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**"Fighting or sustaining corruption network: the role of accounting and
control systems"**

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Firma dello studente

Fighting or sustaining corruption network: the role of accounting and control systems

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INTRODUCTION

The 2014 European Commission's Anti-corruption Report defines corruption as "abuse of power for private gain" (European Commission, 2014, p. 2). The phenomenon's estimated costs in the European Union alone are around €120 billion per year, an amount very close to the entire budget of the EU. The total amount is based on estimates by specialised institutions and bodies such as the International Chamber of Commerce, Transparency International, UN Global Compact, World Economic Forum, which also suggest that corruption amounts to 5% of GDP at world level (European Commission, 2014).

The phenomenon has been increasing in parallel to the unprecedented growth of international trade during the past decades (Barkemeyer et al., 2015). In many developing countries that have been only recently involved in the globalization process, various forms of corruption are still considered the norm, in particular when governments have limited financial resources to invest in the enforcement of laws (Barkemeyer et al., 2015). In many countries and industries, corruption tends to be widely socially accepted, becoming harder and harder to identify and fight.

Research shows that certain industries, independently from their geographical position, seem to be more exposed to corruption (for example healthcare, urban development and construction) while others, for the nature of the activities conducted, are in most cases relatively safer (European Commission, 2014).

The IMF Guide Promoting Good Governance and Combating Corruption reports that "corruption thrives in the presence of excessive government regulation and intervention in the economy" (International Monetary Fund, 2002, p. 2), but empirical analysis shows that in developed and advanced nations there is no correlation between public expenditure and level of corruption. Corruption, anyway, seems to be positively correlated with the degree of regulation of business activity (Hopkin and Rodríguez-Pose., 2007).

Even in many EU Member States, internal controls across the country (in particular at local level) are considered weak and uncoordinated. According to the European Commission and its 2014 anti-corruption report, there is a need to reinforce such controls and match them with strong prevention policies in order to deliver tangible and sustainable results against corruption.

Complexity of legislation is also perceived as an obstacle to smooth operations. Frequent and incoherent legislative changes can generate legal uncertainty and weaknesses in the implementation process and corresponding control mechanism (European Commission, 2014).

Accounting and related control mechanisms play a fundamental role both in the prevention and detection of corruption within public bodies. In some cases, Courts of Audit have played a prominent proactive role in the fight against the phenomenon, pushing anti-corruption reforms forward. But in many cases, controls (in particular at a limited local level) can be ineffective and uncoordinated.

In many environments, for the illegal nature of the phenomenon itself, corruption is informal and auditors, who need to work on well documented evidence, may be unable to fight and limit the phenomenon. Even when they are able to spot clear cases of corruption, auditors could be ineffective in case of well organised collusion between the involved parties (generally citizens and public functionaries) and for the lack of implementation of the regulations.

More or less sophisticated corruption networks require the creation and development of cash flows and a careful management of financial resources and relationships between the individuals involved (Neu et al., 2013). Accounting can also provide the fundamental instruments to achieve sustainable and apparently legitimate results in extremely complex schemes.

A comparison between different corruption scandals may give us a better understanding of the phenomenon and how different forms of corruption affect countries and industries, while observing and understanding the key characteristics and themes of corruption networks, presented in the other chapters of the work.

Trial documents and commissions' reports regarding two prominent examples of corruption network (the MOSE affair and the Canadian Government's Sponsorship Program scandal) have been studied and compared in the last chapter of the work, analysing their key components, the role of accounting practice and their key common elements and differences, along with references to the themes presented throughout the rest of the thesis, to get a better understanding of the reasons behind the failure of the control systems and the challenges they might face fighting the phenomenon.

CHAPTER I: Corruption as a global phenomenon

Corruption has deeply changed during the past decades and it is a major key point in the agendas of most national and supranational institutions. To get a better understanding of corruption and related illegal networks and activities, it's fundamental to study the evolution of the phenomenon and how its characteristics may vary across different industries and countries (United Nations, 2018).

Only studying the major causes and consequences of this phenomenon (and its links with the private sector) institutions can promote an effective war against corruption through adequate control systems and regulations.

However, because of the illegal and shady nature of corruption itself, the phenomenon is in many cases hard to study and understand; a well organised and coordinated series of provisions against corruption is still one of today's greatest challenges for legislators around the world.

1.1 Definition and consequences of corruption

The general definition of corruption provided by the European Commission (2014, p. 2) is "any abuse of power for private gain": many forms are clearly possible, in many cases in the relationship among public officials (which are the ones exploiting their privileged position) and private citizens or firms.

Many other authors propose definitions of corruptive events. For example, Friedrich defined corruption as the situation in which "a responsible functionary or office holder is, by monetary or other rewards (...) induced to take actions which favour whoever provides the reward and thereby damage the group or organization to which the functionary belongs, more specifically the government" (1989, p. 15). Huntington defined corruption as "behaviour of public officials which deviates from accepted norms in order to serve private ends" (1989, p.

377) and Nye as “behaviour which deviates from the formal duties of a public role because of private-regarding (family, close private clique), pecuniary or status gains; or violates rules against the exercise of certain types of private-regarding influence” (1989, p. 966).

From these definitions the key characteristics of corruption emerge:

- the phenomenon is often hidden and informal (and therefore can be very hard to detect and fight), even compared to other illegal activities;
- the phenomenon requires a “supply side” and “demand side” interested in personal gains and ready to go against the law and sacrifice public interest.

Spence (2017), as quoted by Mazzi et al. (2019), outlines five common features that characterise corruption episodes:

- 1) possession of power;
- 2) a disposition to exercise that power;
- 3) an opportunity to exercise that power;
- 4) invisibility or concealment;
- 5) self-regarding gain (not necessarily financial).

This definition summarizes every corruption phenomenon at its most basic and ubiquitous key elements. Culture seems to be a fundamental factor directly affecting the effectiveness of regulatory control practice too.

Moreover, the terms “corruption” and “fraud” are in many cases used interchangeably, but according to a classification provided by Khan (2006), corruption takes place mainly in the forms of:

- bribery (offering money or favours in order to illegally influence individuals in a position of trust and power);
- kickbacks and commissions (when one of the involved parties pays back to the other a percentage of the illegally obtained capital gain);
- other benefits (not necessarily financial rewards).

Adopting one of these forms, the involved parties will try to avoid leaving traces of their transactions and relationships in the official records, keeping the deal as secret and unofficial as possible. This is also one of the main reasons why even when many honest public officials

perceive and denounce the existence of a corruption network, it could be very hard to identify and dismantle: lack of proofs and documentation can obstacle investigations and internal control systems.

Instead, fraud is related to undue benefits obtained by bypassing controls and going against some regulations (using, for example, falsified information and certifications). For the nature of this activity, fraud tends to be more documented and easier to trace: the related auditing process is generally very different from corruption-related auditing.

For these reasons, in this work we won't consider corruption and fraud as synonymous.

The losses caused by the spread of corruption amount to more than 5% of the world's GDP (United Nations, 2018). These amounts are large enough to deeply affect the global economy and political policymaking, damaging welfare and public investments with significative consequences for hundreds of millions of people.

As pointed out by the OECD in its Principles for Integrity in Public Procurement (2009, p. 11), "Weak governance in public procurement hinders market competition and raises the price paid by the administration for goods and services, direct impacting public expenditures and, therefore, taxpayers' resources. The financial interests at stake, and the close interaction between the public and private sectors, make public procurement a major risk area. [...]".

Corruption works and prospers mostly modifying and destroying the flows of capitals, goods and services organised by governments: key resources are moved away from people or institutions who need them and end up under the control of individuals interested only in personal gains. The involvement of corporations interested in obtaining unfair business advantages is very common in major corruption-related scandals.

The phenomenon has deeper and more devastating consequences in the developing world: funds that should be invested, promoting economic growth and development, are often diverted by corrupted officials for private gain, fuelling a vicious circle of inequality and inefficiencies.

At the same time, poor people who are victims of corruption usually sacrifice larger percentages of their income to access basic fundamental public services (United Nations, 2004).

Endemic corruption inevitably generates economic underperformance in the medium-long term, not only destroying growth opportunities, but discouraging foreign investments and

effective government intervention. Corruption can seriously obstacle growth and competitiveness of entire countries and, in the most extreme cases, pushes populations deeper and deeper under extremists' control, underlining the potential role of the United Nations in supporting Member States in the fight against corruption: a more efficient involvement and an expansion of public participation, in particular with the use of new technologies, could increase accountability and limit extremism.

Past years' deadliest conflicts in the African continent have offered enormous opportunities for illicit self-enrichment (as inevitably happens during war economies), with a very clear nexus between corruption and war atrocities (United Nations, 2018).

Even if there is "not a country in the world which does not treat bribery as criminal on its lawbooks" (Noonan, 1984, p. 702), the phenomenon is now more relevant and discussed than ever.

Noonan, in his book *Bribes* (1984), shows that bribery is condemned in every culture and considered "shameful", being a betrayal of the trust of the public. However, corruption in many cases is also seen as a possible and effective solution to failures of the markets and of politics; for this reason, effective and improved systems (with deeply structured changes) are in most cases the best way to fight corruption.

1.2 Main characteristics of corruption

Corruption as a worldwide phenomenon has evolved and changed deeply during the past decades but it is still widespread around the world (United Nations, 2018). Because of its structural complexity and its economic, social, political and cultural dimensions, a war on corruption cannot be easily planned, as there isn't one definitive set of measures or policies which could effectively limit corruption worldwide.

The different settings are characterized by specific political processes and institutional structures which inevitably form different kinds of corruption.

Companies with different sizes and from different sectors will inevitably require different approaches, but distinct backgrounds will also affect deeply the control system.

Different backgrounds (with different cultures, history and politics) will shape different concepts of management and control systems: a general, universally accepted system is impossible to define, especially considering the myriads of specific characteristics which contribute to the uniqueness of each single firm (Hofstede, 2010).

The level of decentralization and related autonomy of the firm's branches also have a fundamental role in shaping the financial structure of the organization (including the profit-sharing system) and the entire management strategy. Cultural differences and national limits can seriously damage the "exportation" of successful management ideas and organization strategies, but in many studies this fundamental assumption is underrated or not considered at all. The behaviour of managers, board of directors and leaders around the world is inevitably going to be affected by the characteristics of their societies, not exclusively by their business environment.

For decades, for example, U.S. models have been considered a key to success and growth: theories supported by the predominant role of American editors, that for decades have been publishing mostly American articles in their management journals. The success of American economy, in fact, is related to an historical context and other factors which can be impossible to reply in other countries.

Johnston (2005) proposes a fundamental distinction between different institutional settings, which are influenced by context-specific factors like forms of political participation and control systems:

- 1) Influence-Market,
- 2) Elite Cartel,
- 3) Oligarch and Clan,
- 4) Official Mogul.

In "Influence-Market" countries (like Canada, USA and Japan), briberies are not very common because they are discouraged by solid institutional structure: direct bribing is avoided, but at the same time more complex and sophisticated forms of corruption are encouraged and certain forms of hidden corruption become more and more inevitable, in particular when the costs of democratic processes are so high that can become unsustainable without the investments (and related influence) of the private sector. Lobbying practices have become widespread and mostly accepted in particular in countries like United States and Canada, where political parties can't possibly sustain costs without resource inflows and raising funds is a key factor for successful campaigns (Neu et al., 2013).

In “Elite Cartels” settings, state institutions are not as strong and corruption networks involving colluding elites are more common and harder to control and fight (South Korea and Botswana are possible examples).

“Oligarchs and Clans” settings present even weaker state institutions, generally controlled by extremely corrupt elites through bribing and even violence against political opposition. In the most extreme cases, public and private sectors are deeply connected and both under the elite’s influence (Russia, Philippines and Mexico are possible examples).

In case of “Official Moguls”, even smaller groups or powerful individuals are free to enrich themselves at the expense of the state, often with total impunity. Anti-corruption organizations are generally very weak and political opposition is often forbidden or persecuted. (China and Kenya are reported as possible examples).

The structure of the political system itself is fundamental too: more rigorous separation of public powers (legislature, executive, judiciary) might help to diminish corruption (Johnston, 2012).

This distinction between institutional settings provides a general description of common settings around the world, but certain forms of corruption are globally diffused, and no nation can be completely described by a simple model, especially considering that transitions from one kind of model to another are always possible in the medium-long term. (Johnston, 2012). Political decisions related to key elements like healthcare, taxation and environment can severely impact even the world’s biggest corporations, creating an inevitable interdependence between politics and business.

This interdependence in some cases can be mutually beneficial, but needs to be heavily regulated to protect the best interest of the population and avoid money-grabbing schemes from the involved parties (Johnston, 2005).

Even if petty corruption is less reported and even less visible than billion dollars corruption scandals, it can still deeply damage entire economies, in particular if these small cases are part of a phenomenon where millions of minor illegal payments are made and especially in an environment where bribes become socially accepted and authorities are incapable of handling the problem (United Nations, 2018).

During the past decades, governments and supranational institutions have invested many resources trying to understand and stop the many forms of the phenomenon and studying possible solutions and identifying “red flags”.

In 2002, the American Institute of Certified Public Accountants (AICPA) published a list of common indicators which internal auditors should consider to estimate possible risks of corruption. If these indicators of transparency and accountability aren't followed by the organization, there is a higher risk of corruption and other illegal activities:

- the organizational environment fosters control consciousness;
- realistic organizational goals and objectives are set;
- written policies (for example, a code of conduct) exist that describe prohibited activities and the action required whenever violations are discovered;
- appropriate authorization policies for transactions are established and maintained;
- policies, practices, procedures, reports, and other mechanisms are developed to monitor activities and safeguard assets, particularly in high risk areas;
- communication channels provide management with adequate and reliable information;
- recommendations need to be made for the establishment or enhancement of cost-effective controls to help deter fraud.

The list of requirements can be easily adapted to many different settings and situations, independently from the size, governance and level of internationalization of the firms, allowing control systems to identify immediately riskier cases.

The World Bank adopted a new Governance and Anticorruption strategy in 2007 too; identifying red flags, institutions can learn from past experiences, recognizing and stopping cases of corruption earlier and more efficiently (Ferwerda et al., 2016).

It's also fundamental to consider that most of the literature adopting risk indicators to estimate and predict illegal behaviours is inevitably affected by estimation bias: this kind of measurement is, for its nature, unpredictable and inaccurate. Many statistics related to corruption and other illegal activities are mostly based on estimates and a full and deep understanding of corruption networks could be impossible to achieve. People directly involved in a corruption network are interested in keeping it as secret as possible and investigating it tends to undermine people's trust in government activities and it's in some cases discouraged (United Nations, 2004).

Corruption inevitably flourishes when a key product or service is controlled by a monopoly that determines its distribution and amounts (Klitgaard, 2011). Concentration of vital products and services in the hands of a limited number of key players should be avoided and monitored by institutions.

When regional and local authorities have wide discretionary powers in the matter of public procurements, there is a higher risk of undetected corruption, in particular in case of limited checks from control mechanisms (Ferwerda et al., 2016). In the most extreme cases, the consolidation of local “clientele networks” presented also relationships with organised crime, in some cases even infiltrated in the local authorities.

1.3 Supply-side and demand-side of corruption

It’s also fundamental to consider that corrupt transactions generally involve a “supply side” (the payer of a bribe) and a “demand side” (the recipient of the bribe) and both sides need to be monitored to stop the phenomenon.

Most of the regulations adopted to stop corruption are devoted to the planning and implementation of internal controls of government officials, obscuring the so called “supply side” of the corruption phenomenon: the corporations providing goods and services for the government departments (Sikka & Lehman, 2015). While the state can and will check on its own functionaries, it is generally excluded from the internal processes of the corporations it is working with; the state’s possibilities to accurately monitor the firms and enforce internal controls are generally limited and are responsibility of the firm’s executives.

Governments tend to be the centre of institutional attention regarding corrupt practices, but it’s also important to consider that in the modern world many corporations have revenues bigger than the GDP of entire nations, with a huge variety of subsidiaries and affiliates around the world. A big and complex network can allow them to camouflage easily their activities to gain extra profits. In many cases, corporations have shown to be ready to subvert regulations and internal control systems to gain competitive advantage, operating according to the laws of private profit (Chatterjee, 2009).

A clear red flag for corruption is conflict of interest (due to family, business or political relationships) or possible impartiality of the tender provider to determined suppliers because of past or present affiliation (OLAF, 2011).

Regular punishments don't seem to discourage corporations' illegal activities, in particular in certain industries; corporations are more and more under pressure because of shareholders' demands and competition, so they are de facto encouraged to use illicit means to achieve faster and better results.

