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The Escalation of Systemic Risk: How Unrealistic KPIs and Organizational Misreporting Drive Moral Disengagement & Breeds Tolerance for Fraud

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Abstract

This conceptual paper proposes a model in which aggressive Key Performance Indicators ("KPI") and engaging in Low-Stakes Organizational Misreporting ("L-SOM") results in Moral Disengagement ("MD"), which in turn leads to Tolerance for Fraud ("TF") via. Aggressive KPIs promote short-term goal achievement at the expense of compliance with ethical standards (Thomas & Uminsky, 2022). Simultaneously, when employees partake in L-SOM, they activate the self-serving cognitive mechanisms of MD which contribute to the 'slippery slope' of corruption and the perpetuation of a systemic culture tolerant of fraud. (Moore, 2008). This paper draws on the Fraud Triangle and Social Cognitive Theory (Petitta et al., 2021) as underpinning theories. The model hypothesizes that KPI Pressure Intensity ("IV 1") and Engagement in L-SOM ("IV 2") contributes towards MD ("MV"), which ultimately impacts TF ("DV"). Data will be collected via surveys from employees, measuring their perception towards the various variable using a Likert scale. This study is innovative since it focuses on a situational, managerially produced environment rather than human deviance as the main cause of fraud vulnerability. Specifically, it establishes that IV 1 and IV 2 are two distinct and necessary inputs that jointly contribute to the decay of ethical thresholds through MD. It hypothesizes that: 1) KPI Pressure will positively predict MD; 2) Engagement in L-SOM will positively predict MD; and 3) MD will mediate the effect of both IVs on TF. This paper contributes to the study of organizational behavioural and fraud prevention by theorizing that unsustainable goals and the need to project unrealistic positive results result in an increased systemic risk of organizational fraud. It argues that the true risk of a flawed performance management system is not the initial compliance breach, but its role in training employees to rationalize wrongdoing. This framework serves as a vital foundation for future empirical research aimed at developing interventions to halt the moral disengagement process, thereby reducing systemic risk across industries.

Keywords

Moral Disengagement, Performance Management Systems, Organizational Behaviour, Tolerance for Fraudulent

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Introduction

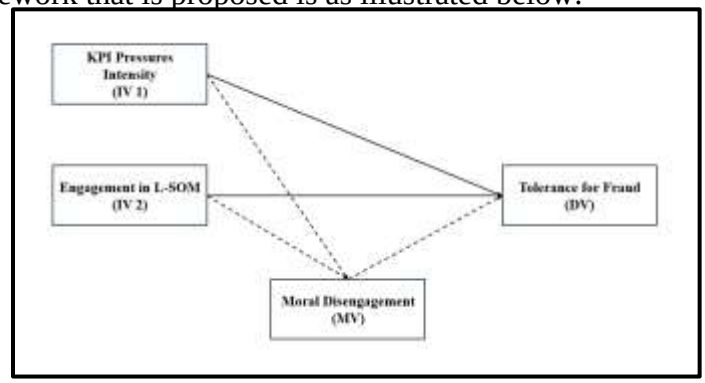
Every year, occupational fraud accounts for an average of 5% of annual revenue on a global basis (Bracco et al., 2024). The pareto principle applies in the context of fraud, while asset misappropriation accounted for most of the reported fraud cases at 89%, the median losses were relatively low at USD120,000 per case, in contrast, financial statement fraud accounts for a comparatively miniscule 5% of reported fraud cases while the median loses stood at a relatively high USD766,000 per case.

In the regional context, we see governments shifting the onus to moderate and prevent fraud to employers and companies, including implementing robust internal controls to prevent the proliferation of fraud, specifically in the Malaysian context of the introduction of S. 17A of the MACC Act 2009 (Deloitte, 2020). Marzuki et al. (2024) noted that "68% of fraud cases occur within organizations by employers and employees" according to a 2014 KPMG survey in Malaysia. This statistic highlights a strong need to examine the motivations of internal perpetrators. In spite of the emphasis for resources being allocated towards strengthening fraud prevention, the ACFE Occupational Fraud report suggests that most frauds are discovered through internal whistleblowing, indicating that employee trust and engagement plays a significant role in fraud prevention.

