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Determinants Affecting the Auditor's Ability of Fraud Detection: Internal and External Factors

(Empirical Study at the Public Accounting Firm in Tangerang and South Jakarta Region in 2019)

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Abstract—**Accounting fraud which in auditing language better known as fraud has now become a kind of headline news in the media. The detection of fraud is an attempt to find out that an act of fraud has occurred, who is the culprit, who is the victim, and what causes it. This study aims to determine the effect of Auditor's Internal Factors (auditor independence, professional scepticism, auditor experience and red flags) and Auditor's External Factors (internal control and whistleblowing system) on the Fraud detection. The population in this study is the auditor who works at the Public Accounting Office (KAP) in Tangerang and South Jakarta area. The sampling technique uses convenience sampling. This research data was obtained from a questionnaire that had been previously shared with the auditors working at the Public Accounting Firm (KAP) in the Tangerang and South Jakarta area. The analysis tool uses multiple linear regression. The result of this study could help Auditors and Public Accounting Firms understand the factors that affecting auditor's ability on fraud detection not only derive from their internal factors, but the external factors of auditor also have a significant influence on their ability on fraud detection. The empirical insights from this study would also be useful for theory building.**

Keywords: independence, scepticism, experience, red flags, internal control, whistleblowing systems, fraud detection

I. INTRODUCTION

Fraud is a word that is rarely known by the wider community. However, without realizing it, in Indonesia, almost every day the mass media publish news about various fraud. Fraud is something that often happens in everyday life, government and even the public.

The occurrence of a fraud is an intentional act, which if fraud cannot be detected by an audit, it will have an adverse and flawed effect for the financial reporting process. Since the beginning of the second quarter of 2017 have been rumours of accounting fraud at British Telecom. British giant company is experiencing accounting fraud at one of its business lines in Italy. As other accounting fraud scandal, fraud in British Telecom affect public accountant. No half-hearted, this time affected is Price Waterhouse Coopers (PWC) which is a renowned public accounting firms in the world and includes the big four. In Indonesia, corruption is the occupational category of fraud is often the case and declared the most destructive fraud. Based on the survey of the Association of Fraud Examiners (ACFE) Indonesia Chapter and White Collar Crime Research and Prevention Centre (*Pusat Penelitian dan Pencegahan Kejahatan Kerah Putih*/ P3K2P) 2016, corruption occurs 67% of the total cases of occupational fraud in Indonesia with a loss of 10 billion rupiah per year, followed by asset misappropriation (31%) and the misuse of the financial statements (2%). According to the Nation on Occupational Fraud and Abuse 2018 detection method most often reveal that occupational fraud are complaints, internal audits and management reviews. The complaint is the most common fraud detection tool to uncover fraud with 40% of the total percentage of cases and 50% of cases of corruption detected through complaints or often called Whistleblowing [1].

Failing to detect fraud can occur due to several factors. These factors derived from the internal side of the inside of the auditor and the external side. On the internal side, namely independence, scepticism, the experience of an auditor and the auditor's ability to capture signals conveyed on red flag. While the external side can be derived from the characteristics of fraud increasingly complex and neatly organized by perpetrators of fraud, the level of internal control. Sometimes the closed attitude of management makes it difficult for auditors to detect fraud. But on the other hand, auditor gets a bright spot of whistle-blower reports.

Independence is an impartial perspective in the implementation of testing and audit processes, evaluation of audit results and preparation of audit reports [2]. The independence attitude shows an auditor's decision not to side with one of the parties concerned, just as when an auditor finds a fraud then the auditor is responsible for disclosing the fraud even though it is burdening one of the parties concerned. The independence of the auditor was also a positive effect on the detection of fraud, which means the higher the independence of an auditor, the ability to detect fraud tends to increase [3].

Auditors who have a high professional scepticism does not easily accept the explanation of the client, but he would give the questions to get the evidence, reason and confirmation about the object of the main problem. Low levels of auditor scepticism will lead auditor is not able to detect the possibility of fraud because the auditor would easily trust the assertions provided by the management without having sufficient evidence supports the above assertions. The level of professional Scepticism that the auditor will affect its ability to detect fraud [4].

In addition, to support the auditor's ability to detect fraud, the auditor shall be supported by the experience. Experience of an auditor is also believed to affect the level of auditor scepticism. Auditors must have technical qualifications and experience in the industries they audit, because this will make the auditor abler to find fraud from the clients they audit. Therefore, the more experience the auditor can produce various kinds of allegations in explaining audit findings [2].