The main reasons why corporations may be interested in engaging in corrupt practices are

- 1) to maintain higher prices;
- 2) to maintain a market for obsolete products or services;
- 3) to remain in the field of competition.

These practices may generate unfair competition in the market and incessant pressures for higher sales, profits and market shares (Moody-Stuart, 1997).

Once a hidden illegal network is successfully initiated, it can become substantial part of the official institutionalized practices: corruption gradually becomes harder and harder to detect and stop. Networks of professionals involved in the same activities could be vulnerable to a collectively accepted lowering of regulatory vigilance (Gabbioneta et al., 2013).

Research has identified a series of red flags (indicators of high risk of corruption) mostly in public procurement, defined as "the process by which governments as well as other bodies governed by public law purchase products, services and public works" (European Commission, 2015, p. 2).

Considering that, always according to the European Commission (2015), 250,000 public authorities in the EU have to spend 18% of GDP to purchase services, works and supplies, it's clear why corruption in this area is so relevant: controlling a limited number of public officials in key positions, corruptors may be able to gain access to enormous capital flows and opportunities.

Ware, Moss and Campos (2007) propose four fundamental procurement stages along which corruption can be organized, based on the investigations of cases of corruption:

- 1) project identification and design;
- 2) advertising, prequalification, bid preparation and submission;
- 3) bid evaluation, post qualification and award of contract;
- 4) contract performance, administration and supervision.

Underperforming firms tend to be more involved in illegal activities, in particular when it's the only possible way to survive, while high-performing firms have clearly less incentives to do so.

CEO compensations and the structure of the board of directors (with related accounting procedures, reward systems and human resource practices) are considered other possible causes of episodes of corruption and other illegal procedures, mostly related to the incentive system (stock options, bonuses...), very common and well affirmed among corporations. Size, complexity and division of labour can also deeply affect corporation's behaviour: in case of decentralized decision processes, opportunities for concealment are more common and the risk of getting caught is lower.

Coffee (2005) proposes a fundamental distinction between American and European illegal activities: radical differences related to the different ownership and governance system. In fact, European corporations tend to be controlled by smaller ownerships and usually are less decentralised. The fundamental role of organizational culture and institutions, anyway, shouldn't be underestimated and can deeply affect very different realities.

Growth and related costs of developments can also be correlated with corruption, but the internationalization process generally expose firms to an increasing number of regulations and procedures which could damage or even destroy domestic corruption network (Sandholtz & Gray, 2003). Overall, international trade in many cases improves transparency and accountability among corporation executives.

Evidences of the effects of corruption can be found in every part of the financial statements. According to a study by Mazzi et al. (2019), in countries with higher levels of corruption, capitalized development costs will be less effective at increasing future earnings, compared to similar situations and expenditures in countries with low levels of corruption, in many cases with reduction of abnormal returns even in the short term. In high corruption environments, efficiency is sacrificed and in many cases sub-optimal allocation of resources becomes inevitable, damaging the entire market.

Another fundamental factor explaining the correlation between country-level corruption and amount of development costs capitalized is given by the fundamental differences in accounting standards, which may vary in the countries where the firm operates. While IFRS prescribe that development costs need to be capitalized if certain criteria are met, IAS 38 impose restrictive conditions to reduce the related managerial opportunism.

This inevitably affects stock returns and dividends as well, influencing stock prices: fighting corruption in many cases is also in the best interest of shareholders.

In more individualistic countries, where intense competition for prestige, status, and material wealth, individuals seem more likely to seek special favours to gain advantages over others for personal gain (Khatri, Tsang, & Begley, 2006).

Elaborate and sophisticated corruption networks resemble organized crime in the most extreme and elaborate cases. As seen inside criminal organizations, in presence of systemic corruption is possible to find real systems of recruitment, hierarchies and even rewards and punishments for the involved parties.

The greater the number of parties involved, the greater the risk of getting caught, but also the potential profit (in particular if the cash flows are properly managed and masked as legit activities).

Studies have shown that in many cases, public employees, for the characteristics of their occupation, are the leaders of these corruption networks (Khan, 2006).

It's also important to consider that the most successful and durable corruption networks are those in which bribing offers sufficient gains to both the corruptor and the corrupted: the parties involved are interested in gaining as much as possible from their illegal relationship.

1.4 The suggestions from national and international institutions

Transparency and accountability are the key words of the war of national and international institutions (like United Nations, European Union, World Bank, International Monetary Fund...) against corruption (United Nations, 2018); these institutions have different roles, influence and authority in diverse areas. Even if international institutions can't replace the fundamental role of national governments, they can still provide a series of principles and guidelines, which can be eventually received and adopted by national legislators.

A good level of transparency should allow full publicity of institutional activities and public access to all the information that may improve competition and avoid illegal collusions (Manganaro, 2009). Some of the most important suggested measures from the UN convention

against corruption are related to transparency: members of the general public should be allowed to obtain information about the activity of public administrations and, at the same time, periodic reports on corruption should be published and administrative procedures should be made more transparent and easier to access.

Allowed levels of transparency should be clearly regulated and the information available thanks to the fundamental principles of publicity and public access should also be presented in an understandable way for the interested involved parties, even simplifying, if necessary, administrative language and formality. The complexity of most bureaucratic procedures, anyway, can inevitably obstacle effective flows of information from institutions to the population; this complexity may vary significantly among different countries and different processes too.

Accountability is also fundamental to keep records and traces of financial transactions, identifying the responsibilities of private firms and public officials while valuing the effectiveness of their activities.

The level of accountability can vary significantly between different countries and, when related to private firms, it's deeply influenced by the size and by the level of internationalization of the observed firm (Nadkarni & Perez, 2007).

Most supranational organizations, including World Bank, strongly support decentralization of local government, in particular in the developing world; decentralization combined with a more direct local democracy may be easier to monitor and, in case of criminal behaviour, replace public officials.

Government officials refusing to introduce adequate reforms or to improve transparency and accountability in many cases will be removed from office, so politicians will likely try to introduce anti-corruption policies if they want to be elected.

On a more local perspective, common problems like information asymmetry and lack of information should be less relevant and easier to overcome, compared to a very centralized government.

Decentralization must be supported by good quality of accounting practices (and all the other anti-corruption strategies should be complementary as well) to achieve better results, a combination that can be very hard to obtain, in particular in poor countries. Decentralization is a very complex process and models working well in some countries may not be as effective

in other environments: for these reasons, decentralization combined with weak quality accounting practices may have negative consequences, in particular if combined with environments with low levels of transparency and press freedom (Changwony & Paterson, 2019).

Governance is defined by Kaufmann, Kraay, and Mastruzzi (2009, p. 5) as "... the traditions and institutions by which authority in a country is exercised. This includes a process by which governments are selected, monitored, and replaced; the capacity of the government to effectively formulate and implement sound policies; and the respect of citizens and the state for the institutions that govern economic and social interactions among them"; combined with good quality institutions, a good system of governance is fundamental to sustain growth and a well-functioning financial system. If the quality of governance is unsatisfactory, it has to be improved or even replaced following the regulated procedures.

A research by Hooper et al. (2009) has shown a significant and positive relationship between positive stock market performance and good quality governance (with adequate levels of transparency, accountability and effectiveness); to get a better understanding of the phenomenon, anyway, quality of governance and financial market stability and related indicators should be considered and studied together. Sherif and Chen (2019) studied the relationship between institutional governance factors and abnormal momentum stock returns, collecting the data related to governance from previous researches of the World Bank. They found a significative correlation between low levels of corruption and governance effectiveness: without corruption, most operations are going to be smoother and more efficient in delivering the required goods or services, granting better economic results.

Accounting has a fundamental role in providing vital information and fight corruption: without a good quality accounting system, other anti-corruption practices could be ineffective as well.

At the same time, however, local bureaucrats may be victims of pressing demands from corporations or local elites, in particular in developing countries where this kind of phenomenon is still extremely common.

The fundamental correlation between corruption, decentralization and accounting practices is one of the most important themes in corruption literature (Changwony & Paterson, 2019) and it's a key to get a better understanding of the phenomenon, in particular regarding its more recent characteristics.

Another strategy is related to privatization policies. The implementation of this kind of measures is not always easy or even possible in many cases and many policies may have other negative consequences (as historically seen in case of extreme privatization, for example), in particular if complementary measures aren't implemented; in poor countries, effective development measures can also have a fundamental role.

Judicial and repressive measures can also have a major role in fighting the phenomenon and limiting criminal organization and systemic corruption. Brunetti and Weder (2003) also show a significant correlation between free press and low corruption.

Governments can demand better quality internal controls introducing new laws, requirements and punishments, but in a globalized and interconnected economy this kind of provisions could become more and more ineffective if states don't cooperate through enforcement of international laws and treaties. Periodic fines are common and seem to be easily accepted in many industries, signalling that in many cases punishments from the state are not a sufficient deterrent, even when executives are perfectly aware of the consequences of their illegal actions.

A program of deschooling, against the current failures of education on the subject (Illich, 1974), with additional improvements in corporate culture to change the perception of corruption and other illegal activities among executives, promoting transparency and more socially conscious behaviours.

Supreme Audit Institutions (SAIs) are the real protagonist in promoting accountability among governments and prevent corruption. Considered the independent watchdogs of public interest, SAIs are putting an increasing focus on ethics in the public service and cost effectiveness while promoting accountability and transparency among governments (Dye & Stapenhurst, 1998).

To achieve good results, SAIs should receive adequate funding and well-trained staff, sharing data and experience with other institutions, promoting a free and efficient flow of information. At the same time SAIs need to remain independent from the executive, to avoid external pressures, which in this environment can be extremely common.

1.5 Focus on EU policies

The European Union Commission (2014) sustains that a “mutual experience-sharing program” could help Member States in the identification of best practices to overcome error and problems in anti-corruption policies. Feedbacks from the directly involved stakeholders may help to understand possible gaps and errors in policies too.

According to the results from two “Eurobarometer surveys” carried out in early 2013, the ranking reported in the CPI index published by Transparency International tends to correspond to the Eurobarometer’s results. Being the result based also on perception, a relatively high perception of corruption as a common phenomenon doesn’t always correspond to an high number of people who say that effectively had to pay briberies. In countries like Belgium, Estonia, France and Germany, for example, more than fifty percent of the respondents claim that corruption in their own country is widespread, but only 2% really had to pay a bribe.

Perception of corruption can be deeply affected also by media coverage and significative political or financial scandals, causing an inaccurate vision of the phenomenon. Always according to the Eurobarometer, 26 % of Europeans affirm to be personally affected by corruption and 76% of them think that corruption is a widespread phenomenon in their country. Only 8% of Europeans, anyway, affirm to have experienced or witnessed a case of corruption in the previous 12 months.

A business-focused Flash survey shows radical variations among Member States: while in Greece the level of perceived corruption is 99%, in Denmark it’s just 10%. From a business-focused point of view, 4 out of 10 companies at European level consider corruption to be a potential problem for business activities. The smaller the company, the higher is the risk of facing problems related to corruption and nepotism.

Anti-corruption policies, in the past years, have become priorities in many European states, in particular after the terrible economic consequences and the scandals of the financial crisis (European Commission, 2014). People all round the world are protesting, demanding more transparency and more accountability for political and financial elites, which even in democratic countries in many cases are not trusted at all: codes of conduct for parties and corporations, when present, generally lack of adequate control systems. One of the most important topics is related to the financing of public parties (further discussed in the fourth

chapter): after recent scandals, several Member States have implemented new policies to improve transparency on financing and donations for public parties.

New policies alone, in many cases, are not enough to reach significant and tangible improvements; coordination and additional strategies for an effective implementation are generally required.

Asset disclosure for officials in many cases helps to achieve more transparency and accountability among public officials. The approaches change according to the required amount of information to be disclosed; in the past decades the requirements have become stricter and stricter even in Member States where initially disclosure wasn't required. In a few Member States, in fact, institutions in charge of monitoring and checking asset disclosure have limited powers and in the most extreme cases asset disclosure wasn't applied at all; even right now, related control systems can be very ineffective because of excessive complexity or lack of independence from governments.

In the European Union, it is for the Member State alone to decide which institutional structure should be focused on fighting corruption in its own territory.

Setting up specialised anti-corruption agencies, active in many Member States, isn't clearly a solution to all problems.

The result obtained by these agencies vary according to factors like effective independence from political interference, cooperation with other institutions and provision of necessary resources and skills; these important requirements obviously aren't respected in every condition and in every Member State and in many case a proper coordination with other agencies and the judicial system is missing too.

If an anti-corruption agency isn't independent from politics, for example, the risk of direct or indirect pressure from the latter may seriously obstacle the agency's procedures and legitimacy.

Independence of the judiciary system, for the same reasons, is also a fundamental element of every anti-corruption policy and of an overall well-functioning framework (European Commission, 2014).

Another obstacle is related to the excessive length of judicial procedures: delays can be extremely costly and benefit people involved in illegal activities, which in some cases can even avoid the finalisation of the court proceedings. Political interference in corruption cases

is still very common even in some European countries and in many cases the powers of anti-corruption agencies themselves aren't matched with adequate levels of accountability.

The most vulnerable sectors are generally the same in every Member State (and outside EU as well).

Urban development and construction are sectors where corruption is traditionally high and even higher in Member States where businesses tend to be directly more affected by the corruption phenomenon. Environmental planning, in particular, has been pinpointed as an extremely exposed sector because of the sector's connections with illegal party funding related with granting of planning permits.

Most of the Member States deeply and constantly affected by the phenomenon haven't started a sector-specific strategy to tackle corruption episodes, which could be more effective than a broad and generic anti-corruption strategy.

Transparency policies and freedom of information should be one of the priority of the EU in the fight against corruption, but at the same time the Member States must be ready to protect whistle-blowers from retaliation and promote "transparency of lobbying", making relationship between public administration and outside stakeholders more transparent and regulated.

CHAPTER II: The role of Accounting and Control Systems

National and international public institutions are protagonists of the global fight against corruption, but also the single organizations need to be able to detect and stop illegal activities within their sphere of influence. Accounting practices and related control systems are among the most important protagonists of this fight, but their roles can deeply change according to the needs of the actors adopting them.

According to a definition of Ahrens (2009, p. 31), “from a practice perspective accounting is an array of activities that is ordered by practical understandings, rules, and objectives and projects, and that forms a nexus of practices together with management and control practices, commercial practices, reporting practices, bookkeeping practices and suchlike”. The definition underlines the inevitable variability of accounting, seen as a set of instruments which can be adopted by different users for different purposes, in some cases illegal activities.

Ahrens also emphasizes the fundamental role of practice (or, to be more precise, of the combinations of different practices) in the realization of reliable and efficient networks: practice should gradually improve through the accomplishments and strategies of the actors involved as a process in continuous evolution, avoiding simple repetitions.

Control systems aren't always mandatory by law, but any firm could benefit from an effective implementation of internal control systems (especially in environments and industries where corruption can seriously damage the firm's performance), in particular if there is an efficient cooperation between different control strategies, both internal and external.

Without an adequate planning and anti-corruption internal strategy, the organization's employees may decide to act for personal gain, getting directly or indirectly involved in corruption networks; regulations and bureaucracy on the subject shouldn't just impose a set of rules, but they must try to understand the employees' needs and anticipate their reactions to be really effective.

Different countries and different industries generate inevitably different organizations, which require distinct approaches to internal control systems: the role of accounting (in particular in the developed world) is fundamental to promote transparency and accountability of the parties involved in financial transactions, but in many cases it isn't enough to stop the realization of corruption networks.

Widely accepted accounting standards and good quality financial reporting are precious and effective tools to identify bribery and small corruption networks, but in certain environments they could help to legitimate and sustain corruption networks and related illegal transactions.

2.1 Role of Management Control Systems

According to Malmi and Brown (2008), the concept of Management and Control Systems (MCS) is related to the implementation of the company's strategy, interconnected with monitoring activities and information flow, to detect and solve a wide range of problems while boosting performance. Other key objectives of the system are the coordination and optimization of interactions between human resources, organizational structure and management.

However, the same authors sustain that literature on the topic doesn't provide a clear and unique definition of MCS, especially considering how quickly it changes overtime and the significant differences of MCS depending on the characteristics of the firms considered.

The fundamental elements of every MCS are (Borsa Italiana, 2014):

- a clear set of planning and control activities to monitor the performances of the firm (for example through SWOT analysis, benchmarking and value chain analysis);
- a set of technical-accounting tools, to accurately process information and provide support to the decision-making processes (like budgeting system, reporting system and analytical accounts);
- a well-integrated information system, to disclose effectively the information (after a proper collection and organization) that could be helpful for the management.

Combining the results obtained through these instruments, corporations can identify the fundamental key success factors they need to survive and grow; being so important and interconnected, they also need to be constantly monitored to detect and stop possible risk factors, anticipating and preventing possible negative scenarios.

