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Auditors' Perceptions towards their Role in Assessing, Preventing and Detecting Business Fraud

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The main objective of this study is to determine auditors' perceptionz towards risk of fraud in Malaysia. Specifically, it seeks to investigate the auditors' perception towards being proactive, (1) in assessing the business risk of fraud, and (2) in preventing and detecting fraud. Using a questionnaire survey adapted from Farrell and Franco (1999), the study findings indicate that auditors in Malaysia have positive attitude towards their role in proactively searching for fraud. The study findings show that auditors have given increased attention to understand and examine related internal controls. Besides scrutinizing fraudulent financial reporting, auditors were also found to place higher responsiveness on misappropriation of physical assets. Positive attitude towards assessing, preventing and detecting business fraud among auditors may serve as an indicator to gradually mitigate fraud in Malaysia.

Key words: *auditor, business fraud, prevention, detection, Malaysia.*

Introduction

Financial fraud is a growing reality in the corporate landscape that is plaguing large companies, SMEs and the public sector in Malaysia. Fraud has cast increasingly adverse impact not only on individual investors but the overall stability of global economies (Zhou and Kapoor, 2011; Zainudin and Hashim, 2016; DeZoort and Harrison, 2016). In a time of fragile economic conditions, corporate fraud remains a major concern for business. In the KPMG Malaysia Fraud Survey Report (2009), nearly two-third of executives (65 %) cite fraud and misconduct as posing significant risk to their industry. The belief is that fraud and misconduct risks, such as misappropriation of assets and fraudulent financial reporting, will either stay the same or increase over the next 12 months. *"Studies indicate that the pressure to do 'whatever it takes' to achieve business goals continues as the primary driver behind corporate fraud and misconduct"* (KPMG Fraud Survey, 2009). Moreover, the PwC's 2011 Global Economic Crime Survey indicates that forty-four percent of businesses and other organizations surveyed in Malaysia were victims of economic crime in the last 12 months. The 44% reported in the survey represent a 57% increase over the 28% reported in the same survey in 2009. In the Malaysian scenario, theft or asset misappropriation was the most common type of economic crime reported (cited by 83% of respondents), followed by bribery and corruption (34%), and accounting fraud (27%).

Regardless of all the attention that fraud, corruption and other forms of economic crime receive, PwC's 2014 Global Economic Crime Survey reports that Malaysian businesses are still underestimating the threat of economic crimes. According to the survey, 47% of the respondents reported that they had neither undertaken a fraud risk assessment in the last two years, nor knew if they had. 38% out of 47 % respondents further indicated that they were not sure what a fraud risk assessment involves. Moreover, a most recent PWC's 2016 Global Economic Crime Surveys reported that 30% of Malaysian companies incurred losses of more than USD100,000 as fraud victims and 13% of the sampled companies lost more than USD1 million due to fraud. The report also found that fraud-risk assessment has not been carried out by 1 in 3 of Malaysian companies in the past 2 years between 2014 and 2016. Although the awareness of economic crimes has improved in recent years, the survey found issue with the fact that most companies still under-estimated the threat of such risk.

This issue is controversial and important, yet little academic research has explored this area of research due to the difficulty in detecting fraud before it occurred (Kamal et al., 2016).

Fraud is hard to detect as it is normally carried out by highly motivated and qualified teams of experienced managers who have the ability to override a firm's internal controls (Kassem, 2018). Further, it was long debated that the responsibility to detect fraud is in the hands of auditors (Halbouni, 2015; DeZoort and Harrison, 2016). In particular, investors expect auditors to detect fraud while the primary responsibility for the prevention and detection of fraud rests with both those charged with governance and management (Smith et al., 2005). Additionally, recent accusations of the original audit report on scandal-plagued fund 1Malaysia Development Berhad (1MDB) had been tampered with and altered has further shaken the Malaysian auditing profession (The Malay Mail, 2018).

In order to reduce expectation gap between investors' expectation and auditors' primary responsibilities, a series of discussions and consequent measures were undertaken by the profession to educate investors concerning the role of auditors and their limitations in finding fraud due to deficit in the nature of audit procedures to detect fraud. However, corporate collapses that involve financial fraud have led regulators to strengthen their concern relating to the auditors' responsibility to consider risk of fraud during audit of financial statements (DeZoort and Harrison, 2016). Based on ISA 240 (p.150), the objectives of the auditor are: *"1) To identify and assess the risks of material misstatement due to fraud; 2) To obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and 3) To respond appropriately to fraud or suspected fraud identified during the audit."* Therefore, with the new clarified auditing standard that requires auditors to consider risk of fraud during the audit process, it is imperative to determine their perception towards risk of fraud in Malaysia. Malaysia has been the focus in this study due to fact that little attention has been given to developing countries on issues related to fraud detection (Kassem, 2018) and the current study could increase the understanding in a developing context, such as Malaysia.

