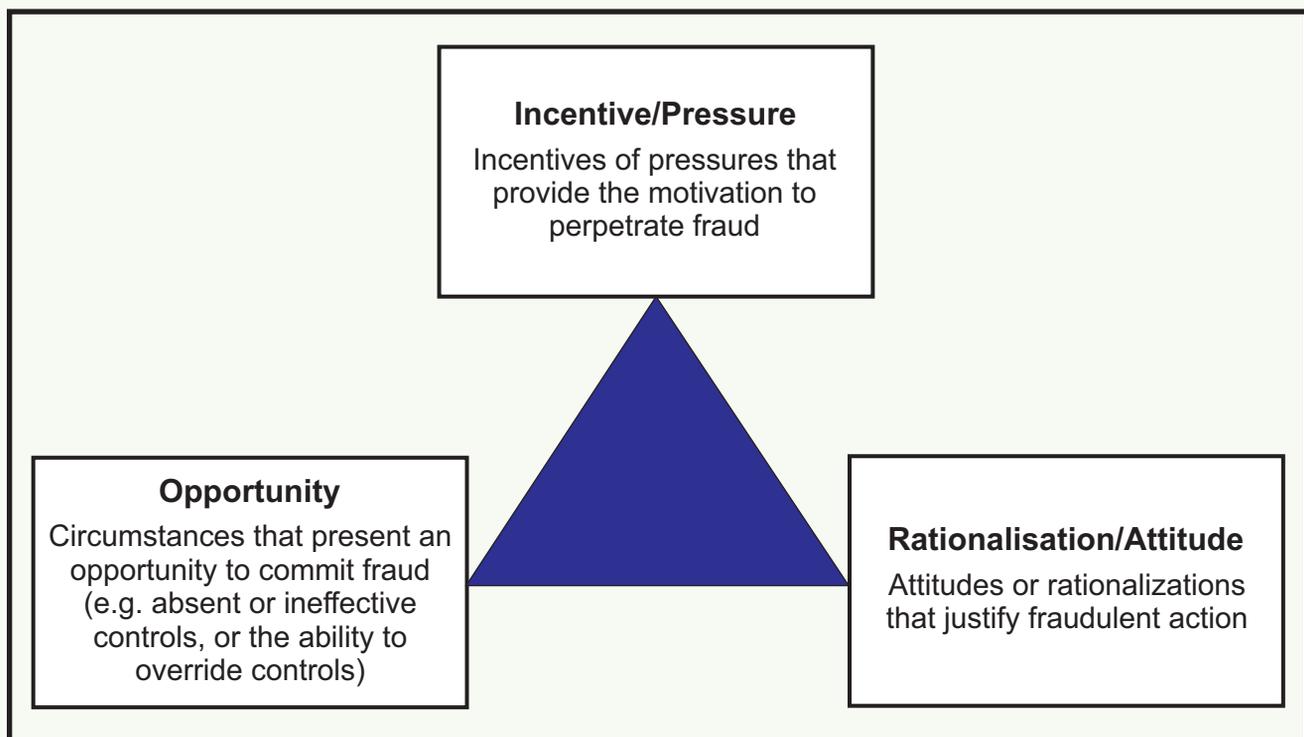


Fig 1. Fraud Triangle (Source: Wells, 2011)

a). Pressure to Commit Fraud

Dorminey et.al., (2012), in their acclaimed work of “the evaluation of fraud theory”, explain that Cressey (1953) theorized that individuals commit fraud due to non-shareable financial pressure, a pressure which an individual does not intend to share with others. The individual's inability to navigate the financial burden motivates to transgress the law to resolve the issue. The literature on 'pressure to commit fraud' can be classified into financial pressures and non-financial pressures (AIC and PwC, 2003). The non-financial pressure can be further classified into (i) work-related pressure (Hilton, 2009); (ii)

pressure associated with gambling and drug addiction (Kelly and Hartley, 2010; Sakurai and Smith, 2003); and (iii) pressure associated with individuals who aspire to live luxurious lifestyles (Neu et al., 2013; Rezaee, 2005). The financial success, if one considers the huge accumulation of wealth through personal achievement, creates strong pressure to accomplish wealth 'by any means necessary' including fraud (Choo and Tan, 2007, p. 209).