Business-related risks can seriously compromise the profitability of the firm, management must be ready to identify and understand (Borsa Italiana, 2014):

- external risks, generated by the alteration of an external factor (from the inevitable risks associated with competitors to the risks of global recessions and disruptive technological innovations), generally harder to predict and control;
- internal risks, which could be:
 - I. process risks, with a focus on the ability of the organization to improve the continuity of the fundamental operating processes, promoting an efficient use of assets and availability of resources (fighting risks related to inadequate production capacity and improper handling of financial resources);
 - II. information management risks, related to the efficient use of information needed for developing and improving corporate strategy (management needs to fight risks associated with an inefficient flow of information, which can compromise activities of performance analysis and forecasting).

Managers and leaders can use several methods to control and prevent corruption inside their organization and their role is complementary to the anti-corruption activities conducted by public institutions. The managers' monitoring strategies can be effective only if they are trusted by the public and if they are following specific ethic values; it can't always be granted and in most sensitive environments an additional "monitor to monitor the monitor" may be required.

As Lange reports in his research (2008), these approaches can be very different depending on the firm's specific characteristics and the results of the implemented strategies are often

studied independently and without proper comparisons, generating high risks of misinterpretation and lack of basic understandings of context of firms' activities. Nevertheless, organizations tend to be "isomorphic" with their own environment (Di Maggio and Powell, 1983) and generally develop common traits for three main reasons:

- coercive pressure, related to the social pressure to follow existing social norms and procedures, not necessarily mandatory by law, for example in case of expectations from the media to address certain problems (including corruption);
- normative pressure, more common when there is an accurate codification and set of norms that organizations need to follow to conduct certain activities. This phenomenon is much more relevant in heavily regulated industries;
- mimetic pressure, related to the imitation of other organizations belonging to the same environment, to appear legitimate and gain recognition from stakeholders.

According to a definition by Cardinal (2001, p. 22), "any process by which managers direct attention, motivate, and encourage organizational members to act in desired ways to meet the firm's objectives" can be considered part of organizational control; the objective of the firm is fighting any opportunistic and deviant behaviour going against the organization's activities, not only corruption. While corruption control is exclusively focused on the "minimization of an undesirable state" (Lange, 2008, p. 713), MCS are also focused on the improvement of cooperation and efficiency, with additional benefits. Corruption control needs to consider the different types of corruption to identify best possible solutions and must be distinguished from other kinds of organizational controls.

Some of the MCS strategies can be more effective if they are combined in the same organization: managers inevitably need to get a better understanding of the intercorrelation between different approaches to build more effective strategies, avoiding inconsistent implementations. Control approaches based on bureaucratic restrictions, for example, could be inconsistent or even contradictory with approaches based on encouraging ethical behaviour among employees.

According to Lange (2008), the different corruption control strategies adopted by firms can be schematized considering two fundamental distinctions.

The first one is between controls based on final outcomes and controls oriented toward processes. In both cases the number one priority is the limitation of the risks related to the

agency problem, ensuring that employees are always working in the organization's best interest and not exclusively for personal gain. This task can be particularly challenging if the firm's hierarchy is complex and managers are significantly independent from the board of directors and have great decision-making autonomy. The organization can try to gain more control through:

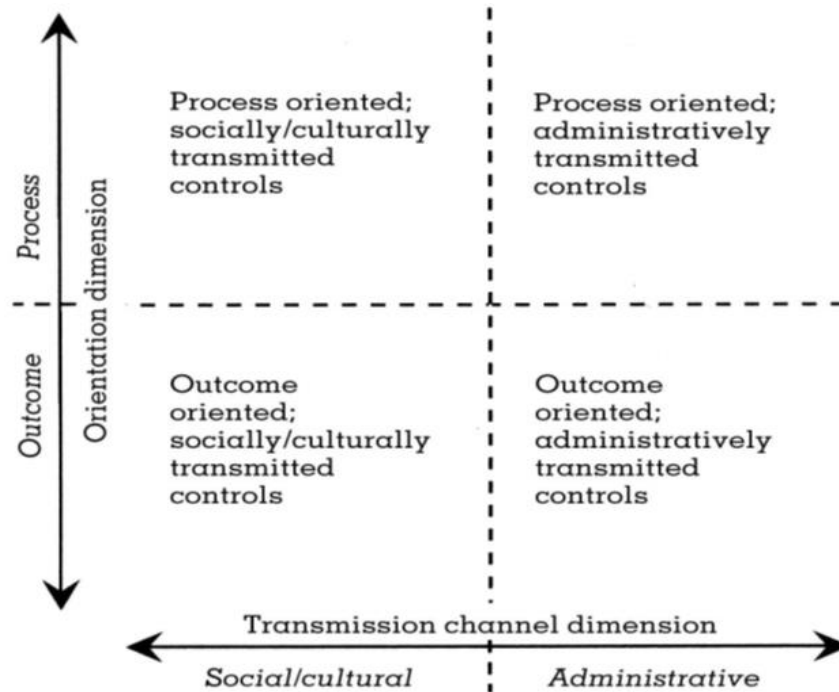
- outcome-oriented methods, through which managers try to punish or reward certain behaviours (generally recurring to economic or disciplinary incentives) trying to align the interest of managers with the interests of shareholders to avoid undesired consequences, while detecting and eliminating possible cases of corruption;
- process-oriented controls, which inevitably involve active interventions before and during the employees' activities. This type of controls requires ongoing monitoring activities at different levels of the organization, which are inevitably more expensive to implement than simpler outcome-oriented strategies.

The second essential dichotomy is related to the adopted means of transmission, with a distinction between controls transmitted through administrative channels and controls transmitted through ethical, social or cultural channels:

- social/cultural controls are deeply connected to the beliefs and values of every organization. They operate through the forces of social obligation, relying on fear of being judged and criticized by peers in case of corrupt behaviour;
- administrative controls, instead, are transmitted using formal and official structures promoted by authorities inside and outside the organization, which operate through coercion and punishments. Differently from social controls, which tend to emerge unintentionally through routine and repeated interactions, administrative controls are intentionally designed for their role; both control systems, anyway, can still be manipulated by managers for personal gain and they aren't sufficient to fully prevent corruption.

Using these fundamental components, we can build a conceptual framework combining orientation dimension and transmission channels.

Figure 2.1 - Matrix of Corruption Control Dimensions-Orientation



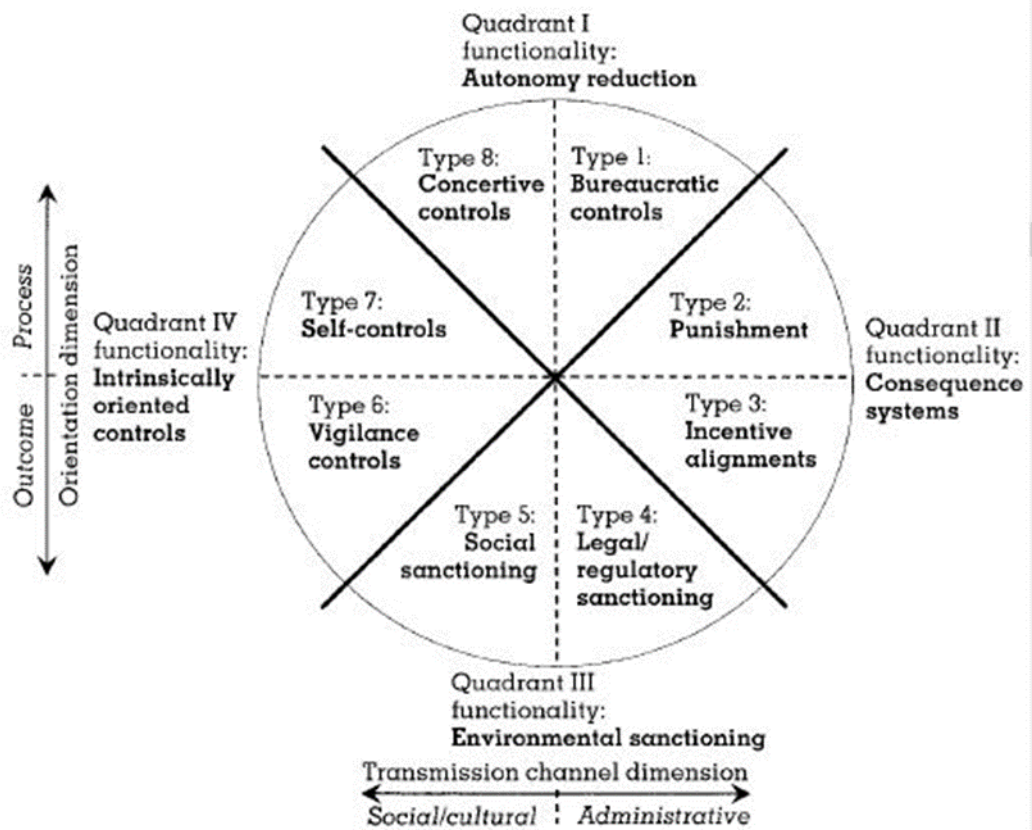
Source: Lange (2008)

According to Lange (2008) there are four main dominant functions offered by these approaches:

- 1) autonomy reduction, in which the organization limits the employees' freedom;
- 2) consequence systems, in which the organization decides to punish and reward certain actions;
- 3) environmental sanctioning, in which the organization interprets external regulatory pressures and informs the employees about their obligations;
- 4) intrinsically oriented controls, in which the organization encourage the member's own inclinations to detect and fight corruption (mostly theoretical and inevitably very challenging to implement in the real world).

Combining the previous 2x2 matrix with the functionality of corruption control types, we obtain a more detailed framework which show eight different (but interlinked) corruption control types.

Figure 2.2 - Organizational Corruption Control Circumplex



Source: Lange (2008)

Looking at the Quadrant I, it's clear that autonomy reduction procedures can be both rooted in regulations and bureaucratic strategies and in social obligation.

Internal consequence systems, both incentives and punishments, are included in the Quadrant II and are located in the administrative part of the framework, being an important part of the organization's administrative structure and authority.

In Quadrant III, the organization is a sort of intermediary, in charge of transmitting information about legal and social sanctions to the employees.

Quadrant IV, instead, contains the social influences within the organization that affect the employees' attitude about illegal and corrupt behaviour.

This model shows the main differences between corruption control systems and their main effects, but it can also provide information about possible combinations of these strategies.

The model allows us to get also a better understanding of the fundamental role of bureaucracy in organizational control: being an inevitable component of formalized procedures and

regulations, bureaucratic control is adopted by most big organizations (Cardinal, 2001).

Managers need to be able to successfully combine bureaucracy with the other control types presented in the framework.

Some control types can coexist in the same environment, but friction and conflict are possible in case of control types sharing the same functionalities, in particular if they try to reach the same results in very different ways (Lange, 2008). Bureaucratic and punishment-related control types are still the most popular among managers trying to fight corruption, but the reactions of the employees involved in the control system need to be anticipated and understood to implement a successful model.

Attitudes and outcomes may vary significantly if individuals are directly involved in the process (promoting empowerment and autonomy) or if they are just forced to follow passively a specific set of rules and bureaucratic procedures.

Applying this model, anyway, it's important to consider the significative differences between organizational contexts: different organizational flexibility, the adoption of organic or mechanistic contexts or the level of task predictability may deeply effectiveness and the costs of implementation of control systems. Most organizations are going to adopt more than one control type and the implementation of different strategies isn't always part of a well-structured plan, but often they just develop overtime alongside with the evolution of the organization's activities.

Future trends that will probably affect the evolution of MCS are going to be related to recent technologies and themes like the proliferation of data, artificial intelligence and automation, combined with the realization of stronger organizations and a better management of the costs of risk management.

2.2 The COSO Model

For decades, international institutions have been studying corruption and the way it affects companies' activities, identifying possible models to control and fight the phenomenon.

The main purpose of the Committee of Sponsoring Organizations of the Treadway Commission (COSO) is providing strategies for the development of comprehensive

frameworks and guidance related to internal controls, fraud deterrence and enterprise risk management. Criteria adopted need to be reasonable and allow management to easily check the effectiveness of control systems. It's a private initiative sponsored by five non-profit organizations, mainly focused on teaching, research and development of accounting-related strategies:

- American Accounting Association;
- American Institute of Certified Public Accountants;
- Financial Executives International;
- Institute of Management Accountants;
- The Institute of Internal Auditors.

The Internal Control- Integrated Framework was originally defined by COSO in 1992, gaining recognition by the organizations involved, it has become widely adopted by American public-traded companies subject to Sarbanes-Oxley Act (SOX) Section 404 compliance requirements (McNally, 2013).

The COSO model has been updated in 2004, 2013 and 2017, in two decades new and different risks have become more and more relevant: risk needs to be considered both in the strategy-setting process and in driving performance. In the updated version have been presented additional ways to handle risk in a more complex business environment and in a more globalized and interconnected world economy. The transition from one version to another of the model can be summarized by a five-step process:

- 1) develop awareness, expertise and alignment;
- 2) conduct Preliminary Impact Assessment;
- 3) facilitate Broad Awareness, Training, and Comprehensive Assessment;
- 4) develop and Execute COSO Transition Plan for SOX Compliance;
- 5) drive Continuous Improvement.

Dealing with many different kinds of risk is a fundamental part of the decision-making process and, even if many practices related to risk management have developed over the past

decades, many economic activities are facing increasing levels of uncertainty and ambiguity. The continuous change of regulations can be particularly challenging and affect the key principles and guidelines of the model: the companies themselves should do their part updating and improving their own control systems.

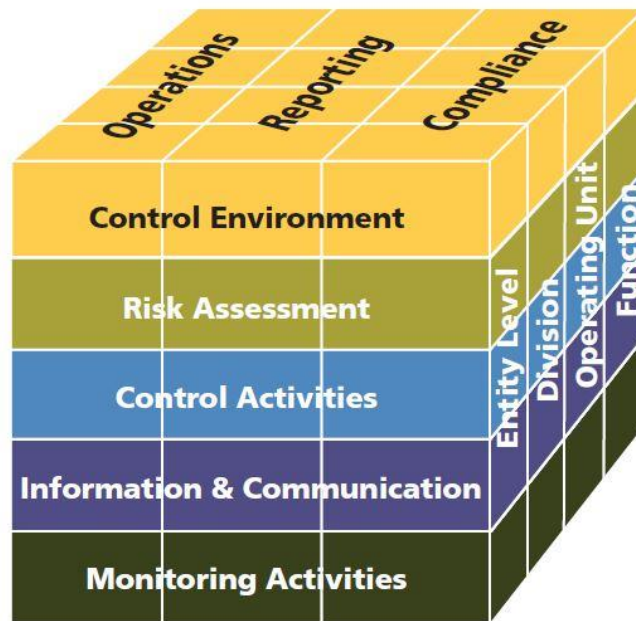
Enterprise risk management shouldn't be considered a function of a single department, but a series of practices that need to become part of the firm's culture and structure; it must address also the relationships with stakeholders and governance, without being focused exclusively on internal control and performance measurement (COSO, 2017). At the same time, stakeholders are getting more and more involved in the firms' activities and tend to demand greater transparency and accountability from management and board of directors.

Integrating properly enterprise risk management in their activities, firms may be able to:

- increase their range of opportunities, as management could be more focused on current possibilities offered by the market;
- identify and manage risk entity-wide, facing compactly the myriad of risks that can affect the different parts of the organizations;
- reduce performance variability, when the risk is not necessarily related to unexpected losses but also to the variability of performance, enterprise risk management allows organizations to anticipate possible risk;
- increase positive outcomes and advantages while reducing negative surprises, with a better allocation of resources to cover unexpected costs and losses;
- enhancing enterprise resilience, as firms need to anticipate changes with a proactive approach.

The concept described by the model can be presented and summarized in the "COSO cube".

Figure 2.3 - COSO cube



Source: McNelly (2013)

Operations, reporting and compliance are considered the three main categories of objectives, while control environment, risk assessment etc. are the related components of internal control.

Being “customizable” for very different kinds of organizations, the framework can be adapted according to the organization’s breeches under control (any entity, division, operating unit or even function of the firm) which will inevitably require different approaches.

The focus on risk can be distinguished in four fundamental subgroups (Jeppesen, 2018):

- 1) strategic risk: it deals with the risk related to business decisions and the overall strategy adopted by the firm;
- 2) operational risk: it refers to the risk of losses related to inefficient procedures, transactions or policies

- 3) compliance risk: it refers to the risk that the company won't follow its mandatory requirements;
- 4) reporting risk: the risk of lack of transparency and disclosure towards the firm's stakeholders.

