Fraud Detection on Banking Industry in South Sumatera: A Study on the Role of Internal Auditors’

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Abstract
Internal auditors function is important as the first filter against fraud in the implementation of fraud detection in banking and financial industry. This study was conducted involving internal auditors at several banks in South Sumatera, Indonesia. Questionnaire was used to collect the data which was then analyzed using SPSS. The results indicate that the auditing expertise of supreme internal auditors do not suit the criteria of fraud detection. Therefore, it is concluded that the internal auditors in banking industry in South Sumatera are not ready yet for the implementation of fraud auditing.

Keywords: Internal Auditor, Fraud, Auditing, Bank Industry.

1. Introduction
Economic development requires companies and industries to apply critical thinking in order to compete and utilize their resources efficiently and effectively to achieve corporate objectives. Maintaining the viability of the companies in processing the available resources effectively and efficiently, particularly with regard to such competition, takes reliable or adequate internal audits. In internal audits, not only does an auditor act as a watchdog, but also as an independent internal examiner.

One of the functions of internal auditors is to detect fraud in companies, commonly known as fraud auditing. Fraud auditing examines more complicated matters than the financial or operational auditing. Therefore, it needs professional and competent auditors who possess professionalism in terms of three mains aspects: skill, knowledge, and character. In terms of expertise, fraud auditors must have special skills different from those possessed by financial auditors. It consists of two skills, expertise as a financial auditor and investigator. This is because the trail of fraud auditing often does not exist.

In Indonesia, (Murtanto & Gudono, 1999) have conducted research examining the auditing expertise of auditors. Furthermore, WHO researchers such as (Bonner & Lewis, 1990); (Libby & Luft, 1993); (Libby & Tan, 1994) have formulated a model of performance auditing. However, a periodic review by (Murtanto & Gudono, 1999) indicated that these studies do not provide a comprehensive framework for identifying and organizing characteristics of audit expertise as they still focus on the aspects of knowledge and experience. On the other hand, (Abdolmohammadi & Shanteau, 1992) revealed that there are personal attributes of auditors’ expertise. They developed a more comprehensive framework and provided additional attributes which they grouped into five aspects: components of knowledge (knowledge component), psychological characteristics (psychological traits), thinking (cognitive abilities), strategy determination decision (decision strategies), and analysis of the task (task analysis).

Research conducted by (Desai et al., 2010) revealed that the quality of corporate governance affects the evaluation of the IA function. Furthermore, research conducted by (Perry & Bryan, 1997) indicated that the internal audit function assists management in the prevention, detection and investigation of fraud occurring in an organization. (Brian, 2016) states that "having honesty and integrity in the workplace is one of the most important qualities of great leadership in business". If everyone is honest, companies do not need to be alert to acts of fraud. However, many individuals claim to have done fraud actions, particularly when the environments in which they work have low integrity, low control and high pressure. This research attempts to examine the audit expertise of auditors in the banking industry, both the audit expertise owned by auditors in general and by fraud auditors in particular.
2. Literature Review

2.1. Definition of Fraud

The Association of Certified Fraud Examiners (ACFE, 1993) defines fraud as "an initial approach (proactive) to detecting financial frauds, using the accounting records and information, analytical relationships, and an awareness of fraud perpetration and concealment efforts." Another definition of fraud auditing is an initial proactive approach to detect financial fraud using records and accounting information, being analytical of the nature of relationships, being cautious over fraud measures and efforts to cover up the fraud actions. (Anonymous, 2000).

Fraud can be understood as aberrations or irregularities committed by individuals with the element of intention in doing so. ACFE defines fraud as a deliberate act of taking advantages by ways of abusing a job/position or stealing assets/resources in organizations (Singleton, 2010). Under Fraud Scheme, ACFE classified fraud into three forms of deviation: financial reporting irregularities (fraudulent financial reporting), asset misappropriation (misappropriation of assets) and corruption.