While the work related to non-financial pressures that persuade employees to commit fraud include employees' dissatisfaction and perceived inequalities at the workplace (AIC and PWC,

2003). Similarly, Bartlett et al., (2004) reported that employees' dissatisfaction and perceived inequalities in the workplace are one of the main indicators in predicting fraud in an organization. Moreover, it has also been reported that discriminatory treatment in promotion and remuneration, and lack of appreciations as part of the reasons for employees to commit fraud (Baucus, 1994). These workers put aside the respect for the organization they work for and usually consider fraud as an act of revenge against the organization (Dellaportas, 2013; Baucus, 1994). Also, some vices including gambling and drugs is another category of pressures that stimulates fraud (Dellaportas, 2013, p.30). The convenient access to gambling such as online, poker, casinos, lotto style games and gambling machines have exponentially increased the gambling industry. Such opportunities motivate individuals to steal money to satisfy their gambling habits (ACFE, 2012). The majority of offender plow back their earning on gambling again (Hing, 2002; Sakurai and Smith, 2003). Their desire to live like their more affluent counterparts creates more pressure (Dellaportas, 2013; Neu et al., 2013).

The type of pressure varies as per one's individual circumstances (Duffield and Grbosky, 2001; Morales et al., 2014; Peterson and Gibson, 2003). Many offenders have "egocentric motivation and a desire to possess more than one can afford, colloquially referred to as 'keeping up with the Jones'" (Dellaportas, 2013, p. 31). The egocentric motivation serves as an incentive to the offender and "it is seen in those people with very aggressive behavior and desire to achieve higher functional authority in the corporation" (Rezaee, 2005, p.283). Offenders of this kind are highly ambitious to gain power and control and they indulge in high-risk behavior that could lead them to commit fraud (Dellaportas, 2013, p.31).

b). Opportunity to Commit Fraud

Lokanan (2015) explains that the opportunity to

perpetrate fraud is another component of Cressey's (1953) fraud triangle. "A perceived opportunity to commit a fraudulent act arises when someone in a position of trust violates that trust to address a non-sharable financial pressure" (Cressey, 1953, p.30). In the accounting literature, the perceived opportunity to commit fraud has been discussed within the framework of weak internal controls which, according to KPMG (2010), is a most important factor attributable to fraud. "Such an opportunity arises when an individual has the technical skills and knowledge of assets, people, information, and computer systems that enable him or her not only to commit the fraud but to conceal it" (Coenen, 2008, p.12). In fact, the opportunity to perpetrate fraud increases as an organization's control system weakens, its governance turns less effective, and monitoring functions deteriorate (Power, 2013; Neu et al., 2013). The opportunity leg of fraud triangle is also explained in the criminology literature (Benson and Simpson, 2009).

Colvin et al., (2002, p.31) argued that coercion and social support are prerequisites for engaging in criminal behavior, and individuals devoid of social support from legitimate sources tend to engage in seeking social support from illegal sources. Individuals who lack social support learn to "manipulate others in efforts to gain social support and in the process develop an intermediately intense, calculative social bond, will be more likely to approach a criminal opportunity with a calculating spirit" (Colvin et al., (2002, p.31). Moreover, Donegan and Ganon (2008) carried forward the work of Colvin et al. (2002) and examined the opportunity from the background of sub-cultural deviance. They concluded that opportunity to perpetrate fraud depends upon a sub- culture that either appreciates or inhibits fraudulent behavior.

c). Rationalization of Fraud

Morales (2014) discussed and evaluated 'Rationalization' of the fraud triangle. It is a

justification mechanism adopted by offenders to suppress any feeling of guilt arising from their transgression (Dellaportas, 2013, p.32). It is pacifying instrument by which an employee determines that his/her fraudulent conduct is 'okay' in his/her mind. Individuals with low moral values, rationalization process may come easy for them, and those with high moral standards may have to persuade themselves that a fraud tolerable by making 'excuses' in their minds (Coenen, 2008, p. 12). The literature of social psychology and criminology provide an extensive study which help to understand rationalization. Lokanan (2015) adds that the criminologists Sykes and Matza (1957) presented neutralization theory, wherein they argued that offenders usually use “the techniques of neutralization” to justify their acts. The neutralization techniques are usually used to defend the individual from his/her internal values surrounding the guilt of offense (Stout, 2007).