Compliance risk is the subgroup where the consequences of corruption can be more relevant, the risk that the company won't comply properly with laws and mandatory requirements.

Organizations, in fact, are expected to manage the possibility that employees may eventually become parts of corruption network and need to prevent this risk. Firms need to identify high-risk environments, trying to measure the possible impact and consequences of corrupt practices in the considered areas. The company policy regarding the fight against corruption needs to be clear, well implemented and widely known by employees: an effective whistleblowing line is the best way to link management and employees suspecting illegal activities, allowing a better communication between control systems and directly involved parts (Jeppesen, 2018).

Detailed documentation reporting the different phases of commercial transactions can also be very helpful for the identification of possible corruption episodes, from the purchase to the effective reception of goods and services (one of the riskiest processes). To avoid bid rigging, for example, preapproval of vendors is a widely adopted strategy, but it needs to be integrated with systematic monitoring of prices on the market and with an adequate bidding process to really stop conflicts of interest. Management, in particular in great organizations, can be relatively independent and often in a perfect strategic position to override internal controls.

An independent monitoring of internal control systems is needed to identify and sanction managers who refuse to implement and follow anti-corruption policies; this has gradually become one of the key tasks of auditing too.

Promoting accountability of the involved parts (meant as responsibility of administrators of funds, in this context especially regarding public officers) is fundamental to fight any form of corruption and illegal activity and it's one of the most important roles of accounting and auditing, which in many cases are fundamental to help governments shape new flexible policies against the phenomenon.

2.3 Accounting as a system to prevent corruption

For centuries, well-implemented accounting practices have been associated with fair government and a key to reach prosperity. Accountants have been considered essential protagonists of development economic growth in many different realities and ages. During the XVI century, accountants were even represented by Dutch artists as honest and probe figures, painted with symbolic elements of transparency and balance (Johnston, 2015).

British artists began to produce similar representations of the figure of the accountant as well, adding a sub-genre in which auditors where even judging the dishonest and the lavish, as a sort of authoritarian religious figure. Good accounting practices meant that even the richest and most powerful individuals had to pay their debts, respect their obligations and follow laws, promoting fundamental business-friendly principles like fair competition and accountability.

The role of major firms providing accounting services has changed over the past decades: now they tend to be larger and integrated, offering a much wider variety of services and expertise, with a range of operations that includes much more than basic bookkeeping and accounting services, with a specific focus on consulting activities.

According to the World Bank (1994) the key steps that developing countries should follow to improve accountability and fight corruption are:

- implementation of an effective and integrated financial management information system;
- development of an adequate number of accountants and auditors;
- adoption and application of widely accepted international accounting standards;
- empowerment of a strong legal framework for supporting modern legal accounting practices.

Independently from the strategies adopted and from the specific context, accounting is going to be a fundamental part of control activities and its role is changing constantly: for these reasons, improving and investing in accounting procedures could be particularly helpful in developing countries where they are still scarce or non-existent and corruption is still a major problem. A more efficient and reliable measurement of economic performance could be very helpful to understand the effectiveness of government policies too.

Each of the three extremely broad categories of solutions for fighting corruption (control, exit and voice) are based on accounting practices.

- control, in which accounting is naturally oriented toward control systems;
- exit, in which accounting is oriented to improve profitability and efficiency as well;
- voice, in which accounting has an important role in showing how public money is handled and offering possible improvements and solutions to problems.

Research shows that in most cases anti-corruption organizations tend to prefer exit over control strategies (Neu, 2007), as an excessive amount of controls and regulations could have unintended effects and increase costs and inefficiency and, at the same time, privatization could fight and limit corruption by promoting active competition at a macroeconomic level.

Petty corruption is more common in developing countries, in particular when private actors have to interact with lower level government officials or administrative bureaucrats (Elliot, 1997), with interactions mostly related to licensing, tax payments and the allocation of government-subsidized benefits. The role of accounting in preventing corruption in these cases is limited, because basic information and fundamental documents are in many cases not available at all.

In developed countries, anti-corruption barriers are in most cases built following accounting-based principles (Neu et al., 2013): related provisions can eliminate certain forms of corruption (like the straightforward payment of bribes), but at the same time can encourage different and more sophisticated forms of corruption. This phenomenon generally assumes the form of “networks” where different participants (politicians, accountants etc.) can contribute using their influence and help to build an effective corruption network, in many cases involving high-level public officials and considerable amounts of money. At these levels, the line between regular and irregular transactions can become less clear (Elliot, 1997), in particular considering there are often very radical regulations regarding public procurement and other government-related activities.

According to Johnston (2015), accounting techniques can become effective anti-corruption tools only if they are supported by adequate support from elites and social participation, involving other control systems too. At the same time, accounting processes need to be as

standardized as possible to be easily applied and to accurately compare different cases across the world. In many situations, accounting can be considered a sort of “neutral technology”, which is more likely to serve the best interests of whoever is in charge of paying them, with notable exceptions only in case of particularly “socially-aware” businesses or public agencies and organization subject to more advanced scrutiny.

Using well-affirmed and widely accepted accounting practices and strategies, the protagonists of these networks can configurate capital flows for personal gains, manipulating the distribution of capitals and the strategic positioning of the involved actors.

Accounting-implicated strategies can allow participants to bypass even very sophisticated anti-corruption barriers: in many environments accounting is a powerful tool not only to fight corruption but also to facilitate it, providing alternative and effective techniques. In some cases, corruption can become commonplace and universally accepted.

Sargiacomo et al. (2014, p. 90) reported a famous speech delivered Bettino Craxi in the Italian Parliament on July 3rd, 1992, in which he describes the terrible condition of the Italian System during the “Mani Pulite” scandals:

“A network of small and large corruption has spread around in the country, in the institutions and public administration life, which results in the decay of public life. [. . .] Unfortunately, also in regards to political parties, it is often difficult to identify, prevent and amputate infected areas, both because of the objective impossibility of adequate controls and, sometimes, because of the existence and prevalence of wicked logics. And so, in the shade of the irregular financing of political parties and—I repeat—as a consequence of the nature of the political system, corruption and bribery flourish, intertwined. These latter offenses must be defined, considered, proved and judged as such.”

Craxi himself was the most important political figure involved in the scandal, being the leader of the Socialist Party, but several other public officials, functionaries and entrepreneurs were part of corruption networks and the magnitude of the scandal deeply affected the entire Italian society, showing the weaknesses and the limitations of accounting-based control systems (Sargiacomo et al., 2014), in particular related to public procurement practices.

Charges of corruption in Italy were pretty common even before the “Mani Pulite” scandal and reforms of the justice system were introduced during the eighties, increasing the power of judges (Sargiacomo et al., 2014).

There are three main streams of literature describing corruption from an accounting perspective (Barkemeyer et al., 2015).:

- 1) one of these streams (conceptual studies) is mostly focused on the distinction between the orthodox and radical framings of accounting:
 - the orthodox one, which consists on the contribution of accounting to anti-corruption activities (as presented in publications by major supranational organizations like World Bank, the OECD or Transparency International);
 - the radical one, instead, is focused on the possible strategies that could be used in accounting to facilitate corruption and other illegal activities (Sikka, 2010);
- 2) a different stream observes and examines in detail different cases of corruption and the role of accounting in each case;
- 3) a third stream is focused on the socio-economic and cultural factors influencing corruption in a certain country or industry, including the overall quality of accounting procedures. Kimbro (2002), for instance, shows that countries with better financial reporting scandals tend to show lower levels of corruption.

Quality of reporting is always fundamental to understand and constrain corruption, but it's definitely not the only factor affecting the phenomenon.

Generally, good quality accounting practices and a system which is well-integrated with international accounting standards are characteristics of developed economies and best governed countries in the world, which are generally characterized by a well-developed and efficient public sector as well.

According to Bourdieu's studies (1990a, 1990b, 2005), in rich countries anti-corruption strategies are mostly based on accounting-based barriers, which also have a fundamental role limiting the exercise and sale of political influence. Accounting can be very effective against explicit bribery activities and very helpful facilitating internal controls, but it isn't a definitive solution to corruption-related problems.

In the wrong hands, accounting can provide a great set of tools to build corruption networks involving politicians and bureaucrats (from one side) and private firms (on the other side), bringing the phenomenon to a different level. Distribution of cash flows and transfer of capitals inside a network inevitably require accounting tools, which can also be used effectively to go against the barriers imposed by accounting provisions themselves.

In organized criminal networks involving corruption and other illegal activities (like for example money laundering), relationships are built around the accomplishment of a specific set of accounting transaction, which may vary according to the needs of the involved parties: in these cases accounting isn't just a tool to "mask" illegal transactions, but becomes the backbone which allows the realization and organization of these networks (Neu et al., 2013).

2.4 Evolution and characteristics of the Auditing process

The auditing process is one of the protagonists of the fight against corruption involving private firms: a proactive approach of auditors may be very helpful to identify illegal activities and could become an increasingly important service offered by auditors.

Auditing may have a fundamental role both in detecting and preventing corruption (Jeppesen, 2018): the two roles are deeply interrelated and need to be adopted simultaneously, even if literature has been mostly focused on the "preventive side", considered in many cases the real purpose of the auditing process.

Dye and Stapenhurst, for example, affirm that the mere existence of financial auditors should "discourage" corruption as "auditors in the private or public sector who have been trained to audit financial statements do not have a history of finding much fraud through their audits. Their main contribution to preventing corruption has been the strong psychological factor of deterrence" (1998, p. 13-14).

Supreme Audit Institutions (SAIs) have a fundamental role in reporting on deviations from ideal principles of legality, efficiency and effectiveness (Stapenhurst & Dye, 1998), being an important pillar while non-SAIs accountants still have an important role, enhancing voice by disclosure of the firms' financial information.

SAIs, anyway, have not been particularly successful in the detection and investigation of the corruption phenomenon in the past (K. Reichborn-Kjennerud et al., 2019), generally limiting their activities to auditing processes and leaving the responsibility of most anticorruption procedures to administrative and judicial authorities. Khan (2006, p. 5) is of the opinion that auditors “can hardly detect or investigate into the actual event of corruption, since the culprits, generally, do not leave any documented evidence”: in the most extreme cases, the complete absence of information and data could be an obstacle impossible to overcome for auditors.

International organizations including the International Organization of Supreme Audit Institutions (INTOSAI) have been trying to promote additional anti-corruption practices among SAIs, but their powers in this field are limited compared to other public institutions and can become completely ineffective if they aren't adequately supported by Parliaments and can't count on free and independent media. Well-developed and free information is a crucial factor, if auditors want to communicate effectively the results of their work.

Private auditors generally accept to identify episodes of corruption when it has the form of “non-compliance with laws and regulation”, an activity that doesn't necessarily require an investigation and research of possible corruption networks (K. Reichborn-Kjennerud et al., 2019) and inevitably requires exchange of information with the audited firm's management, but not with the authorities. Public sector auditors often have different professional backgrounds and very different approaches to anti-corruption activities: in this case INTOSAI standards can become more important and shape the auditors' approach.

Even if most of the SAIs activities is conducted following international principles and frameworks approved by INTOSAI itself, which in the past decades have become increasingly important and influential: when it was originally founded it used to provide non-binding auditing standards, but now its “International Standards of Supreme Audit Institutions” are widely accepted standards to promote good governance in the public sector, improving the credibility and the recognition of INTOSAI worldwide. Auditors, anyway, inevitably need to consider local mandates and legislation (INTOSAI, 2016) to conduct their activities, with the inevitable formation of different areas of influence.

A research conducted by K. Reichborn-Kjennerud and others (2019) considers the three main differences among auditing processes regarding the levels of the risk related to corruption, the number of auditors in each one of the countries studied, and the amount of total investments in the auditing process. The study compares SAIs in the Scandinavian regions (with low levels of corruption according to international rankings), in Southern Europe (medium levels

of corruption) and in Africa (very high levels of corruption). The results show that African SAIs have a more active role in the fight against corruption, in most cases going directly against the will of local corrupted governments. Anyway, it's fundamental to consider that an active approach doesn't necessarily mean that SAIs will achieve a satisfactory outcome: even if corruption episodes have been successfully identified and exposed, they can only be stopped with an effective intervention of local authorities, which in many environments can be really challenging, in particular (as seen before) when corruption is completely socially accepted. In many developing countries SAIs often don't have sufficient funds and technical skills to conduct adequate audits.

INTOSAI guidelines (INTOSAI, 2016) underline also the importance of effective internal financial management systems, in particular the ones based on effective financial reporting and disclosure, but only if they are cooperating efficiently, following auditors' guidelines and improving relationships and exchange of information with other key stakeholders (in primis judicial authorities and anti-corruption organizations, but also media and other businesses).

CHAPTER III: Structure and characteristics of Corruption Networks

Corruption networks are still extremely common even in developed countries and among businesses above any suspicion; during the past decades extreme cases, involving even thousands of people and causing damages for billions, have seriously damaged the reputation of industries and even entire countries. As previously discussed, accounting has a fundamental role in fighting illegal activities building barriers against corruption, but the same principles can be adopted to find specific ways around these barriers, offering at the same time the level of accuracy and secrecy required by the nature of the corruption network's transactions (Neu et al., 2013).

Accounting can become a fundamental and reliable tool to realize efficient corruption networks. Any kind of complex activity involving cash flows and transactions inevitably requires a certain level of organization and control, accounting processes can be powerful instruments to mask corruption, hiding and disguising illegal transactions between the involved parties. To achieve more productive relationships between involved social actors, the components of the network should be focused on contribution and not mere imitation of accounting procedures, combining them with other forms of expertise and technology (Ahrens, 2009).

This phenomenon is clearly more common when the amount of money and the number of people involved can justify the realization of a corruption network: these levels of corruption can require a complex network to be sustainable and effective overtime (unlike isolated episodes of petty corruption). Tools and strategies adopted in these activities are going to be extremely different according to the environment, the context and the size of the corruption network.

3.1 General characteristics of a corruption network

Significant episodes of systemic corruption and corporate fraud have been always based on “networks that are explicitly built around the accomplishment of a specific set of accounting transactions” (Neu et al., 2013, p. 506). Corruption networks adopt strategies and techniques very similar to those adopted in other illegal activities involving huge amounts of capital, like international money laundering.

Vannucci (2015) identifies the fundamental components of a corruption network in a definition of Banfield (1975, p. 587, emphasis added) “The frame of reference is one in which an agent serves (or fails to serve) the interest of a principal. *The agent is a person who has accepted an obligation (as in an employment contract) to act on behalf of his principal in some range of matters* and, in doing so, to serve the principal’s interest as if it were his own. *The principal may be a person or an entity such an organization or the public.* In acting on behalf of his principal the agent must exercise some discretion; the wider the range (measured in terms of effects on the principal’s interest) among which he may choose, the broader his discretion. *The situation includes third parties (persons or abstract entities) who stand to gain or lose from the action of the agent.* There are rules (both laws and generally accepted standards of right conduct) violation of which entails some probability of penalty (cost) being imposed upon the violator”. Corruption networks may adopt very different shapes and sizes (according to the flows they have to hide and to the nature of the protagonists of the network itself), but are generally based on principal-agent theoretical frameworks and a form of abuse of power born from a delegation of decision-making power and subsequent betrayal of the trust of the principal (in many cases the public), where the agent (generally a public officials) can benefit from the inevitable information asymmetry generated by these kind of processes, often bypassing control systems (Vannucci, 2015). The misuse of power and connections is going to be more profitable if the agent has the opportunity to build mutually beneficial relationships with third parties (the “demand-side” of the corruption network), generally private firms or individuals interested in accessing the resources handled by the agent. An excessive number of actors directly involved in the corruption network may compromise the secrecy of the affair, so the components should handle their connections and information carefully and select cautiously eventual new components.

For its strategic position within the organization and having access to the principal’s funds, the agent is generally the leader of the entire network and it’s in charge of handling relationships and transactions between the network components (Khan, 1996).

The activities of the network may require the creation of slush funds for occasional bribery of important figures outside the network or to handle more accurately the compensation of the network's components.

The potential profits coming from privileged relationships with public officials encourage rent-seeking, referred as "the activities and expenditures of individuals who seek to change rights to earn the above normal profits described as rents" (Khan, 1996, p. 687). It's not necessarily an illegal practice and it's also common in form of legitimate activities, such as lobbying, but it's anyway a fundamental component to measure corruption and its consequences: getting approximations of the total amount of money invested in this kind of activities, researchers can also get an idea of the total number of possible agents "competing" for the rent and obtain more detailed information about the size of the corruption networks and about the characteristics and roles of the social actors involved.

When the "habitus" of the corruption network is finally established and the social actors know and understand the real nature of the disguised accounting transactions, the components can always adopt new practices if the evolution of the network will require it, while keeping their role inside the network and creating a consolidated and effective series of activities (Bourdieu, 2005).