Three steps can be implemented to minimize fraud actions, which include fraud prevention, fraud detection and fraud investigation. Cheating on the presentation of financial statements generally can be detected through the analysis of financial statements, including vertical and horizontal analysis. On the other hand, the abuse of assets can be detected by such methods as analytical reviews, statistical samplings, vendor or outsider complaints, and site visit-observation. Corruption can be detected through complaints from co-workers who are honest and through reports from colleagues or from suppliers who are not satisfied and submit complaints to companies. Based on suspicion of irregularities, an analysis of suspects or transactions then is carried out. Detection of this deviation can be seen from the characteristic (red flag) of the recipients and the givers. (Rezaee, 2002) identified several attributes of fraud: (1) identifying the symptoms and red flags; (2) identifying opportunities; (3) assessing symptoms, red flags and opportunities; and (4) reporting.

2.2 Internal Audit Role

Internal audit is an independent activity that provides objective assurance and consulting, designed to add value and improve the operations of an organization. This activity helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes (The IIA Research Foundation, 2011). According to International Professional Practices Framework (IPPF) & the (IIA Research Foundation, 2011) has given a definition of internal audit: “Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.” Based on the definition, internal audits plan should be based on assessing the risk and the impact and that the risk-based audit helps to produce better accountability for all types of organization (Pickett, 2006).

Internal audits aim to improve the operations of an organization and to reduce the possibility of negative things to occur, including unreliable financial reporting. Internal auditors assist management in the design and maintenance of the adequacy and effectiveness of internal control structures. Internal auditors are also responsible for assessing the adequacy and effectiveness of each control system which guarantees the quality and integrity of the financial reporting process. The interpretation of Professional Standards Internal Audit (SPAI) - 120.2 standard 2004, concerning knowledge of irregularities, stated that internal auditors should have sufficient knowledge in order to identify, examine and test the indications of irregularities. In addition, the Statement on Internal Auditing Standards (SIAS) No. 3, 1985, list down the responsibility of Internal Auditors including deterrence, detection, investigation, and reporting of fraud, provides guidance for internal auditors to conduct prevention, detection and investigation against fraud. SIAS No. 3 IS ALSO emphasized the responsibility of internal auditors for the audit reports of fraud.

2.3 The Hypothesis Formulation

Professional proficiency can be obtained through internal auditors’ continuing education, their work experience and skills in the field of internal audit, banking operations and other disciplines relevant to their expertise. The minimum educational requirement for internal auditors determined by each bank aligns with the size of the organizations as well as the complexity of bank activities. Studies on the expertise of auditors have been done by some researchers, including (Francis, 2004) who conducted a study on auditors’ expertise. The results of Francis’ research suggested that auditors’ expertise consists of eight aspects: task analysis, component knowledge, personal ability, strategy and decision-making, planning ability, psychological characteristics, the ability to think and ethical behavior. Francis further adds that ethical behavior is very closely related to the word ‘professional’, because professionals are responsible for behaving, meaning that they are more than just fulfilling the responsibilities assigned to them and more than meeting the laws and regulations in the society.

(Murtanto & Guadino, 1999) conducted research on audit expertise, replicating (Abdolmohammadi & Shanteau, 1992) study. The results of this study indicate that “experience” and “knowledge” are important elements of auditors’ expertise;
the improvement of the quality of the auditing profession needs to consider characteristics identified in the study. Furthermore, it was also found that such categories as "Psychological Characteristics" and "Components of Knowledge" are important, followed by categories of other skills. All industries need internal auditors who possess sufficient expertise to detect fraud occurring in organizations. The hypothesis in this study was developed based on previous research and under the assumption that the banking industry increases rapidly; it is complex and must anticipate fraud by placing internal auditor in organizations. The following is the hypothesis of this study: "the expertise of internal auditors in the banking industry in the city of South Sumatera is positively associated with the detection of fraud audit (fraud auditing)".

3. Research Methodology

3.1 Population and Sample
The population of this study was the banking industry in Sumatera, Indonesia. The samples were the internal auditors in the banking sectors practicing in South Sumatera. The samples were determined using purposive sampling method.