3.2. Summary of Theories Around the Fraud Triangle

After Cressey's work many theories budded out from it, majority of them explained a phenomenon described by Cressey. The fraud triangle was further explained by so many researchers to present it as a modern fraud (Choo and Tan, 2007; Wolfe and Hermanson, 2004). Morales et al. (2013) contend that the present debate on the elements of the fraud triangle is structured around the discourse that assumes dishonest individuals perpetrate fraud because of their weak moral values and advise organizations to establish credible control structures to prevent their

employees to commit fraud or at least detect frauds timely (p.184). The Fraud Scale Model, introduced by Albrecht et al. (1984) suggested that the probability of fraud incidence can be predicted by assessing the “relative forces of pressure, opportunity and personal integrity”.

Rezaee (2002) provided another model referred to as the “3-C” model consists of three elements essential to commit corporate fraud: “Conditions”, “Corporate structure”, and “Choice”. Wolfe and Hermanson (2004) suggested a fourth element, “capability”, to the fraud triangle and transformed it into the “Fraud Diamond”. Some preferred to associate the fraud triangle with criminology, psychology, and sociology. Choo and Tan (2007) explained the fraud triangle in the context of corporate fraud and associated it with American Dream Theory (ADT) of crime, presented by Messner and Rosenfeld's (1994).

Contrarily, Ramamoorti et al., (2009) theorized the “Bad Apple, Bad Bushel, or Bad Crop Syndrome, the ABCs of fraud” to comprehend the occurrence of fraud from various perspectives including individuals, groups and macro level fraud. Besides, Krancher et al. (2010) presented Money, Ideology, Coercion, and Ego/Entitlement (MICE) Model wherein they modified the pressure leg of the fraud triangle and provided an extended set of fraud motivation beyond non- shareable financial pressure to perpetrate fraud. There have been many theories one after the other mostly budding out from the fraud triangle as illustrated in the Fig 2.