Because of this "solidification" of practices and strategies, sudden external changes may deeply damage the structure of the corruption network, in particular if there isn't proper communication between components. The corruption network needs stability and predictability to prosper, even more than regular traditional businesses.

Corruption networks have to face challenges and problems even unrelated to problems with the law or with control systems, for example:

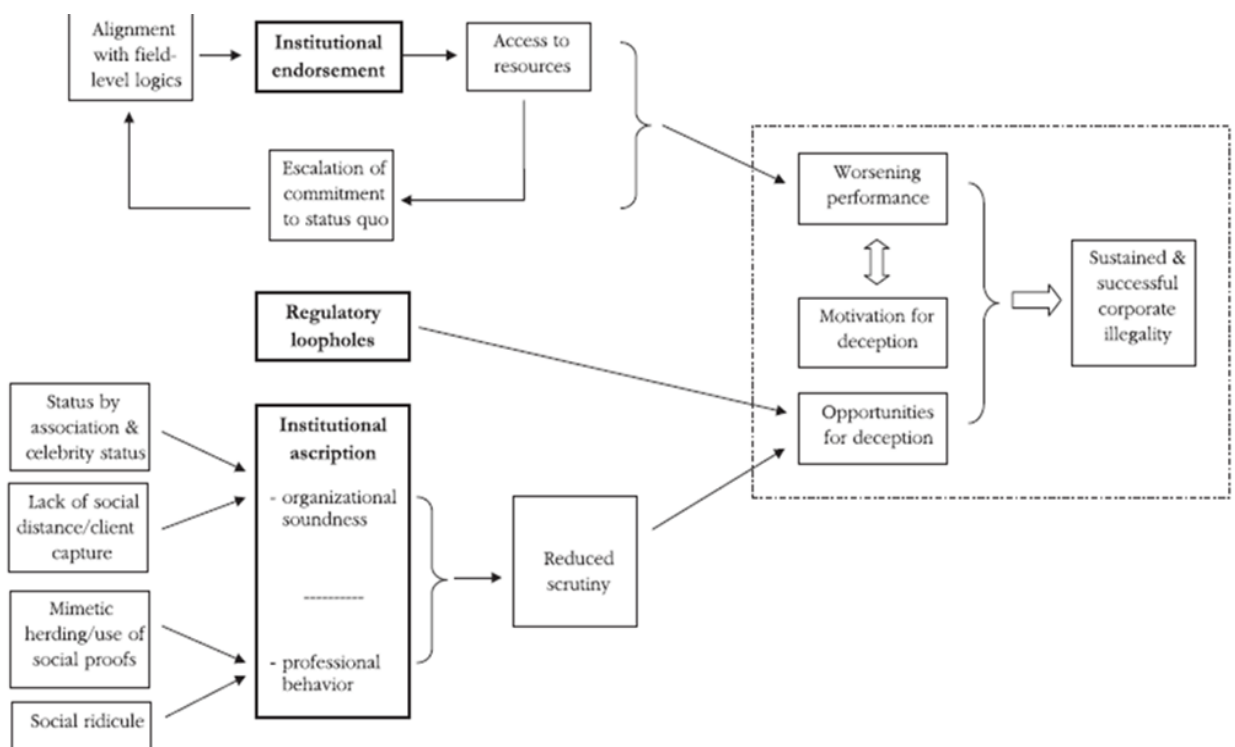
- key components may retire or be transferred to a different position, possibly compromising the entire network;
- significant and unpredictable external changes affect the project and/or the industry of the corruption network.

These kinds of issues may generate instability and may require a complete reconfiguration of the entire network, disrupting the current habitus and forcing the components to completely revise the accounting practices previously adopted.

If firms have already “invested” time and resources in key connections to become part of a corruption network, losing a key social actor involved in the network (for example after the arrest of a public official involved) could seriously damage the financial position of the firms and their future development.

Becoming part of a corruption network can provide significant comparative advantage, especially becoming a key component of the affair, with important connections to the other parties and with a significant control over cash flows. However, at the same time an important role within the network can cause a dangerous and risky interdependence with the other social actors involved. The human component (both corruptors and corrupted) of the corruption network can be harder to replace than in most legitimate business transactions, in particular in contexts where removed bureaucrats have been gaining influence and power while building their own corruption network for years.

Figure 3.1 Theoretical model of sustained and successful corporate illegality



Source: Gabbioneta et al., 2013

In their research, Gabbioneta et al. (2013) provide a theoretical model of sustained and successful corporate illegality, showing the most important factors which can allow firms beyond any suspicion to build effective corruption networks.

The “celebrity status” of a firm involved in a corruption network or other illegal activity is an underrated key factor: a successful expansion in the previous years combined with a rapid growth of the firm in an international context can generate a very positive (and even too optimistic) presentation of the firm by the media, inevitably influencing the opinion of stakeholders.

Even independent analysts, working on a firm universally presented as extremely successful and promising, may end up conforming to the public opinions merely for reputational matters, in particular in conditions of uncertainty.

Companies like Parmalat (before the scandal) even conducted sorts of “road shows” promoting the successes of the firms to financial observers (Gabbioneta et al., 2013) like a sort of political convention. Analysts criticizing the firm’s financial situation may even get discredited by the media, discouraging future criticism towards the company, especially if the latter can count on an unconditioned and irrational support from its investors, a phenomenon that can dangerously decrease the necessary “social distance” from a company and its stockholders.

These factors can generate a process of institutional ascription, where the firm ends up being recognized as professional and successful without real support from reliable data and in the most irrational situations can even become above any suspicion, reducing the levels of scrutiny and scepticism from external and internal observers (Gabbioneta et al., 2013).

Well-affirmed companies can also count on regulatory loopholes related to accounting and auditing principles to hide their worsening performance or illegal transactions through specific accounting tools (even for several years and handling billions).

Combining all these conditions with a privileged access to key resources and with a reason to hide the firm’s activities (for worsening performance in case of Parmalat, but also in case of embezzlement and bribery), corporate illegality can become successful and sustainable for years, reinforced by the apparent success and trustworthiness of the firm involved in the scandal.

Relationships between the social actors involved are often the most precious resources of the corruption network, but estimating the effective value of connections with key social actors is

in most cases impossible, especially considering the secret and illegal nature of many of these relationships. In his research, Fisman (2001) shows that the consequences and the real importance of political connections generally are visible and understandable only when the social actors are finally identified and the corruption networks are dismantled, after investigating on companies accounting for a significant percentage of economic activity in Indonesia. The disruption of local companies' political connections with the Indonesian government is seen as one of the main causes of the Asian country's crisis in 1997, as the companies' profitability wasn't based on efficiency or profitability, but mostly based on the firms' privileged relationships with the local government.

Comparing the performance measurements of a list of firms involved in scandals (return on sales, return on assets, return on equity and market-to-book ratio) with the data related to similar firms which weren't involved in corruption scandals, it is clear that the companies that took part in corruption networks have been underperforming after the removal of their political connections, showing that their connections were a significant component of their competitive advantage (Fisman, 2001).

3.2 The role of accounting practice

According to Ahrens (2009, p. 43) "The literature is filled with examples of how accounting can become a resource for change or an obstacle to it; how it can be used to exercise tight control or support debate and innovation; how it can be combined with other forms of expertise or remain isolated; and how it can dominate social and organizational debates or be consigned to the realm of the technical and ignored".

Accounting as a social and organizational phenomenon can be effectively implemented in different contexts and combined with different technologies and practices, adapting to the different needs of the involved social actors.

Flows of capital can go through apparently legal accounting entities, which can allow the members of the network to provide financial returns to the involved public officials, disguising them as legitimate transactions. Adding these additional entities, costs can be artificially increased, justifying bigger capital flows following a "cost plus" pricing strategy,

which is one of the most widely adopted in this kind of activities (Neu et al., 2013), especially when government spending is involved.

Bourdieu (2005) underlines the fundamental difference between professional accounting practices, regarding professional accountants in legitimate businesses, and the mere adoption of accounting practices and principles, adopted to efficiently keep track of corruption networks' transactions: in the first case accountants have strict rules and procedures to follow, while in the second case the basic bookkeeping principles can be completely shaped according to the needs of the actors directly involved in the illegal network. As a consequence, accounting practices adopted inside a corruption network are going to be directly shaped by the wishes of the participants and could be hard to interpret and understand outside the network.

Bourdieu describes three fundamental concepts required to understand the role of accounting in the realization and configuration of networks: capital, habitus and social position:

- “habitus” is a sort of practical sense and institutional memory, regarding a series of actors that share the same ways of thinking, planning and acting;

- “social position” is a relational concept, separating the corruption network in different social spaces, with different areas of influence, relations and access to capital flows;

- “capital” can be separated in four fundamental types:
 1. cultural capital, related to knowledge and fundamental skills;
 2. economic capital, representing access to significant financial resources;
 3. social capital, related to the role of the relations involved in the network;
 4. symbolic capital, the ability to mask the illegal activities.

These fundamental components need to be progressively combined and adapted to the characteristics of the corruption network. The main role of the accounting practices adopted is the successful organization of this components: the important relations between the components of the network are strictly interconnected with the amount and intensity of cash

flows and related accounting transactions, which are also the key to the process of distribution of the illegal gains produced by the network (generally recurring to slush funds).

Different businesses and different transactions offer different opportunities to the corruption network. For example, public procurement processes (before, during and even after the processes of selection and assignment) offers great opportunities for corruption in very different settings.

At the beginning of the process is even possible to accurately determine the typology and the number of social actors which is going to be involved in the network, while stopping any form of competition and even agreeing to limit external controls (Ravenda et al., 2018).

Besides, in public procurement the market price of goods and services isn't available and can be very hard to accurately quantify even by an external observer (for the nature of the process itself), especially considering that auditing can't cover every possible corruption strategy and in this field there are countless ways to hide illegal network behind legitimate formal processes (Neu et al., 2013).

Accounting practices have similar roles both regarding corruption networks and regarding legitimate business activities: they provide accountability and details about every transaction, allowing interested actors to obtain information about the evolution of the recorded activities.

These processes are also fundamental to valorise the different types of capital, according to the possible contributions to the network and their "re-valorisation" as symbolic capital, accepted and recognized as legit capital outside the corruption network. Through the repetition of these processes inside the network, illegal activities become gradually accepted and accounting contributes to "normalize" corruption (Ahrens, 2009), which becomes an apparently legitimate business activity even to external observers; when these practices become common and constant, even outside control systems may end up trusting the network, whose processes can even become universally accepted.

Research shows that an effective combination in corruption techniques can deeply influence the accounting choices made by management, when choices regarding the registration and capitalization of certain costs are discretionary (Mazzi et al., 2019): the adoption of different approaches for personal gain can negatively affect the firm's financial reports, providing inaccurate and potentially harmful information to investors and other stakeholders.

An alteration of the value of the current assets reported on the balance sheet is one of the most important and common phenomenon of corrupt accounting procedures: it allows management

to boost expectations of future growth and profitability (in particular regarding investments in research and development), in many cases exploiting the accounting regulations among different countries (Ahmed & Falk, 2006) which in many cases generate different results even when international accounting standards should be mandatory. Nonetheless, uniformity of accounting principles doesn't necessarily mean completely identical registration of the same items and transactions

Anti-corruption policies are in many cases focused exclusively on preventing public-sector levels of corruption, ignoring the tools provided by apparently legal and legitimate accounting procedures. Managers are inevitably protagonists of these activities, but can have very different roles according to their position and access to accounting instruments and reporting choices.

Strategic management of accounting transactions can be a very effective tool to conduct illegal activities, especially among firms which aren't publicly traded and have less incentive to provide reliable and accurate financial statements, in particular if they already have a dominant market position (Ravenda et al., 2018).

Accounting and auditing-related internal control processes may be unsuccessful in fighting corruption, in particular if they are still primarily focused on measuring economic performance instead of preventing illegal activities. Accounting practices should therefore be focused on promoting accountability through the improvement of quality and type of all available information needed by stakeholders (Johnston, 2015), in particular intensifying mandatory disclosure regarding:

- sources of funding and supply;
- anti-competitive practices;
- legislative and regulatory privileges;
- awarding criteria for public infrastructure and concessions;
- terms of trade with suppliers and customers.

These are the relationships which offer more opportunities for corruption and money laundering, in particular regarding organized crime.

3.2.1 The Enron scandal: a failure of control systems

Enron's bankruptcy is one of the most important recent cases of corruption network (especially from an accounting perspective) for its indiscriminate use of Special Purpose Entities (SPEs) to rearrange its financial statement and for the direct involvement of Arthur Andersen, auditor of the company and one of the most important CPA firms in the world.

Benston and Hartgraves (2002) have individuated a series of key accounting and auditing related issues which were widely adopted by Enron to manipulate their figures:

- the privileged accounting policies related to the consolidation of SPEs (ideal for hiding debt and losses);
- accounting treatment of sales of Enron to unconsolidated SPEs (treated as arm's length transactions);
- inaccurate income recognition;
- Enron's accounting for its stock, that was issued to and held by SPEs;
- fair-value accounting resulting in restatements of inaccurate merchant investments;
- inadequate disclosure of related party transactions and their consequences for stockholders.

Enron used to have transactions with hundreds of different SPEs, to hide foreign-driven income from US taxation, but also to conduct domestic business with Enron itself, which used them to guarantee its debt too. These SPEs didn't even required consolidation as long as third parties kept equity interest in the SPE, even with insignificant participation (3% of the SPE's assets was considered sufficient by the GAAP regulation).

The Enron scandal generated massive lack of trust regarding independent public accountants, which in this case lacked the scepticism required by their role and were unable to identify the massive corruption network built by Enron managers, underlying the possibly catastrophic potential offered by apparently legal and legitimate accounting practices.

For these reasons, Benston and Hartgraves (2002) consider in their research US GAAP (and related promoters and administrators like the Securities and Exchange Commission and the Financial Accounting Standard Board) among the main responsible of the Enron scandal, especially regarding the regulation of SPEs, considering that Enron was able to use them so effectively to legally hide its liabilities, underlying the fundamental role and responsibilities of the regulators.

Benston and Hartgraves (2002) also provide three main reasons why the involved auditors (and other auditors in the same situation) may have failed to identify Enron's illegal practices:

- lack of necessary scepticism exclusively from Andersen's auditors (so it can be seen only as a failure of the auditors directly involved);
- a protract association between Enron and the same auditors for several years;
- a direct support of certain aggressive and misleading accounting practices, for personal interest;
- direct involvement of the auditors in illegal practices;
- incapacity of understanding the complex structuring of the network.

These possible causes, even in a less sophisticated context, may be challenging to prevent and avoid, especially considering that one of the fundamental components of the auditing process is a full understanding of the audited firm's pre-existing activities and for this reason successfully replacing auditors may be a complex procedure.

3.3 Corruption networks in developing countries

One of the most important factors affecting corporation illegality in several environments is the institutional context, in particular in the realization of the most sophisticated and lasting corruption networks (Gabbioneta et al., 2013). "Creatively planned" accounting inaccuracies can be very successful instruments to hide irregular transactions and manipulating financial reporting.

These distortions and manipulations can become the norm if institutional ascription allows it and if legislation provides significant loopholes; the phenomenon is extremely common and often devastating in developing countries.

3.3.1 Short-term financing and corruption networks: the example of China

In countries like China, where corruption has still roots in almost every level of any industry, even very important corporate financing choices made by publicly traded companies can be influenced by key connections with public officials, in many cases ignoring the effective profitability of the investments, as shown in a research made by Fan, Rui, and Zhao (2008).

In particular in emerging markets, short-term debt is still the most important source of financing even for big and medium-sized companies: obtaining stable capital flows from short-term debt is still crucial for the early development of any firm, but in many countries the access to this key resource is influenced mostly by the relationships of the firm's managers with financial institutions and their participation in a corruption network.

In China, an important position in a powerful corruption network can also generate additional benefits. Politically well-connected firms can obtain access to long-term debt with an important comparative advantage and, as a consequence, gaining a privileged strategic position, in the most extreme case with a significant and unfair competitive advantage (Fan, Rui, and Zhao, 2008), creating a vicious cycle rewarding more and more illegal transactions while damaging fair competition.

In industries and environments where this kind of corruption networks is more common, corruption can allow a successful market positioning of low-quality or even dangerous products, damaging the final customers too.

In this way, companies in developing markets tend to have very high corporate financial leverage (in particular if compared to western firms with similar size and active in the same industry) and are consequently more exposed to external risks and dependent from debt. Through loans, bureaucrats and managers in charge of financial institutions can easily send enormous amounts of capital to the firms involved in their corruption network, the situation can be particularly extreme in countries where the entire financial system is directly controlled by the government, increasing the possible power and area of influence of corrupted officials.