3.2 Data quality test
Reliability and validity test were computed with SPSS (Statistical Product and Service Solutions) software. To assess the reliability of the questionnaire administered, Cronbach Alpha coefficient was computed. A construct can be regarded as being reliable if the Cronbach Alpha value is ≥ 0.60, Nunnaly, as mentioned in (Drost, 2011); (Nunnaly & Bernstein, 1994); (M Shevlin, 2000); (Ghozali, 2004). The validity test was used to measure whether the questionnaire is valid or invalid. A questionnaire is considered valid if it is able to reveal/disclose aspects which the questionnaire was designed to reveal/disclose. The validity test was done by analyzing bivariate correlations between each score total indicator constructs. If the total correlation constructs showed significant results, then each indicator is a valid question.

3.3 Hypothesis Testing
Hypothesis testing techniques were employed in this study to test the level of significance of each independent variable (X) to the dependent variable (Y). The independent variable in this study is the expertise of the internal auditors and the dependent variable is the detection of fraud audit.

4. Results and Discussions

4.1 Descriptive Statistics

4.1.1 Characteristics of Respondents
The characteristics of respondents were obtained from the questionnaire. They can be seen in Table 1 below.

<table>
<thead>
<tr>
<th>No</th>
<th>Description</th>
<th>Total</th>
<th>Percentage(%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Gender</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Male</td>
<td>39</td>
<td>81,25</td>
</tr>
<tr>
<td></td>
<td>Female</td>
<td>9</td>
<td>18,75</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>48</td>
<td>100</td>
</tr>
<tr>
<td>2.</td>
<td>Age</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>≤ 40 years old</td>
<td>8</td>
<td>16,67</td>
</tr>
<tr>
<td></td>
<td>Age &gt; 40 years</td>
<td>40</td>
<td>83,33</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>48</td>
<td>100</td>
</tr>
<tr>
<td>3.</td>
<td>Education</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Postgraduate</td>
<td>17</td>
<td>35,41</td>
</tr>
<tr>
<td></td>
<td>Undergraduate</td>
<td>29</td>
<td>60,41</td>
</tr>
<tr>
<td></td>
<td>3-Year Diploma</td>
<td>2</td>
<td>4,17</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>48</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Processed Data, 2013

The demographic profile above shows a high percentage of male auditors as compared to the female auditors. This imbalanced distribution by gender is reflective of the population of auditors in Indonesia in which the field is dominated by men. Auditors are dominated by individuals aged more than 40 years (83% of the sampled auditors were older than 40). Looking at their educational background, there was 35% of the auditor’s possess postgraduate qualification.
4.1.2 Goodness of the Questionnaire

The reliability coefficients (see Table 2) show that both constructs in the questionnaire were reliable. The high correlation coefficients (see Table 3) within the items in the constructs indicated that the questionnaire was valid.

Table 2. The reliability test result

<table>
<thead>
<tr>
<th>No</th>
<th>Variable</th>
<th>Cronbach Alpha value</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Expertise internal auditors</td>
<td>0.67</td>
<td>Reliable</td>
</tr>
<tr>
<td>2</td>
<td>Fraud Auditing</td>
<td>0.75</td>
<td>Reliable</td>
</tr>
</tbody>
</table>

Source: Processed Data, 2013

Table 3. Validity of Test Results

<table>
<thead>
<tr>
<th>No</th>
<th>Variable</th>
<th>Correlation range</th>
<th>significance</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Expertise internal auditors</td>
<td>0.799**-.858**</td>
<td>0.01</td>
<td>Valid</td>
</tr>
<tr>
<td>2</td>
<td>Fraud Auditing</td>
<td>0.723**-.751**</td>
<td>0.01</td>
<td>Valid</td>
</tr>
</tbody>
</table>

Source: Processed Data, 2013

4.1.3 Hypothesis Testing

From the analysis using error rate ($\alpha = 0.05$) and a degree of freedom ($n - k$), the $t$ critical known value is 2.006; from our calculations, the value of the $t$ calculated for the variable internal auditor expertise was 1.890 (therefore, $t$ calculated < $t$ critical). The result that the $t$ calculated value for the variable of internal auditor expertise was smaller than $t$ critical indicates that the expertise of internal auditors does not have a significant effect on audit fraud detection, as illustrated by the following figure:

![Figure 1. Significant effect on audit fraud detection](image)

Based on the result of the hypothesis testing, it is known that the $t$ calculated value for the variable of internal auditors’ expertise is smaller than the value $t$ critical. Thus, the hypothesis that the internal auditors’ expertise in the banking industry in the city of South Sumatera is positively associated with the detection of fraud audit (fraud auditing) is rejected.

4.2 Discussion

According to (Abdolmohammadi & Shanteau, 1992); (Bonner & Lewis, 1990); (Kevan & Jeff, 2003) an internal auditor's expertise includes:

- Having adequate analytical capabilities to manage and analyze the tasks (task analysis), which heavily influenced by audit experience and will have an influence on decision making. The complexity of the tasks will affect the choices of decisions made by the auditor.
- Having sufficient knowledge of components, knowledge of facts, processes, and procedures.
- Having the ability to make strategic decision-making, decision-making strategy (decision strategies), both formal and informal, that will contribute to the decision-making skills in a system and help overcome the limitations of human.
- Having good psychological characteristics; psychological characteristics (psychological traits) refer to self-presentation-image attributes such as the ability of an expert in communication, creativity, collaborating with others, and being trusted with regard to the expertise. Thinking skills (cognitive abilities) refer to the ability to accumulate and process information.
- Having good thinking skills, which include the ability to adapt to new or even ambiguous situations, to pay attention to relevant facts and ignore irrelevant facts, also having the ability to manage pressures.
Having ethical behavior; as a professional, the auditor must be aware of their responsibilities towards the community, clients and peers.

From the hypothesis testing, several conditions of internal auditors’ expertise in the banking industry in the city of South Sumatera can be observed. This does not include all criteria implied. In other words, the internal auditors in the banking industry in South Sumatera are not ready to carry out the fraud auditing. Such identified criteria were due to the work environment which does not encourage auditors to increase their expertise. For example, trainings, professional developments or short courses which are aimed to increase the expertise of internal auditors.

5. Conclusions and Suggestions

5.1. Conclusion

The importance of internal auditors’ expertise in detecting fraud is in line with the results of 2010 ACFE report which explains that 60% of respondents reported that internal auditors have a very important role in the efforts to detect fraud. The results indicate that the internal auditors in the banking industry in South Sumatera do not have sufficient skill and expertise to detect fraud in fraud auditing process. This is because the work environment factors do not encourage the auditors to increase their expertise. Another contributing factor is difficulty in getting an expert auditor who can help and assist the auditors in banking industry in West Sumatera.

5.2. Implication

This study has broad implications in the future, particularly for research related to relationship skills of internal auditors in detecting fraud. The model of this research is developed from previous research conducted by (Abdolmohammadi & Shanteau, 1992); (Bonner & Lewis, 1990); (Kevan & Jeff, 2003). Therefore, this research needs to be followed up with a re-examination to address whether the expertise of internal auditors is a major factor that is required in detecting fraud and whether audit should also be developed to examine other technical factors. It is advised because the level of expertise of auditors is significantly determined by both knowledge and technical factors. Further research is also suggested, particularly to expand the research objects by selecting respondents who have equivalent positions, so that the results can be generalized.

5.3. Suggestions

• For Banking Industry

The results of this study indicate that the internal auditors working in the banking industry in South Sumatera are not ready for implementing fraud auditing. Therefore, these results can serve as empirical evidence suggesting that when the banking industry would like to carry out fraud auditing, the issue of human resource still becomes a problem. With regard to such an issue, a specific training to support the required expertise related to fraud auditing is central.

• For Further Research

To get better research and better representations of the phenomenon of auditors’ expertise, it is necessary for future research to expand the scope of the study sample. The sample should include both auditors of industrial banks or private industry and government banks.

References


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