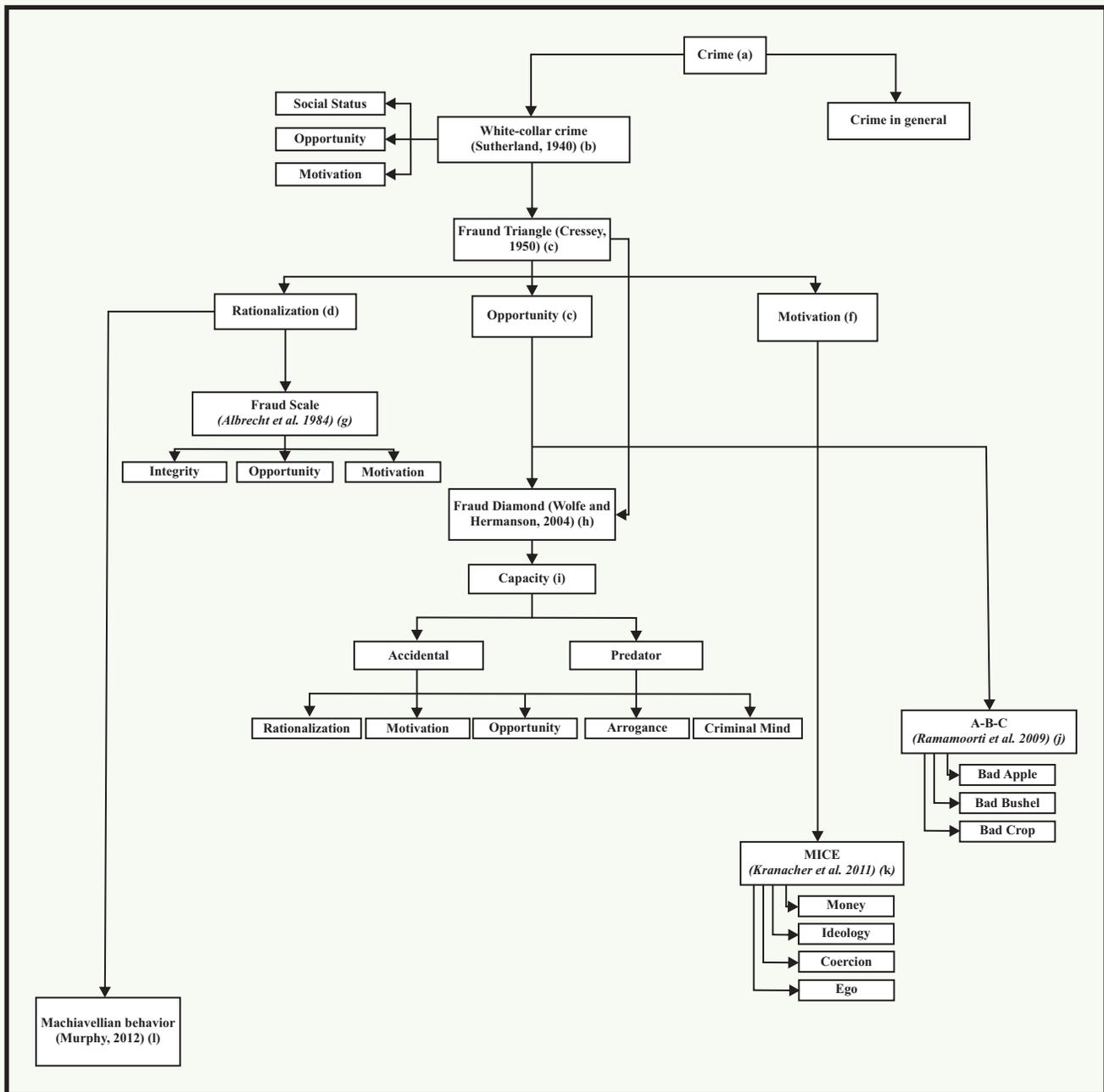


Fig. 2. Literature map: Evolution of Fraud (Maragno and Borba, 2017)

In short, theoretical models addressing behavioral aspects of a fraud perpetrator originated in 1940-50's with pioneer work of Sutherland on white collar crime (1944) and later on by the work of his doctoral student Cressey (1953) which was converted into fraud triangle (Morales et al., 2014).

3.3. Critique on the Fraud Triangle:

Just a few researchers looked beyond the fraud triangle to understand fraud in its multi-variety and

complexity. While tracing the genealogy of the fraud triangle, Morales et al., (2014) contends that nevertheless Joseph Wells, the founder of the ACFE presented fraud both as an act of personal enrichment and as a general problem that demands effective internal controls and monitoring of the individuals in an organization. But the fraud triangle represents intentional conversion orchestrated to legitimize fraud profession including ACFE and other allied bodies. He put it as:

In other words, the triangle provides fraud

specialists with an investigative template that individualizes fraud, holds organizations responsible for controlling it, and renders futile any systemic questioning. Fraud is thus constituted as a problem at the confluence of the individual and the organization; it is certainly not represented as a social, political, or historical problem (Morales et al., 2014, p.178)

To move beyond the individualized focus of fraud research dominated by fraud triangle some other theories were presented wherein collusive fraud is tried to be addressed (Ramamoorti, 2008) as discussed in the proceeding section. Moreover, Free (2015) in his work of “looking through the fraud triangle” expressed his concern on the “oversimplified and individualized nature of fraud triangle is unable to capture the complex notion of fraud in practice”.

Similarly, Power (2012) in his acclaimed work of 'the apparatus of the fraud risk' emphasizes to understand fraud and allied fraud risks in wider heterogeneous context which could be beyond the cognizance of the board that sets the 'appetite' to manage fraud risk. He advises to be vigilant to collusive practices whether inside or outside parties or the mixed of the two that breach the security systems. His apparatus of the fraud risk has been perceived to consider fraud beyond the fraud triangle as it has inherent limitation of being an individualized nature of the model. He further added that:

Even where organizations act in collusion, such as in cases of price fixing, these three subjects which give rise to fraud risk and misconduct – employee, leader, organization – are essentially internal. They may be distinguished from frauds conducted by outside agents, known or unknown, against the organization itself. In this case the risk subjects are other rogue groups, organizations and states utilizing hacking and other methods to breach security systems (Power, 2012).

Furthermore, Morales et. al. (2014) discussed “the genealogy of the fraud triangle” and traced it conception and progression along with highlighting its shortcomings. The term 'ideology' may be taken as a representation of “complex ways in which meaning is mobilized for the maintenance of relations and domination” (Thompson, 1990, p.8). Thompson (1990) explained the construction of the concept of ideology that it draws our attention to the ways in which meaning is mobilized to extend a benefit to dominant individuals and groups (p.73). The construction and propagation of fraud discourse by professional associations serve their own self-interests (Miller et al., 2008):

[the] analysis of fraud and wrongdoing involves the shaping of definitions and constructions of reality and what is seen as immoral, wrong or illegal. It is closely linked to the global spread of ideology and discourses that define some practices as fraudulent, others as immoral, others as tradition, and yet others as innovative (Cooper et al., 2013, p.446).