Furthermore, countries where this practice is more common are often characterized by weak public governance, so investors tend to prefer debt because it offers more guarantees and enforcement abilities compared to equity, which in the most extreme cases could be even stolen by the firm's managers. Improving the efficiency and the transparency of the equity market, deserving businesses could gain access to alternative source of financing and improve

their leverages, becoming gradually independent from corrupted officials, who can't possibly control and manipulate equity markets.

Bribing public officials sometimes becomes the only way firms have to access short-term debt, while implementing solid relationships with corrupted bureaucrats is the only way to gain access to stable and significant flows of long-term debt (Fan, Rui, and Zhao, 2008). Long-term debt is riskier for lenders and harder to obtain for small firms, but it's fundamental to allow businesses to grow: if organizations directly involved in corruption networks can obtain loans more easily (even without real merit), corruption becomes an obstacle to fair competition as well and corruption networks end up causing massive misallocations of capital that entire countries desperately need, while the financial system ends up rewarding poorly managed companies. Corruption in this case is damaging society as a whole and not only single, isolated companies.

Inevitably, these illegal processes have generated enormous amounts of non-performing loans for the state-owned Chinese banks during the past decades (Allen et al., 2005) and obtaining more detailed information and transparency can be challenging because of the Chinese government's opaque policies. When political officials have direct control over natural resources or development licenses and are actively involved in a corruption network, they may promote a very harmful allocation of key resources: the outputs of a corrupt market aren't a product of competition and innovation, but they are deeply influenced by the needs of the actors involved in the corruption network.

Money could be invested in unprofitable projects and employees may be hired and placed in key positions even without real merit or required technical skills.

As shown by Fan, Rui, and Zhao in their research (2008), after corruption scandals and the removal of guilty public officers and relative connections, the companies that participated in corruption networks have shown a statistically significant underperformance after the scandal.

3.3.2 Patrimonial and clientelist patron-client networks

In many African countries, the very sudden government transitions, from authoritarianism to democracy and from planned economy to free market, have been deeply interconnected with higher levels of illegal activities involving public officials and with the reinforcements of corruption networks: socioeconomical crisis and continuous changes of power are the perfect

environment to create new key connections between different social actors within corruption networks, especially if government transitions are followed by increasingly interventionist economic policies, historically extremely common in the African continent (Rock & Bonnet, 2004).

When corrupt governments have the opportunity to build from scratch a new set of laws (for example after revolutions) they have the possibility to legitimize their activities while appearing as a legitimate government, allowing them to commit various atrocities while reinforcing their positions within the corruption network, hiding the profits of their activities in offshore bank accounts. Peaks of corruption activities and capital flow right before these regimes' collapses, with even more catastrophic consequences for the nations' economies.

In Asian countries, instead, corruption networks have had a fundamental role in implementing and financing governments' economic policies, achieving their objectives through patron-client networks (Khan, 1996). The main distinction, in this case is between "patrimonial" and "clientelist" patron-client networks.

In case of patrimonial patron-client networks, the network is not focused exclusively on the personal gain of clients, which are generally the dominating players inside the network, but on the needs of patrons and of society as a whole, in some cases actively investing in the countries' growth and enforcing property rights, key strategies for the countries' development (Rock & Bonnet, 2004); this typology was more common in Asian countries.

In South Korea, for example, the government patrons even adopted performance monitoring to keep their clients accountable for their activities, checking and measuring if businesses involved were boosting the country's economic growth while accepting occasional bribes through well organised channels, with mutual benefits for both parties and in some cases for the entire country, through the protection and enforcement of property rights and the acceleration of economic development, especially during the second half of the 20th century (Rock and Bonnet, 2004).

This kind of network can survive only if the state can enforce effectively property rights and can protect the interest of the social actors involved in the network: these conditions are generally respected in developed countries, but aren't common in the developing world, especially in African countries and in unstable political situations. Even if in some cases this model provides some benefits to developing economies, this kind of network inevitably generates injustice and solidification of the connections between political power and private firms, damaging fair competition.

In clientelist patron-client network, instead, property rights aren't as well affirmed and the allocation of rights and related distribution of power are going to be less accurate and stable, mostly because the personal power and the connections of the public officials involved are less significant and organized (Khan, 1996). This scenario is more common in the developing world and it's also characterized by much lower levels of efficiency and, in many cases, by the involvement of additional "clientelist" social actors (like criminal organizations) which can work for different parties, compensating the weaknesses of legitimate institutions.

The scenario is also determined by the organization of the involved corruption networks: if they are organized by a strong central social actor, generally an authoritarian state (but also an industry monopoly), corruption is going to be less harmful compared to the case in which a small group of corrupted officials is acting as a monopolist exclusively for personal profit, a case which is much more common especially in the developing world (Shleifer and Vishny, 1993). In the latter case, public officials just want to profit as much as possible from their position before getting replaced, both from the state they should be serving and from the private component of the corruption network (Rock and Bonnet, 2004).

3.3.3 Organization and social costs of corruption networks

Shleifer and Vishny (1993) provide a fundamental classification of possible bribes and their social costs, from drops in efficiency and productivity to higher costs for fundamental goods and services:

- in the first case there is an extreme concentration of power, with a single agency supplying all relevant rights;
- in the second case, in a fragmented state there are different agencies providing complementary rights, so users will consequently have to deal with agencies separately;
- in the third case there are always different agencies, but they can all provide all the services required by the users (becoming de facto sort of "competitors").

In the first case there is a sort of monopoly, in the hand of public officials: the total amount of bribes spent is going to be the highest, as public officials in charge are free to ask as much as they want to maximize their profit.

The second case, instead, can be compared to a Cournot oligopoly in industrial organization: different agencies are allowed to provide only part of the total amount of services required by bribers. If one of the agencies will increase too much its prices, it could discourage additional investments and overall reducing the total activities of the corruption network, damaging other agencies too. Both output and overall efficiency of the corruption network are consequently lower than in the first case.

In the third case, competition between different public officials will lower the total amount of bribes required: even if the activities of the corruption networks don't decline, the prices offered by the competing agencies are going to be much lower than in the two previous case (theoretically close to zero).

Consequently, to reduce the costs of corruption, agencies should compete and be allowed to provide the same services, while the worst-case scenario is the inefficient fragmentation of the second case. The third condition is very hard to find in the real world, while governments of countries like South Korea and the Philippines have shown in the past decades characteristics which were compatible with those of the monopolistic case, with an omnipresent and influential central government, directly involved in almost every industry (Khan, 1996).

In this case, the briber can be almost sure that after paying the bribe he will effectively get the service he needs from the public officials; if these basic conditions aren't met, a potentially unlimited number of bribes involving countless corrupted may be required (Shleifer and Vishny, 1993), with even more negative consequences for the entire economy.

It's important to notice that most complex economic activities require several permits and authorizations from public officials. An importer, for example, will have to contact different officials to import, transport and finally its goods. To build an efficient corruption network, these different bribes need to be effectively standardised and organized, penalizing deviations from standard procedures: these practices were extremely common in Eastern Europe during Cold War, where bribes were channelized through the local offices of the Communist party (Shleifer and Vishny, 1993). The situation radically changed after the fall of Communism: without a central authority in charge of handling the bribes and without any collusion between government agents, social actors interested in starting any kind of business had to bribe

several different agencies (in some cases including the police and the army), in an unstable and chaotic environment, extremely undesirable in particular for foreign investors.

It's important to consider, especially for actors which aren't directly involved in the network, that secrecy is a fundamental component of any corruption network and this will inevitably cause a distortion of the values reported and of the characteristics of every transaction (at least compared to the values reported by a regular business). To maintain acceptable levels of secrecy, the network should also involve a possibly very small numbers of components, covering a few key positions, while hardly accepting newcomers (Shleifer and Vishny, 1993).

To obtain desired levels of secrecy, corrupt governments may even decide to promote goods and services which allow to get higher bribes or goods which are easier to over invoice or overpay, to mask illegal transactions more effectively. This practice can sensibly reduce the import of goods from abroad, in particular from developed countries, in some cases limiting the access of the population to key technologies while boosting the purchases of completely unnecessary goods, further damaging local economies (Shleifer and Vishny, 1993).

This phenomenon can cause an unfair redistribution of income even on a macroeconomic level, especially for the catastrophic effects of systemic corruption on taxation and redistribution of wealth; businesses can't even afford to pay bribes are completely cut out from any possible corruption network and can't survive, especially if even courts of justice end up being absorbed by the network (Barkemeyer et al., 2015).

For these reasons, many poor countries end up spending so much on sectors like defence and infrastructure: they are perfect to build effective corruption networks while hiding enormous bribes through apparently legitimate transactions and invoices. Generally, a price to pay for major secrecy is an overall major inefficiency of most transactions, in particular in developing countries.

CHAPTER IV: Italian MOSE and Canadian government's Sponsorship Program scandals

4.1 Study design

As seen in the previous chapters, accounting practice can provide a wide range of tools to realize and organize effective corruption networks, which can involve a wide range of social actors and be sustainable in the medium-long term, avoiding control systems and regulators. Through a qualitative research approach, this chapter provides a presentation and comparison of two examples of corruption network:

- The Venetian MOSE project scandal;
- the Canadian government's Sponsorship Program scandal (1994–2003).

The case studies have different backgrounds and involve different social actors, but interestingly they both present similar patterns and encase the key characteristics of accounting practices within corruption network (Johnston, 2015; Neu et al., 2013; Neu et al., 2015; Roberts, 2015; Sargiacomo et al., 2015).

Studying previous scandals, it's possible to get a better understanding of the proper red flags characterizing the different phases of the phenomenon, in particular in public procurement settings and with deep interconnections between politics and businesses, extremely common conditions in corruption episodes worldwide (Søreide, 2002).

Qualitative approaches have been adopted before in other researches focused on cases of corruption and on the role of accounting in the realization of the corruption network (Neu et al., 2013; Benston and Hartgraves, 2002; Gabbioneta et al., 2013) and the study has been

conducted as a qualitative research, analysing the material and searching for the following key elements:

- the roles of the components and the nature of the relationships among the social actors involved;
- the use of accounting tools in the realization of corruption networks;
- similarities between the two case studies and the factors illustrated in the previous chapters.

The available data have been studied and compared to provide a more accurate presentation of the cases, with different perspective on the scandals and on the role of accounting in the process.

After a description of the history and background of the two scandals, the chapter presents an analysis of the previously mentioned key elements of corruption networks and a final discussion with a comparison of the two cases' key characteristics.

4.2 Data and method

For the nature and the peculiar characteristics of the corruption phenomenon, it isn't possible to conduct interviews toward the protagonists of a corruption network.

As previously illustrated, corruption and other illegal activities can be challenging to investigate and study because of the inevitably hidden and opaque nature of the transactions and relationships between the involved parties: in most cases, the only sources of information available on the subject are the documents related to the judicial procedures of the participants, which become available only when and if the corruption network is successfully identified and stopped.

The main sources of information of the study are the trial documents of the two scandals and reports provided by auditors and commissions in charge of examining the cases and their consequences.

To present the MOSE corruption network, in this chapter were reviewed and analysed the trial documents of the scandal (over 800 pages), with particular attention toward the description of the accounting strategies adopted to hide the illegal transactions. Moreover, was analysed an examination of one of the enquiry's verdicts regarding the key protagonists of the corruption

network, focusing on the involvement and the role of each component and on the accounting tools adopted to hide the network's illegal activities.

To present the Canadian government's Sponsorship Program scandal, the documents reviewed were related to the forensic audit report provided by Kroll Lindquist Avey (Kroll Lindquist Avey, 2005) and the report of the activities conducted by the Gomery Commission (2005a and 2005b), a multi-million dollar government project presided by Justice Commissioner John H. Gomery, realized to investigate the nature of the scandal and the responsibilities of the subjects involved; in their research Neu, Everett, Rahaman and Martinez (2013) compare the inquiry to the "Mani Pulite" investigations regarding the Italian Tangentopoli scandals.

The Commission interviewed 172 witnesses from 7 September 2004 to 17 June 2005, discovering precious details about the micro-procedures and the cash flows between the network's participants, key elements of this research, publishing the findings in a 700 pages report and an additional document with an overall analysis of the case and suggestions and guidelines for the policymakers regarding the corruption phenomenon.

Through the Kroll Lindquist Avey audit report, we can also see the case from a different perspective, getting also a better understanding of the role played by accounting tools in the identification of irregular procedures and corruption: recording irregular capital flows, even if disguised as legitimate transactions, leaves traces on companies' financial statements, offering auditors opportunities to identify episodes of corruption (Jeppesen, 2018).

4.3 MOSE scandal: an Italian example

4.3.1 History of MOSE scandal

The corruption network built around the realization of the MOSE (abbreviation of *MODulo Sperimentale Elettromeccanico*, "Sperimental Electromechanical Modul"), is an interesting example of successful and sustainable corruption network and it presents many of the common key factors of corruption in public procurement. As previously illustrated, public procurement (especially regarding major infrastructural projects) provides excellent

opportunities for corruption and, at the same time, tools to hide illegal activities and to adequately mask cash flows.

The MOSE is an ambitious Venetian infrastructure project realized to save Venice from the phenomenon of rising water levels, which have become increasingly dramatic over the last decades (Sargiacomo et al., 2015).

The Consorzio Venezia Nuova (“New Venice Consortium”, from now on referred as “NVC”) was put in charge of the project in 1984: the NVC would have been responsible for all the phases of planning and realization of the plan. For the magnitude of the project itself, the Consortium enjoyed a privileged and extremely influential position: it was allowed to directly handle the contracts with private companies for the realization of the project, without regular open competitions generally required in this kind of projects.

The original reason behind this decision was to speed up the entire process, to reduce the costs and limit bureaucratic procedures which could have excessively slowed down the works, further increasing the costs of the infrastructure: this decision guaranteed to the Consortium a significant decision-making autonomy and financial independence.

Building the right relationships and controlling private firms in charge of the project, the Consortium had the perfect opportunities to build a very profitable corruption network and, thanks to its fundamental role and its privileged position, it easily became the leader and the main hub of the affair’s cash flows. The Consortium was also able to successfully handle and exploit its important connections with political figures, exercising its power and influence and bribing important public officials in key positions, the Consortium and his associates were able to keep the network for years without legal consequences.

The components of the network managed to successfully share the profits from their illegal affairs, while providing various benefits even to important figures which weren’t involved in the project, to be sure to avoid investigations and slowdowns.

In June 2014, 35 people involved in the realization of the project were arrested on charges of the alleged payment of bribes and the appropriation of funds paid to the NVC (more than €23 million passed through the Consortium only from 2005 to 2011).

The verdicts of the enquiry were reached in 2017, the total budget required to finish the works has been updated (the current one is €5493 million) and the MOSE project still hasn’t been completed.

4.3.2 Protagonists of the scandal

The network's leader was identified as the President of the NVC, in charge of allocating the slush funds among the other components of the network.

During court hearings, the President of NVC was referred to as the leader of the illegal operations by several witnesses and considered for years the “dominus” of the network, underlying the fundamental role played by trust and personal relationships between the involved parties, fundamental in a corruption network with so many components, to limit the risks related to whistle-blowers and keep the network sustainable in the long term. This strategy worked and, after years of illegal transactions and bribing, the components ended up feeling completely untouchable and above the law, even after the initial investigations of Guardia di Finanza (Italian Fiscal Police) for causes unrelated to the redistribution of slush funds.

A board of trusted members oversaw the NVC's illegal activities and relationships with other components of the network, assigning the construction activities and establishing the rates of slush funds with the other main partners of the Consortium.

“...a continuous cash flow was required, of let's say *slush off-accounts funds*, to handle two principal kind of operations. *Greasing*, that's the term adopted to, ehm, receive positive attitudes from public officials directly involved. *And also toward all the people needed to receive funds and carry forward the project*. Because this is a common problem which has always existed in Italy...” (Hearings, Court of Venice, 16-06-2016, emphasize added).

There were also funds for regular and systematic corruption of public officials, for example bribes for the President of Magistratura delle Acque di Venezia (Venice Water Board) and for occasional irregular benefits towards important figures outside the network.

The latter included even prominent cases involving thousands of euros, like the irregular financing of a Venetian candidate mayor's electoral committee and even the corruption of a general of the Fiscal Police.

The control over the Venice Water Board according to witnesses was especially challenging because of the continuous alternate of the Board's members: this could have seriously

damaged the structure of the network, considering that replacing key members of a big corruption network can damage the fragile and opaque interconnections between pre-existing components (Bourdieu, 2005), but the network was able to keep stable and efficient its internal relationships, while keep paying individuals in key position even if they weren't directly involved in the network anymore. The Venice Water Board was in the key position to speed up the approval of projects, so the cooperation of the Board and related Comitato Tecnico ("Technical Committee") was fundamental to avoid any slowdown of the network's activities. greasing the skids of this decisional process was one of the main priorities of the NVC to keep the network profitable.