This research aims to deepen the body of knowledge relating to behavioural factors that enable organizational fraud. While it is established that organizational pressures, driven by unrealistic performance metrics (KPI Pressure Intensity), often lead to intentional misreporting (Liu et al., 2023; Su & Alexiou, 2022), the critical psychological process connecting this external pressure to internal misconduct remains under-examined. Drawing on Bandura's Moral Disengagement ("MD") framework, this study proposes that organizational and leadership factors, specifically KPI Pressure Intensity (IV 1) and employee's engagement in L-SOM (IV 2), function as antecedents that increase an employee's MD (MV) (Idensohn et al., 2025; Petitta et al., 2021). The resulting MD, evidenced by rationalization techniques like diffusion of responsibility and advantageous comparison, leads directly to the study's key outcome: the organizational tolerance for fraud (DV) (Alqhaiwi, 2024; Nair & Kamalanabhan, 2011). By modelling MD as the crucial psychological mediator, this research offers a clear behavioural mechanism that explains the escalation of systemic risk within corporations.

Methodology

The conceptual framework that is proposed is as illustrated below:



The table below illustrates the research objectives, research questions and hypotheses arising from the conceptual framework:

Focus / Purpose	Research Objective ("RO")	Research Question ("RQ")	Hypothesis ("H")
Path 1 (IV1→MV)	RO1: To examine the influence of KPI Pressures Intensity on Moral Disengagement.	RQ1: Does KPI Pressures Intensity significantly predict Moral Disengagement?	H1: KPI Pressures Intensity will be positively related to Moral Disengagement.
Path 2 (IV2→MV)	RO2: To examine the influence of Engagement in L-SOM on Moral Disengagement.	RQ2: Does Engagement in L-SOM significantly predict Moral Disengagement?	H2: Engagement in L-SOM will be positively related to Moral Disengagement.
Path 3 (MV→DV)	RO3: To examine the influence of Moral Disengagement on Tolerance for Fraud.	RQ3: Does Moral Disengagement significantly predict Tolerance for Fraud?	H3: Moral Disengagement will be positively related to Tolerance for Fraud.
Path 4 (IV1→DV)	RO4: To assess the direct effect of KPI Pressures Intensity on Tolerance for Fraud.	RQ4: Is there a significant direct effect of KPI Pressures Intensity on Tolerance for Fraud?	H4: KPI Pressures Intensity will be positively related to Tolerance for Fraud (Direct Effect).
Path 5 (IV2→DV)	RO5: To assess the direct effect of Engagement in L-SOM on Tolerance for Fraud.	RQ5: Is there a significant direct effect of Engagement in L-SOM on Tolerance for Fraud?	H5: Engagement in L-SOM will be positively related to Tolerance for Fraud (Direct Effect).
Path 6 (IV1→MV→DV)	RO6: To determine the indirect effect of KPI Pressures Intensity on Tolerance for Fraud via Moral Disengagement.	RQ6: Does Moral Disengagement significantly mediate the effect of KPI Pressures Intensity on Tolerance for Fraud?	H6: Moral Disengagement will mediate the effect of KPI Pressures Intensity on Tolerance for Fraud.
Path 7 (IV2→MV→DV)	RO7: To determine the indirect effect of Engagement in L-SOM on Tolerance for Fraud via Moral Disengagement.	RQ7: Does Moral Disengagement significantly mediate the effect of Engagement in L-SOM on Tolerance for Fraud?	H7: Moral Disengagement will mediate the effect of Engagement in L-SOM on Tolerance for Fraud.

The targeted subject of this research is confined to the Malaysian labour force. According to the Department of Statistics Malaysia (DOSM), Malaysia has a Labour Force Participation Rate of 70.9% (DOSM, 2025) over a total population of 34.2 million people (DOSM, 2025), effectively resulting in a population of approximately 24.25 million people. Data analysis will be performed using Partial Least Squares Structural Equation Modelling (PLS-SEM) using SmartPLS which is highly suitable for handling complex models and the expected non-normal data set inherent in research based on psychological measures. The required sample size for PLS-SEM is determined by the complexity of the proposed model and the desired statistical power (Hair et al., 2017). A target sample size of approximately 300 is appropriate as it exceeds the statistical minimum required by the PLS-SEM "10-Times Rule" for this model and is sufficiently robust compared to previous studies into Moral Disengagement (MD) which utilized larger samples (Idensohn et al., 2026; Ahmed & Khan, 2023).