From the perspective of ideology creation, the prevailing fraud prevention framework (the Fraud Triangle) is an ideology that expresses the interests of ideology creators (ACFE, in this case) in explaining, detecting and preventing fraud (Cooper et al. 2013; Donegan and Ganon, 2008; Morales et al., 2014). However, Morales et al. (2014) illustrated that what fraud discourse is, what its motivation is and what its control measures are, can be unraveled with critical examination to the text that produces it (Miller et al., 2008; Tupper, 2008).

For example, Morales et al., (2014) built his argument through Foucaultian literature and examined the conception of the fraud triangle. They argued that the promoters of the fraud triangle tacitly frame the problem in such a way as to enforce their preferred solution on 'the problem'. They explained that fraud can be controlled by better surveillance of the individuals. In this way,

the job of accountants and auditors is made essential and valuable. Consequently, it strengthens the argument that the ACFE applies the fraud triangle because it validates its very survival. Lokanan (2015) concluded that “[ACFE's] chosen solution(s) actually specify or constitute the very problem that needs to be addressed”. In this regard, Morales et al. (2014) provided some interesting but provocative insights which lead to questioning the reliability of the fraud triangle.

Although the fraud triangle theory is mainly anchored in Cressey's (1953) work, it also draws upon other much-acclaimed work in criminology (Wells, 1997) to understand and analyze its elements. Discourses are (ab)used to attain and maintain dominance. Discourses are taken in the form of explicit support to endorse a position while blocking alternatives in toto (Fairclough, 1992, 1995a; Van Dijk, 1993). The fraud triangle discourse gets legitimation and dissemination through various public and private means, hence, a 'specific perspective' propagates which confines options to change (Lokanan, 2015). The researcher will refer to this section in chapters of discussion and findings. Fraud, as a research area falls between various disciplines including criminology, psychology and business.

In the areas of auditing and forensic accounting, conventional fraud research has tended to focus on individual patterns of fraudulent activity. Although the commentary surrounding the major framework in the field of auditing practice, the so-called fraud triangle, is primarily focused on solo offending and the psychology of the individual fraud perpetrator (Morales et al. 2013). But the co-offenders may be “individuals within an organization, individuals across organizations, or multiple organizations, and often span multiple jurisdictions—local, state, federal, and international” (Dormminey et.al, 2012). Although the educational material and standards available

generally indicates the perception of collusion but show limitations in detecting fraud involving collusion. For instance, International Auditing Standard (ISA) 240 refers as “Collusion may cause the auditor to believe that audit evidence is persuasive when it is, in fact, false” (paragraph 6). Likewise, Australian Auditing Standard (ASA) 240 states “...auditing procedures may be ineffective for detecting an intentional misstatement that is concealed through collusion among client personnel within the entity and third parties or among management or employees of the client entity” (paragraph 12). The co-offending phenomenon has attracted little attention of researchers especially from accounting and forensic auditing professionals (Lokanan and Sharma, 2018).

Michael Power concludes his work of “Apparatus of Fraud risk” as:

“...the grammar of fraud risk management is essentially individualistic.”. Power (2012).

4. Discussion and Results—Revisiting the Fraud Triangle:

Data triangulation from multiple sources of primary and secondary data reveals some interesting facts about corruption in context of Pakistan's public sector. It also unfolds the relevancy of the fraud triangle in this specific context. Opportunity

The data sources, analyses and results have been compiled from the Dissertation titled, Looking beyond the Fraud Triangle: a case study of corruption in Pakistan's Public Sector of M.Sc Forensic Audit & Accounting of the author. The dissertation was submitted to the University of South Wales, UK in 2018. According to the data presented through multiple sources in the i.e., case studies, observation and interviews, the common precursor of committing fraud has been

'opportunity' in all instances. As the respondents expressed the public-sector official from civil service act as 'sahulatkar' (facilitators) to commit corruption by colluding with politicians and/or private parties. The facilitators have 'opportunity' to exploit their positions entrusted to them by their public offices. Some officers, as expressed by the respondents try to cling to the lucrative positions that possess enormous opportunity (authority) to commit financial crime. The opportunity played a pivotal part in committing corruption. For example, as described in case study 2 "the accused misused his senior management position towards causing illegal financial benefits to 7 other co-accused through imprudent loaning from DFI" and case study 3, "the accused misused his official

position as public servant and extended loaning facility through undue favors to persons and financial ventures of his choice". This authority provided them 'opportunity' to commit fraud by involving several employees, private parties and politicians as explained in case studies. Such positions impregnate huge legal financial benefits, facilities and perks.