Another important consortium involved in the affair was COVECO, the consortium in charge of handling the relationship of the network with many of the firms involved and one of the key components of the supply chain of corruption managed by the NVC.

The Italian construction company Mantovani S.p.A., specialized in major infrastructure projects, had also a key position in the network, with direct links to the NVC decisional process, in particular after taking over the position of other firms in key roles of the realization of the process, buying their participations in 2004.

Mantovani has also been for years the main "contributor" of the fund in charge of covering the bribing needs of the network and was directly in charge of providing additional benefits for individuals and organizations in key positions (even if they weren't directly involved in the corruption network activities), including even the former President of Veneto Regional Authority; hundreds of thousands of euros were spent by Mantovani on renovations of the former president's house, just to avoid any possible intrusions from the Regional Authority and slowdowns to the operations.

"...In fact, it wasn't negotiated...because there was, how to say, a kind of relationship which made us understand that the works had to be done almost for free. At least, this wasn't part of the deal's details at the beginning, but it was clear that being the President...*This was a sort of strategy to establish a good relationship which could have been able to facilitate the firm's business...*" (Hearings, Court of Venice, 22-09-2016, emphasis added).

Like in this case, obtaining the favour or at least stopping possible oppositions from key individuals (even if they aren't directly and continuously involved in the network's activities) is one of the priorities of any sustainable corruption network.

For the same reasons, the NVC tried to improve the relationship with the Regional Council of the Veneto region too, keeping the contacts between the two parties constant and positive. Cooperation between the two was also in the best interest of the President of the Regional Council, which could achieve a better relationship with the entrepreneurial environment and therefore political support, in particular after the instauration of more informal personal relationship and reciprocal trust.

The redistribution of slush funds, the administration of the already paid funds and the strategy adopted in the emission of invoices were all handled within the same fund, which according to witnesses even reached a size of €24 million. Depositing the entire amount of capital in a central common fund, the effective contributions of single organizations or even individuals become harder to identify and the parties can't exactly know which parts of their "contributions" was used to bribe which public officials, but the component's financial position and eventual debts/credits with the fund were accurately documented. (Sentence, Court of Venice).

The main actors involved in the affair and their roles are summarized in the following table.

Figure 4.1 The MOSE affair Corruption Network

Key components of the corruption network	Role
New Venice Consortium	<p>Consortium in charge of the assignment of contracts regarding the realization of the MOSE.</p> <p>Leader of the network, it handled the redistribution of slush funds generated through the irregular invoicing procedure.</p>
Mantovani S.p.A	<p>Italian construction company specialized in major infrastructure projects.</p> <p>The most important private firm involved in the scandal, handling contracts with other smaller firms involved in the affair, providing bribes for other key actors, both systematically and occasionally.</p>

Venice Water Board	<p>It's a suppressed administrative authority, in charge of supervising activities of quenching and maintenance of Venetian territory.</p> <p>It was object of systematic corruption from the other key players of the network, for its fundamental role in the approval of projects in Venice Lagoon.</p>
COVECO	<p>Another important consortium involved in the project.</p> <p>Directly handling the connections between the firms participating to the fake invoicing process.</p>

Significant external recipients of benefits from the corruption network	Nature of the benefits received
President of Veneto Regional Authority	Renovation works worth thousands of euros paid and provided by Mantovani S.p.A.
General of the Fiscal Police	Occasional bribes.
Venetian candidate mayor's electoral committee	Irregular donations for the election campaign of the candidate.

4.3.3 Role of accounting in the realization of the corruption network

Public procurement offers many opportunities to corruption networks (Søreide, 2002), in particular adopting the cost plus pricing strategy to justify additional capital flows and redirection of public funding toward the component of the network (Neu et al., 2013): this practice becomes extremely common in particular during the realization of major infrastructure projects, like the MOSE.

In these situations, accounting tools adopted to sustain the corruption network aren't as sophisticated as those adopted in the Enron case and similar major scandals, where the company's management implemented complex strategies and accounting tools like SPEs to

exploit the weaknesses of American regulations and auditors' controls (Benston and Hartgraves, 2002).

The most common instrument adopted in public procurement settings is the emission of fake invoices, in particular when they are presented to justify unexpected expenses or in case of prolongation of the project.

The project enjoyed a "closed price" status: the greatness and importance drove the Comitato interministeriale per la programmazione economica ("Inter-ministerial committee for economic planification" from now on CIPE), in charge of financially estimating the needs of the entire affair, to assign a budget to the project. However, additional funding was successively added after the intervention of the Venice Water Board and an extra 18% risk fund was added to the total budget.

Estimating in advance an accurate approximation of the total budget required can be extremely challenging or even impossible for this kind of projects; the corruption network was able to exploit this limitation to extend the duration of the works and their personal profits.

In the MOSE affair, misuse of invoices was the most important tool adopted by the network's components to redistribute slush funds: the construction companies directly involved in these illegal procedures took advantage even of the favourable San Marino legislation on the subject to provide fake invoices and sustain the illegal transactions inside the network. Before 2012, in fact, in San Marino there were no criminal penalties for the emission of invoices regarding non-existent operations: the two companies were able to conduct these operations from 2004 to 2010 through the consulting firm BMC Broker, officially registered in San Marino.

Many fake invoices were also provided on the Italian territory, in most cases with extremely generic subject, and were generally referred to technical assistance operations, such as:

"support in the study and planification of environmental monitoring activities, acoustic detection (...) of the seafloor, bathymetric analysis and coring of the seafloor, including in the technical professional valuation of military risk in the sea and in other watershed" (doc. 2, attached to the statement of defence, Court of Venice, 18-07-2017).

Many invoices didn't even mention the number of workers involved, the hours required to complete the operation and the technical means adopted to conduct the activities: analysing if

the invoices have been oversized can be challenging or even impossible and an eventual technical verification would be inconclusive, keeping secret and unidentified the illegal transactions.

NVC adopted different invoicing policies regarding different kind of operations to get back part of the money through apparently regular transactions.

“So, the operations of NVC involving stone works had a net profit higher than the average net profit from operations. The deal inside the Consortium was that to have a distribution plan with uniform margins, assignees with a particular margin would have had to give back to the Consortium part of it. Stone works were an example of these operations, 5% of the total value of the category had to be given back (...)” (Hearings, Court of Venice, 15-09-2016).

If firms wanted to work for the project, they had to accept the NCV conditions, considering that public competition wasn't expected for the peculiar nature of the project.

After the determination of the amount of slush funds required by the NCV, another of his main partner firms would have asked the new firm for an invoice, without the provision of any service.

“QUESTION: Normally what amount was given back to the Consortium?

ANSWER: It partially depended on the situation, but it was around the 50%...

QUESTION: Can you tell us which firms adopted this practice to give back amount of money to the Consortium?

ANSWER: Almost all of them, directly or indirectly...” (Hearings, Court of Venice, 31-07-2013).

The main partner firm of NVC would have then invoiced the NVC itself for the total amount. So, the Consortium would have paid the partner firm, which would have finally paid the other firm, following regular and legal procedures, but after the transaction the firm would have secretly given back to the NVC a significant percentage of the total amount received.

The ratio which was given back used to differ according to the service provided, from the 5% related to the previously mentioned stone works, to over 50% in case of generic provisions of services which, for the unpredictable and specific nature of the activities theoretically carried out by the firm, allowed to fake larger margins and move larger amounts of slush funds.

The process was successfully repeated for years.

The contracts involving fake invoices were distributed in four different “bocche di porto” according to their geographical positions (Treporti, Lido, Malamocco and Chioggia) and assigned to different firms, which were in charge to periodically give back to the NVC part of the money.

“...this contract required that allotments had to be paid every three months. *The payment was adjusted according to two main aspects, a so-called fixed one and a variable one connected to the revenue of the bocca di porto in the examined period of time...* regarding us this amount was around 200-220.000 euros, but it was never the same and 50% of the amount was given back to the Consortium, so around 100.000 euros of slush funds every 4 months...” (Hearings, Court of Venice, 16-06-2016, emphasis added).

Slush funds assigned to different components of the network were accurately recorded, providing proofs of the network’s illegal transactions and distribution of tenders.

4.4 Sponsorship Program: a Canadian example

4.4.1 History of the Canadian government’s Sponsorship Program scandal

The scandal was widely discussed and politicized by the Canadian media in the early 2000s, in particular because of the involvement of many key figures of the Liberal Party and for the political nature of the Sponsorship Program itself, deeply damaging even the reputations and the careers of several members of the Party which weren’t involved in the scandal at any level (Sutherland, 2003).

After the electoral success of the Bloc Quebecois, a party promoting the independence of Québec, both in the federal election of October 1993 and in September 1994 provincial election, the ruling Liberal Party decided to start a program promoting national unity,

affirming that it was mandatory to contrast secessionist pressures, granting the project significant funds and great decision-making autonomy, considering the urgency and importance of the fight against secessionism (Neu et al., 2013).

Furthermore, the Liberal Party didn't want to lose political support from the Québec region, the second most populous in Canadian territory: the electoral success of the Liberal Party was based on the success of the party in the two large-population provinces, Québec and Ontario, home for over 50% of the Canadian population (Sutherland, 2003).

The fleur-de-lis, symbol of the Bloc Québécois has been the symbol of the French-speaking minorities of Québec since 1948, promoting independence and sovereignty of the province, even recurring to violent attacks and robberies in an attempt to obtain recognition and additional autonomy; one of the most significant achievement of these movements was the passing of a French-only Official Languages Act, in 1977 (Seymour, 2000).

The success of the Bloc Québécois as a third party in the province was jeopardizing the dominance of the Liberal Party not only in the province but also at a national level, and the eventuality of a secession of the entire province started to seem possible. The Liberal Party therefore decided to fight the secessionist movement hiring an additional number of organizers at a local level and promoting national unity through a parallel communication and advertising strategy, involving government organizations like the Human Resources Development Canada (Gomery, 2005a).

Human Resources Development Canada (from now on HRDC) was founded in 1993, born from a government-wide reorganization from components of Employment and Immigration Canada, Secretary of State and the department of Multiculturalism and Citizenship, Health and Welfare Canada, Labour Canada.

The department was mostly focused on employment insurance programs, income security and "investment" programs administered by grants and contributions (Sutherland, 2003), including the Sponsorship Program described in this chapter, focused on the promotion of national unity.

From 1994 to 2003 around \$322 million were invested in the Canadian federal government's Sponsorship Program, of which 44.4%, or \$147 million, was spent on fees/commissions paid to advertising agencies, which often inflated their revenues through irregular invoicing practices (Gomery, 2005b), while an amount between \$13 million and \$50 million was directly distributed to the participants of the corruption network (Neu et al, 2013).

The responsibility of overseeing the government advertising projects were transferred to the Public Works Department, as part of a reform previously introduced to reduce bureaucracy and streamline the government's most urgent projects, while the Sponsorship Program was put directly under the control of the Advertising and Public Opinion Research Sector (from now on APORS), a smaller organization controlled by the HRDC.

The director of APORS was able to successfully exploit the autonomy of the program, constantly bypassing the Parliament's approvals of funding and personally handling the nomination of the private agencies involved in the project and the relationship with the firms' directors, realizing a profitable corruption network both for the corrupt public servants and politicians (including prominent fundraisers of the Liberal Party) and for the private advertising agencies working to the program. The corruption network lasted from 1994 to 2000, when an internal audit of the program and subsequent investigations gradually exposed its irregularities (Gomery, 2005b).

The media coverage and the size of the scandal were unprecedented for a country like Canada, which traditionally achieves very good positioning on corruption international rankings like the Corruption Perception Index (Transparency International, 2018). The investigations and the activities of analysis of the Gomery Commission allowed control systems to get a better understanding of the mechanisms of corruption in Canadian public procurement, exposing many risks and critical issues of the system (Sutherland, 2003), which could become an endemic phenomenon without a proper intervention of the institutions.

4.4.2 Protagonists of the scandal

APORS was an organization within the area of influence of Public Works and Government Services Canada (from now on PWGSC), in charge of managing government advertising and related contracts with private advertising firms.

The program started without a public announcement of any kind, without clearly measurable objectives and without well-established administrative guidelines, providing great opportunities for misspending practices and creating from the beginning the perfect conditions for the realization of a corruption networks.

The director of APORS kept a very strict control over the organization for years, imposing fixed rules on the negotiation of contracts with communications firms, in many cases offering exaggerated compensation (based on commission criteria) for irrelevant services; costs were estimated ex ante, often without accurate approximation of the expenses related to hours, materials and personnel invested by the firms (Gomery, 2005a).

Anyway, because of his relationships and connections with key political figures, the director ended up being above any suspicion, de facto exempting him from standard reporting procedures; over the years he was even recognized as efficient and capable of managing public funds.

The Gomery commission identified the director of APORS as the main organizer of the corruption network.

“After the first two years, a practice was adopted of including estimated production costs in virtually every contract with a communication agency.

The production costs were sometimes determined as a percentage of the total value of the sponsorship, and little effort was made to assess what additional costs might be incurred by the agency. This produced the result that production costs became a more important source of revenue to the communication agencies than the commissions, and the commissions really covered no services at all. In almost every case, the agency charged almost exactly the full amount of the estimated production costs” (Gomery, 2005a, p. 177, emphasis added).

The components of the network were de facto allowed to completely make up the money needed to provide their services, granting ample mark-ups which would have then been shared between the involved actors in the form of repatriations (Neu et al., 2013).

The Minister in Charge of Public Works was the most important key connection of APORS’s director with public officials and during his mandate helped to sustain the corruption network and the bypassing of the Parliament’s approvals and Treasury Board’s policies (Gomery, 2005a). It was extremely criticized for the lack of control and management over the entire Program,

Lafleur Communication Marketing, Groupe Everest and Groupaction were the most important private advertising firms involved in the scandal, key protagonists of the sponsorship contracts with the Canadian government.

Lafleur Communications, as lead member of a small consortium of communication agencies, received contracts for millions of dollars since 1995 (which significantly increased after the official introduction of the Program), even without being part of a pre-qualified suppliers list, raising suspicion about the legitimacy of the selection procedure (Gomery, 2005a), in particular considering the firm's generous donations to the Liberal Party in the second half of the 90s.

In many cases, the firm obtained important sponsorship contracts without any competing bid thank to its privileged relationship with APORS's president.

By the end of the Program, in 1993, Lafleur handled on the Government behalf contracts worth around \$65 million, with significant profits in particular for the owner's family (Gomery, 2005a).

Groupaction was also an important contributor of the Liberal Party of Canada, and it was selected for the Sponsorship Program along with a small number of other firms (all Liberal Party supporters), while several other firms were completely discarded. Th Gomery Commission (2005a, p. 245) reports the hearings of the Prime Minister on the subject and on possible justifications of the adopted strategy:

“The Sponsorship Program was not partisan. It was not about the Liberal Party. It was about promoting the visibility of Canada in Quebec. A conventional wisdom had nonetheless been created about “Liberal friendly” advertising agencies.

We have to be very careful about labels. In Quebec, there are basically two types of advertising agencies; those who are “separatist friendly” and those who are “federalist friendly”.

“Federalist friendly” agencies tended to support the Conservatives when they were in power and the Liberals when they were in power. I do hope the Government of Canada used “federalist friendly” agencies to promote the visibility of Canada in Quebec, not because the agencies contributed to the Liberal Party until we abolished corporate donations or contributions, but because the only alternative in practical terms was to use “separatist friendly” agencies to promote Canada” (Hearings, Transcripts vol. 72, pp. 12516-12517).

These reasons can justify the exclusion of firms from the Program, but don't justify the total lack of fair public competition for such a relevant project. The president of Groupaction admitted that the firm occasionally overcharged PWGSC and took care of relationships with key political figures for personal gain (including Liberal Party fundraiser with fundamental contacts with important public servants), providing them a wide range of benefits, but denied

any involvement for political ideals. Between the 1996 and 2002, Groupaction and its subsidiaries managed sponsorships worth around \$90 million (Gomery, 2005a).

Liberal Party fundraisers also had an important role: providing contacts for sponsorship payments to Groupaction, in exchange of commission payments, becoming key actors in the interconnections between public servants and private firms involved in the network.

One of the main fundraiser’s company, PluriDesign, even received sub-contracts for hundreds of thousands of dollars from the advertising firms involved in the network.