Data collection will be via questionnaires designed with a 5-point Likert scale. The measurements of the variables will feature questions such as:

Illustrated Question	Source
Independent Variable 1: KPI Pressure Intensity	
"The demands of my job often require me to meet targets that are impossible to achieve without cutting corners."	(Nair & Kamalanabhan, 2011)
"I frequently feel pressured to report performance results that look better than the reality."	(Luo et al., 2023)
Independent Variable 2: Engagement in L-SOM	
"My immediate manager only focuses on his/her own benefit when making decisions."	(Nair & Kamalanabhan, 2011)
"My leader has used company rules or policies to serve his/her own needs."	(Ahmed & Khan, 2023)
Mediator: Moral Disengagement (MD)	
Moral Justification: "Considering the pressures we face, it is acceptable to bend the rules to achieve targets."	(Petitta et al., 2021)
Euphemistic Labelling: "Hiding minor financial inaccuracies is just 'creative accounting,' not lying."	(Lo Presti et al., 2023)
Diffusion of Responsibility: "Since everyone in the company is responsible, it is unfair to blame one person when misconduct occurs."	(Nair & Kamalanabhan, 2011
Dependent Variable: Tolerance for Fraud (TF)	
"I would not report a colleague if I knew they inflated results, provided it helped the company meet a target."	(Nair & Kamalanabhan, 2011)
"I would conceal negative internal information from the public if it protected the organization's reputation."	(Alqhaiwi, 2024)

Results and Discussion

The results presented here are the hypothesized findings that the PLS-SEM analysis is expected to uncover because this study represents a proposed model. The results will show the exact behavioral

mechanism that connects corporate pressure to systemic risk if the data is consistent with the Conceptual Framework (Guix & Lotfi, 2025).

For the direct paths that link the organizational antecedents to the mediator and the mediator to the outcome, we expect to discover a positive and significant relationships. It is anticipated that H1 and H2 will be validated, proving that external and internal pressures drive moral self-exoneration. KPI Pressures Intensity (IV1) is expected to be a significant positive predictor of MD, as performance and institutional pressure are frequently mentioned as major contributors to misconduct and a key inducer of it (Luo et al., 2023). Similarly, Engagement in L-SOM (IV2) will positively predict MD, as Engagement in L-SOM creates an organizational environment that models or promotes unethical rationalization (Nair & Kamalanabhan, 2011). Furthermore, H3 will be supported, as MD is a key neutralization technique that immediately precedes and positively relates to unethical or corrupt organizational behavior (Luo et al., 2023; Lo Presti et al., 2023).

The analysis is expected to confirm the traditional direct links between the IVs and DV, Tolerance for Fraud significantly and positively. These findings reflect the immediate influence of poor performance metrics and destructive leadership in creating a permissive environment where compliance and loyalty are valued over ethics (Ahmed & Khan, 2023).

This research's main contribution is the demonstration of the two separate indirect effects, H6 and H7, which should be fully supported by PLS-SEM bootstrapping. This validates MD as the crucial psychological pathway that connects systemic tolerance for fraud to organizational deficiencies. Specifically, H6 is anticipated to show that KPI Pressures Intensity forces managers to rationalize rule-bending via MD before tolerating fraud (Nair & Kamalanabhan, 2011). Simultaneously, H7 will confirm that Engagement in L-SOM acts as an organizational trigger, allowing employees to disengage their moral standards and tolerate fraud by minimizing consequences or shifting responsibility (Schüßler et al., 2024; Luo et al., 2023). Collectively, these findings will substantiate that systemic risk is driven by a psychologically justified behavioral pathway.

Conclusion

Collectively, the expected findings will illustrate that the escalation of systemic risk in the Malaysian workforce is best understood not through isolated incidents, but through a compounding behavioral pathway that is psychologically justified by the organizational environment.

The model’s principal contribution is expected to substantiate that MD is the crucial psychological pathway that connects systemic tolerance for fraud to organizational deficiencies like flawed performance metrics and destructive leadership. By focusing on a situational, managerially produced environment rather than human deviance, this study provides an innovative perspective on fraud vulnerability.

This framework also serves as a vital foundation for developing targeted interventions. Ultimately, the conceptual paper seeks to identify if the true risk of a flawed performance management system is not the initial compliance breach, but its role in training employees to rationalize wrongdoing. Future empirical research will be essential for developing managerial strategies aimed at halting

MD, thereby reducing systemic risk across various industries. This research encourages employers to consider strengthening fraud prevention systems by focusing on employee trust and ethical integrity instead of performance management systems.

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