To sum up, the study reveals that as long as the fraud triangle is concerned in context of understanding, detecting and deterring fraud in context of Pakistan's public-sector corruption, the pressure and rationalization components are least important to be present to commit corruption. The findings are in also line with the conclusion drawn by Dorminey et al. (2012) who concluded that

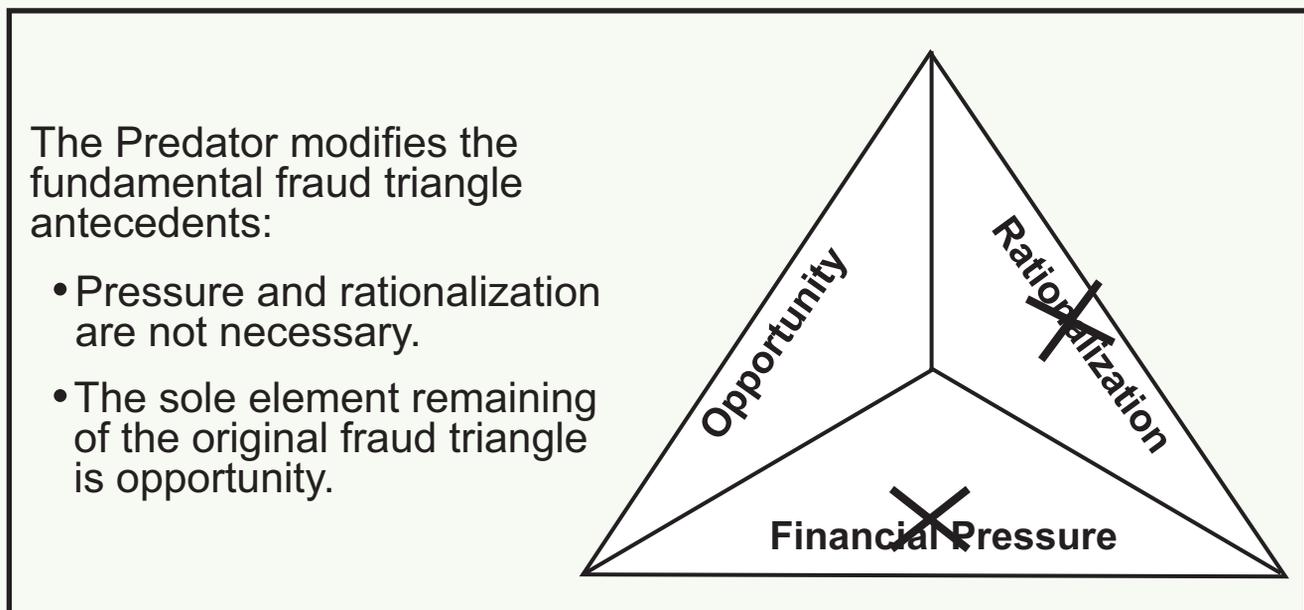


Fig.3 Impact of Fraudster (predator) on the fraud triangle
Source: American Accounting Association, Dorminey et al. (2012)

pressure and rationalization "play little or no role as a predator needs only opportunity". As elaborated in the literature review, there is paucity of research contrary to the discourse of fraud triangle. But recently, Lokanan and Sharma (2018) who conducted their study on "A Fraud

Triangle Analysis of the Libor Fraud" also highlighted occupational fraud through collusion in the perspective of an organizational culture and showed the presence of an element of the fraud triangle, 'opportunity' which led to committing occupational fraud.

Conclusion:

As discussed in detail in literature review (critique on the fraud triangle), the fraud triangle is an individualized model devoid of addressing complex, intricate and sophisticated fraud schemes like collusion. The findings of the study reveal that corruption was committed through collusion in Pakistan's public sector. The group dynamic of collusion in this study also corresponds to the findings of Free and Murphy (2015) who concluded that "group norms of loyalty, trust and distrust, and even antagonism

toward other parties can cement a group together..... this clearly imposes a renewed challenge on managers and audit firms to sharpen their fraud risk diagnostic tools". The critical approach of the study shows fraud a multi-faceted, interrelated, and complex problem, which makes the fraud triangle unlikely to be presented as a valid model in context of corruption in Pakistan's public sector. The author advocates a holistic cross-disciplinary research to understand, identify and prevent fraud in general and corruption in specific in the context of public sector of Pakistan.

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