All the firms directly involved in the scandal offered donations to the Liberal Party, both in conform and illegal ways, with the clear intention of getting better connections with public servants exclusively for personal gain, underlying the risky possible consequences of related to relationships between businesses and politics (especially if when they are based on financial contributions).

The main actors involved in the affair and their roles are summarized in the following table.

Figure 4.2 The Canadian Government’s Sponsorship Program Corruption Network

Key components of the corruption network	Role
APORS	<p>Government organization in charge of managing the Canadian Sponsorship Program (under the influence of PWGSC)</p> <p>Leader of the network, it handled the key connections between the other protagonists of the affair.</p>
Minister in Charge of Public Works	<p>The main key connection of APORS’s director with public officials</p> <p>He helped to sustain the corruption network, even bypassing of the Parliament’s approvals and Treasury Board’s policies.</p>

<p style="text-align: center;">Groupaction</p> <p style="text-align: center;">Lafleur Communication Marketing</p> <p style="text-align: center;">Groupe Everest</p>	<p style="text-align: center;">The three main private advertising agencies involved in the scandal.</p> <p style="text-align: center;">They irregularly obtained privileged contracts and relationship with APORS, regularly over invoicing for personal gain.</p>
<p style="text-align: center;">Liberal Party Fundraisers</p>	<p style="text-align: center;">They irregularly provided contracts to advertising firms in exchange of commissions</p> <p style="text-align: center;">They received substantial and irregular donations and even contracts from the private firms involved in the scandal</p>

4.4.3 Role of accounting in the realization of the corruption network

The scandal started after the Report of the Auditor General to the House of Commons, where have been initially presented the key characteristics of the Sponsorship Program corruption network, later summarized and studied by the Gomery Commission (2005b):

- failures of internal control systems;
- lack of adequate documentation and bureaucracy to justify significant expenditures of public money;
- the payment of large sums of money to private firms, even without any kind of service provided;
- systematic disregard of the rules and procedures regarding public procurement;
- irregular lack of competition in the selection of agencies directly and indirectly involved in the project;
- a general bypassing of Parliament's authority.

Many of these elements are present in most cases of corruption networks regarding public procurement: in this case in particular, the almost total lack of transparency and the excessive

independence of the Sponsorship Program from central authorities are seen as the main causes of the success of the corruption network.

The role of the Commission was to provide an “investigation into the issues and events referred to in the terms of reference” (Gomery, 2005a, p. 524), without conducting a trial and without “establishing criminal culpability or civil responsibility” of the involved parties, studying the scandal to provide recommendations to effectively prevent and fight similar episodes in the future.

The Gomery Commission identified a series of key elements, to allow a more accurate understanding of the reasons behind the failure of the control systems and the success of the corruption network:

1. “the *identity of those who received the sponsorship, communications and advertising funds, including any commissions or fees payable with respect to them...the purpose for which the funds were disbursed, and the extent of value for money received in return by the Government of Canada...*;
2. whether there was *political influence on the distribution of the funds, including questions relating to whether there were direct or indirect political contributions or gifts made by recipients of the funds;*
3. whether there *were sufficient external monitoring and financial controls used by fund recipients described in 1 above; if not, why not and to what effect*” (Gomery, 2005a, p. 533, emphasis added).

Overcharging was one of the most common strategies adopted within the network, with the adoption of simple but effective techniques, very common in this kind of corruption network. The techniques reported by the Gomery Commission as examples of overcharging include inflation of hourly rates, invoices without any corresponding services provided and even double billing for the same service.

Eight main categories of consistent overbilling practices adopted by the advertising firm LaFleur Communications can be identified from the investigations (Gomery, 2005a):

1. even many employees and officers of the firm didn't know what kind of work could be invoiced as production costs and which agency services were covered by a 12% commission, which was contractually paid to the company even when no service was provided;
2. presentations of the projects were provided at a flat rate of \$2750 each, the price was justified as industry standard and as an approximate average of the costs sustained for the realization of a mock-up (even if, according to the firm's employees themselves, the real cost was around \$300);
3. costly hours of works, attributed directly to the owner of the firm, were charged even on projects where he wasn't involved at all (including even the production of promotional items);
4. the charges for hours worked were in many cases billed at much higher rates than those justified by the nature of the service provided (for example \$245 an hour paid for packaging and shipping promotional items, while the industry average was less than \$40 an hour);
5. the amount presented in the contract as an allowance for production costs was generally billed in full, with an upwards adjustment of the invoice in case of works less time-consuming than expected;
6. unjustified variations of the working hours billed for the same event, when it was sponsored for more than one year. A sponsorship of the Montreal Expos in 1995 and renewed for the same amount in 1996, but the number of reported hours of work went from 234 to 1105, without any explanation;
7. even people who were reported as employees of Lafleur Communications started to bill Lafleur for the services they provided, as they were independent contractors, allowing Lafleur to rebill faking higher expenses and, additionally, billing the hours worked by the fake contractors, charging twice for the same, overpaid service;

8. the subcontracts were assigned without any regular competition (standard practice during the entire history of the corruption network), in some cases justifying the decision saying it was mandatory for the urgency to complete certain operations. Some projects were even offered to Publicité Dezert, an advertising firm controlled by the same family in charge of Lafleur Communications. Subcontracts didn't allow any time savings and didn't provide any effective additional know-how to the program and the services provided were generally pretty simple and generic and could have easily been offered by the advertising agencies already involved in the Sponsorship Program. The relationships between Lafleur and its subcontractors were just a way to justify higher mark-ups on the services provided and, consequently, higher bills.

These strategies allowed the owner of Lafleur Communications to justify and legitimize continuous infringements of regulations and the direct and indirect appropriations of millions of dollars, even through his family members and their firms.

The accounting practices previously summarized were used in a wide range of different events and sponsorships, even unrelated to the Sponsorship Program, from the sponsorship of the Grand Prix du Canada in 1996 to the payment and distribution of copies of the Encyclopédie du Canada in schools in 1997 (Gomery, 2005b).

The advertising agencies involved were able to successfully implement the accounting tools and practices described in the previous chapters, using them to build a profitable corruption network, adapting the same principles to different settings, repeating undisturbed the same procedures and creating an effective habitus, without the needs to create slush funds; even occasional bribes were paid directly by the advertising firms, in most cases disguised as irregular "donations" towards fundraisers and other key political figures (Gomery, 2005a).

The Commission criticized the total lack of internal control and questioning from PWGSC, especially regarding the use of invoices, not exclusively concerning the case of overcharging, but also in relation to expenses completely unrelated to the promotion of national unity or any key aspect of the Sponsorship Program, including even tickets for sport events (Gomery, 2005b)

The advertising agencies involved in the network relied on subcontractors to get around the intent of the government's contracting policy, with additional costs and no benefits for the project: the practice most widely adopted allowed the advertising firms involved (mostly

LaFleur Communications and its subcontractors) to split a mark-up on the cost of the services provided and even profiting from additional commissions.

The illegal activities of the network remained undetected for years despite the audits periodically conducted by the Audit and Ethics Branch (AEB), in charge of checking on the legitimacy of the operations of government organizations.

Even an audit provided by Ernst & Young in 1996 (at the time auditor in other organizations of the Canadian government) indicated instances of noncompliance to policies and procedures, but the actors in charge didn't intervene (Gomery, 2005a).

Kroll Lindquist Avey carried out an administrative review of the Sponsorship Program even before the formation of the Commission, founding episodes of noncompliance in almost every file reviewed (2005): irregularities were significant regarding both certifications for payment of invoices and bids for sponsorship contracts.

The mismanagement of the Sponsorship Program was also caused by an almost complete absence of guidelines and criteria to determine the accomplishment of key objectives and result (which would have allowed a more accurate valuation of the program), but this kind of policies would have been implemented only from 2001, by Communication Canada.

After the initial reports regarding the contracts with communication agencies, irregularities started to emerge and when the government tried to intervene and fix the Program, the strategies and connections involving the protagonists of the network gradually became clear (Sutherland, 2003).

4.5 Discussion

The Gomery Commission was formed specifically to provide recommendations to avoid similar episodes in the future, and after its investigation and analysis summarized its findings in a few fundamental key points (Gomery, 2005b):

- evidence of political involvement at different levels of the Program's management;
- secrecy and lack of transparency regarding the program's activities;

- circumvention of proper contracting procedures and basic reporting, even at the very senior levels of the public services;
- blind obedience of public servants to the will of their managers, despite the irregularities of their practices;
- significant and unjustified overcharging by advertising agencies;
- artificially inflated commissions and production costs, even if they were unrelated to the program;
- involvement of the Sponsorship Program even on project completely unrelated to national unity, for a lack of clear guidelines and final objectives;
- actions meant to avoid compliance with federal legislation and contracting policies, including the Canada Elections Act, Lobbyists Registration Act, Access to Information Act, Financial Administration act and Treasury Board Transfer Payments Policy;
- a complex network of cash flows among government organizations and advertising private agencies, providing profits to the actors involved;
- channelling of funds from advertising agencies to political fundraising activities in Québec, to improve connections and receive additional government contracts;
- enlistment of people working for the Liberal Party even on the advertising agencies' payrolls;
- the refusal of Ministers to acknowledge and public servants to acknowledge their role and responsibility in the management of the program.

Starting from these findings, the Commission provided a series of recommendations which regulators should consider to prevent and fight this kind of episodes in the future, promoting the key requirements discussed in the previous chapters (accountability and transparency in primis), with a particular emphasis on the role of control systems, especially regarding the

management of public servants, stopping them from the instauration of personal and corrupt relationships with the private firms involved in the projects (Gomery, 2005b), while promoting whistle-blowing channels and increasing penalties.

The same suggestions are valid for most kind of public procurement setting, including the MOSE scandal. As previously seen, public procurement still offers many opportunities for illegal activities and for irregular handling of public money. These two cases report all the key elements used by Beets (2005) to explain the relationships between public procurement and corruption networks: from the inevitable lack of accountability generated by the distance (and in these cases independence) between actors and stakeholders to the management of financial resources to fund political campaigns and to bribe key figures. These conclusions also confirm the theory of Khan (2006), mentioned in the first chapter: the leaders and main organizers of the corruption networks were in both cases public officials in charge of dealing with private firms.

Both corruption networks used simple accounting practices to legitimize the embezzlement of the funds they managed and to build the repartition system of their illegal profits and both scandals were uncovered after controls related to accounting procedures.

In the MOSE cases, the inquiry started after a Fiscal Police's control for suspected tax evasion related to the misuse of invoices, irregular but accurately reported by the components of the network. In the Canadian case, instead, the illegal practice where uncovered by a qualitative audit of management to control, always to clarify some suspicious transactions from previous years' records (Sutherland, 2003).

As long as accounting tools are adopted (and it becomes inevitable when millions of dollars are involved), control systems will have ways to prove and identify irregularities.

Both scandals received wide media coverage and were the main subjects of political debate, also because of the political figures directly or indirectly involved in different areas of the areas. For the high number of components and for the amount of money involved in the project, both cases were perceived as wake-up calls to change and improve the current systems, trying to find solutions to the phenomenon and trying to understand the failures of control systems. Millions of public funds were stolen during the realization of both projects which, since the beginning, offered great opportunities of personal gains for the component of the network.

In the Canadian Sponsorship Program, the corruption network didn't even have to constantly bribe people in charge of control systems: for years auditors and people in charge of the project failed to identify the several red flags of the program, accepting unjustified and unpredictable spending, while satisfying the yearly audit of the project (Sutherland, 2003); the few criticisms presented remained completely unheard.

The illegal contributions of both the corruption networks to political parties reflect the importance of relationships with key political figures in this kind of projects, often outside the circle of relationships initially planned for the nature of the project.

Connections are important also in developed countries and, when the projects involve hundreds of millions or even billions of dollars, they can be more valuable than cash flows. For these reasons even the MOSE corruption network decided to illegally fund the electoral campaign of the Venice mayor, even if he wasn't involved in the network.

Even when significant resources have been invested to internal and external control systems (like in the Canadian case) and accountability and transparency are recognized as crucial, especially when public funds are involved, there are always grey areas which can be exploited for personal gains, independently from the nature and from the mode of the benefits provided (from regular bribery to occasional supply of services).

These practices reflect very common problems which are still relevant worldwide and are not exclusively related to the embezzlement of public money for personal gain. Elections are inevitably expensive, especially in developed democratic countries, and political campaigns are becoming more and more costly (Johnston, 2005), reaching the right amount of funding is crucial for any political party. These strategies of financing can easily involve billions of dollars and a very wide range of sponsors, creating a potentially fertile ground for opaque interconnections and corruption networks; it's clear that the importance of connections isn't an exclusive practice of tyrannical governments, but is a theme still extremely relevant even in the most developed and unexpected settings.

Procedures of internal control and regulations regarding financing during political campaigns have not been completely successful, considering how common corruption still is in this environment; stricter regulations (like in the Canadian case) often don't stop illegal cash flows but simply change the ways illegal payments are made, in most cases recurring to more or less advanced accounting tools (Sutherland, 2003).

The practice of lobbying has become widespread and accepted in countries like Canada, where the two largest Canadian political parties (the Liberal Party and the Conservative Party) have become more and more dependent on donations and contributions from private corporations, especially during the last decades, inevitably increasing the influence of the private sectors in industries like health, environment and taxation, creating more and more interconnections between politicians and businessmen, both in official and unofficial ways (Neu et al., 2013). These connections can become even more effective and dangerous when these relationships become more personal and informal, as seen during the MOSE affair.

Public management has clearly many faults and in many situations it was completely inadequate considering the amount of funds involved and the duration of the corruption episodes, but since the beginning of the projects was guaranteed great independence from the central authority (in both the cases presented in the chapter).

Both projects, in fact, were perceived as urgent and costly by the respective governments and for these reasons in both cases were offered the possibility to public organizations (respectively NVC and APORS), directly put in charge to handle the relationships and related contracts and subcontracts with private firms in charge of the project; APORS and its connections even ended up bypassing the Parliament's approvals, becoming *de facto* allowed to spend as much as they wanted when they needed it.

The complex nature of the projects and the opaqueness regarding final budgets and techniques to be adopted to measure the performance of the firms involved (especially for the Canadian Scandal), provided fertile ground for irregular invoicing and assignment of important works to trusted parties. The lack of legitimate selection of deserving firms was in part a strategy to speed up the selection and, consequently, the entire project, avoiding a time-consuming bureaucratic public competition. Inevitably, this strategy eliminated the economic benefits of competition and allowed the private firms to build stronger relationships with the government organization in charge of the projects.

Conclusions

Literature worldwide still hasn't fully understood the corruption phenomenon and its wide range of tools, tricks and practices. As seen in the cases analysed in the previous chapter and in the rest of the work, no country or firm is completely safe from the phenomenon and its consequences, regardless of optimistic statistics and positive global rankings. For its peculiar and opaque nature and for its significant presence in so many settings, the effectiveness of control systems (both internal and external) can never be completely trusted in the prevention and fight against the phenomenon, independently from the amount of funds invested and the quality of control processes. Corruption is probably impossible to completely classify and eradicate and it has been changing over the past decades, widely and successfully adopting new tools while exploiting the opportunities provided by a more and more interconnected corporate world, indirectly affecting countries and realities where the phenomenon has been fought more effectively.

For these reasons the problem right now is more alarming and important than ever and needs to be studied and investigated in all its forms, from petty corruption in developing countries to massive corporate corruption scandals in the developed ones.

Accounting practices have been in many cases the backbone of very successful and durable corruption networks, but accounting controls also provided proof of irregular transactions and links between the same networks' components, gradually uncovering massive scandals. It's important to consider that, as seen in the rest of the work, the accounting practices adopted within most corruption networks (including the networks worldwide still active and profitable right now) tend to be similar for organization and for the roles of the actors involved. They also generally rely on very basic accounting tools in particular regarding public procurements, where corruption still prospers worldwide. Additional controls on invoicing processes and a greater supervision over spending of public money may allow to detect corruption episodes earlier, but they would inevitably generate a general slowdown of many projects and investments involving public funds with inevitable wastes of time and money; the protagonists of the MOSE and Sponsorship Program scandals were granted great independence and allowed to bypass controls for the same reason.

The effort and investments of international institutions can't be effective if it isn't accepted and implemented even by smaller businesses and local governments, considering how the phenomenon is still widespread and deep-rooted in so many environments worldwide.

Controls are inevitably costly and time-consuming, especially when they involve accounting practices: businesses and governments need to find the right compromise between money savings and inadequate levels of supervision, with the risk of higher damages and costs in the long term.

Stricter controls and regulations regarding the financing of political parties and additional benefits provided to public officials could allow a progressive limitation of opaque and irregular interconnections between the public and private firms, even in the most developed democratic countries, where relationships which should constantly follow the principles of transparency and accountability are still in many cases ambiguous and shady.

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