To support the auditor's ability to detect a situation that raises potential fraud, the auditor also needs to pay attention to the appearance of red flags, namely the existence of circumstances peculiar and different from the normal state. Sufficient understanding of the red flags and followed with a good analysis of the irregularities that are around will help the auditor to find evidence that would indicate the presence of fraud [5].

Level control of the company which is the external factors, a major impact in the detection of fraud. Internal control factors include the organizational structure, methods, and size are coordinated primarily to keep the company's assets as well as check the accuracy and reliability of accounting data. The internal control significant effect on the accounting fraud [6].

Based on data from the Association of Certified Fraud Examiners 2016 Report to the Nation on Occupational Fraud and Abuse shows that the fraud was revealed from informal report (whistle-blower). This information from internal parties. This means it needs a system that makes the community dared to reveal the fraud. Survey results also indicate that external audit may also be a medium for the detection of fraud. The percentage into the first level of some form of disclosure of fraud in many cases.

II. THEORETICAL FRAMEWORK

A. Fraud Triangle Theory

There are three conditions that would lead to fraudulent financial reporting and misappropriation of assets2. The third condition that affects the cheating contained in the fraud triangle Theory is as follows [7]:

1) Incentives or pressure: Incentives that encourage people to commit fraud due to lifestyle demands, helplessness in the matter of finance, gambling behavior, try to beat the system and job dissatisfaction. General incentives for companies to manipulate financial statements are decreasing the company's financial prospects.

2) Chance: Opportunity is a situation that opened the opportunity for management or employees to commit fraud.

3) Attitude or rationalization: The perpetrators of fraud assume rationalization is thought to justify his actions as a normal behavior, which is morally unacceptable in a normal society.

Key to anticipate fraud is awareness and prevention. Processes that are considered most effective to prevent fraud is to minimize the chance, effective leadership, auditing, and strict selection of employees.

B. Fraud Detection Ability

Fraud is any illegal acts characterized by deceit, concealment, or breach of trust [8]. The detection of fraud is an act committed with the aim to find a series of indicators of fraud that can provide a warning for fraud investigator. The auditor should understand how to detect early occurrence of fraud arising. The detection action cannot be generalized to all cheating. Each type of fraud has its own characteristics, so as to be able to detect fraud it is necessary a good understanding of the types of fraud that may arise within the company.

C. Auditor's Fraud Detection Ability

One important factor in detecting fraud for an auditor is independence. Independence is an impartial perspective in the implementation of testing and audit processes, evaluation of audit results and preparation of audit reports [2]. The independence attitude shows an auditor's decision not to side with one of the parties concerned, just as when an auditor finds a fraud then the auditor is responsible for disclosing the fraud even though it is burdening one of the parties concerned. An auditor has the capacity to safeguard the public interest because it is an auditor must not only maintain their independence attitude, an auditor must have a critical attitude and meticulous.

D. Skepticism

Auditor's Professional Scepticism is an attitude or mindset of auditors who always question the correctness of audit evidence presented by a business entity or enterprise and an attitude (attitude) in performing audit assignments. Understanding Scepticism Professional Auditor is a critical attitude in assessing the reliability of the assertions or evidence obtained, so that in the process of auditing the auditor has confidence high enough on an assertion or evidence that has been gained and also consider the adequacy and appropriateness of evidence obtained [4].

E. Experience

Experience an auditor will continue to increase along with the number of audits performed. It was identified that the longer length of service and experience of the auditor, the better and also increase the resulting audit opinion. The experience will affect the sensitivity of auditors against fraud cues. The more experience, the more audit an auditor can produce various kinds of allegations in explaining the findings of the audit [9].

F. Red Flags

Red Flag is a set of unusual circumstances on the nature or variation from normal activity. Red flag is a signal that there is something unusual and may need to be investigated further. Recognizing the red flags is important that the auditor is able to identify potential fraud so that the prevention and identification of fraud in so effectively, efficiently and economically. Being able to recognize red flags necessary not only for public accountants but also for every auditor working in the public sector where there is potential for fraud even by each organization. After the red flag was realized, one must take action to investigate the situation and determine whether fraud has been done [10].

G. Internal Control

Internal control system includes organizational structure, methods, and measures are coordinated primarily to keep the company's assets as well as check the accuracy and reliability of accounting data [6]. Internal control is a form of success of a company management in achieving goals related to maintaining the reliability of financial reporting, operational efficiency and effectiveness, and compliance with the legislation in force. Internal controls can also play an active role in preventing fraud in a company.

H. Whistleblowing

Whistleblowing is the disclosure violations or disclosure act unlawful, unethical or immoral or other actions that may be detrimental to the organization and stakeholders conducted by employee or organizational leadership to the leadership of the organization or other institution can take action on violations [11]. In general, the disclosure is done confidentially. Disclosure must be made in good faith and not a private complaint on a particular company's policy (grievance) or based on the will of the bad / slander.

III. METHODS

In this study using a survey method to Obtain primary data. This study uses Partial Least Squares Structural Equation Modelling (PLS-SEM) for the data analysis. This research is a quantitative study to identify an association between the variables studied. Quantitative research is an inquiry about the social problems based on the theory test consists of multiple variables, as measured by the number and analysed by statistical procedures to Determine Whether the predictive generalizations are true [12].

The population in this study are all auditors working in Public Accounting Firm in Tangerang and South Jakarta Region in 2019. Methods Convenience Sampling has been associated with the limited time available to conduct research.

IV. RESULTS AND DISCUSSION

SEM-PLS method is used to analyse multivariate models. The models consist of three exogenous latent variables namely independencies, Scepticism, experience, red flags, internal control and whistleblowing, while the endogenous latent variables items, namely the auditor's fraud detection ability.

A. Measurement Model Test

Measurement models this test consists of the validity and reliability Because test results measuring the outer consistency in explaining a construct model. Recommended test measurement results of this model of Affect the structural test models.

B. Internal Consistency Test for Reliability

Reliability of composite value varies between 0-1, the higher the reliability of composite Showed the higher the degree of reliability of variables. In general, the composite reliability interpreted as Cronbach's Alpha. For exploratory research, the reliability of composite score must be above 0.60-0.70 [13].

TABLE I.   CONSTRUCT RELIABILITY AND VALIDITY

	Cronbach's Alpha	Rho_A	Composite Reliability	Average Variance Extracted (AVE)
Auditor's Fraud Detection Ability	0.899	0.913	0.920	0.593
Experience	0.456	0.471	0.784	0.646
Independencies	0.814	0.839	0.876	0.639
Internal Control	0.751	0.766	0.856	0.665
Red Flags	0.762	0.812	0.843	0.576
Sekpticism	0.784	0.803	0.871	0.693
Whistleblowing	0.985	0.918	0.926	0.758

Table 1 shows that the entire latent variable has a value of composite reliability above 0.70. The test results stated that the models can meet the reliability test.

C. Validity Test

To test the convergent validity, we evaluated the value of Average Variance Extracted (AVE) on each of the latent variables. 0.50 AVE value above shows that on average constructs can account for more than half a variant of the indicators [13].

Also, Table 1 shows that all latent variables have AVE value above 0.50, this means that the latent variables in the study passed the test of convergent validity, showed that on average constructs can account for more than half a variant of the indicators.

D. Path Coefficient Test

In this study the structural test models using T test (two-tailed) with a significance level of 10%, then the path coefficient significant when t empirical value is greater than the critical value is 1.65 [13].

TABLE II. PATH COEFFICIENTS

	Original Sample	Sample Mean	Standard Deviation	T-Statistic
Experience -> Auditor's Fraud Detection Ability	0.449	0.443	0.072	6.271
Independencies -> Auditor's Fraud Detection Ability	-1.222	-0.120	1.208	0.101
Internal Control -> Auditor's Fraud Detection Ability	0.229	0.239	0.171	1.340
Red Flags-> Auditor's Fraud Detection Ability	0.322	0.342	0.100	3.216
Sekpticism -> Auditor's Fraud Detection Ability	0.091	0.093	1.225	0.074
Whistleblowing-> Auditor's Fraud Detection Ability	0.277	0,261	0.116	2.392

V. CONCLUSION

Based on the test results known that the auditor's experience, red flag and whistleblowing have a significant relationship to the Auditors for fraud detection ability. However, independencies, internal control and Scepticism have no significant effect to the Auditors for fraud detection ability.

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