The following sections of this paper are organised as follows. Section 2 discusses the relevant literature, followed by an explanation of research methodology in Section 3. Section 4 analyses and discusses the research results. Finally, the conclusions are considered in Section 5.

Literature Review

The Association of Certified Fraud Examiners (ACFE), in its study entitled the Report to the Nation on Occupational Fraud and Abuse (2014, p.5), defined occupational fraud as *'the use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organisations' resources or assets'*. The report categorises occupational fraud as financial statement fraud, corruptions and misappropriation of assets. In addition, Alleyne and Howard (2005, p.258) suggest *'creating fictitious creditors, "ghosts" on the payroll, falsifying cash sales, undeclared stock, making unauthorised "write-offs", and claiming excessive or never incurred expenses'* are several frequent types of fraud experienced by the organisation.

Fraud adversely impacts employees, shareholders, creditors, and in a broader sense, market efficiency by undermining the reliability of financial statements and confidence in the financial market (Perols and Lougee, 2011; Kassem, 2018; Obay, 2018). The effect of fraud is severe to a nation as it does not only affect shareholders of the company financially, it will also affect other stakeholders including society as a whole. Economic crime continues to be pervasive, affecting both private and public sectors in Malaysia (Ghazali et al. 2014). In fact, no industry or company in any country is immune from the impact of fraud. Survey participants of the ACFE 2014 approximated that the typical organization loses 5% of revenue annually to fraud. This translates to a potential projected global fraud loss of nearly $3.7 trillion in light of the 2013 estimated Gross World Product (Report to the Nation on Occupational Fraud and Abuse, 2014).

A total of RM 63.95 million of losses was reported from January 2006 to December 2009 by 47% of the listed and non-listed companies which took part in the KPMG fraud survey that urged for an established system and processes to pre-empt and detect fraud (KPMG Malaysia Fraud Survey Report, 2009). There are demands for financial professionals to acquire skills that enable them to assess, detect and prevent fraud. As the financial statements remain the primary means of informing shareholders and other stakeholders about the financial performance, progress and position of the business (Sikka et al., 2009; Siala Bouaziz & Jarboui, 2019), auditors are primarily responsible to provide assurance to financial statements stakeholders. Auditors perform audit procedures to attest financial statements and ensure the financial statement issued are faithful presentation useful for decision making. Auditors are expected to comply with auditing standards when conducting an audit. They will be blamed for conducting an inferior audit if a company fails shortly after being audited (Dopuch, 1988; Namazi and Namazi, 2017).

Nevertheless, detection of fraud remains the challenge for the authorities as there are many perpetrators (Kamal et al., 2016). Various techniques have been used to detect fraud (Zainudin and Hashim, 2016) but the new variations in the methods designed for committing fraud always require new methods that are effective to detect financial statement fraud (Zhou and Kapoor, 2011). Until recently auditors believed that responsibility for fraud detection lay in the hands of management (Jizi et al. 2018). Farrell and Franco's 1999 study found more than 61 per cent of certified public accountants disagree that they should be accountable for fraud detection.

Due to a fiasco of corporate failures that involve fraud, auditors are now expected to be more involved in assessing fraud risk. They are required to take more proactive steps to restrain corporate fraud (DeZoort and Harrison, 2016; Nxumalo & Naidoo 2018). Particularly, whenever there is a financial scandal that involves fraud, it must be interrogated as to why the auditors did not carry out their duties and obligations with due care. Owing to the nature of their work, auditors are among the parties that have the ability to detect fraud at the earliest stages (Smith et al., 2005). Moreover, auditors are expected to report financial irregularities in company accounts by enhancing transparency and accountability. Therefore, auditors and the public hold a divergent perception of the auditor's role (Koh and Woo, 1998). Given the significance of the difference in perception, prior research concerning fraud and auditors focused on the expectations gap between the public and auditors (DeZoort and Harrison, 2016).

Recently, ISA 240 was introduced to deals with the auditor's responsibilities relating to fraud in an audit of financial statements. An auditor conducting an audit in accordance with ISAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error (ISA, 240). Recent empirical research by Halbouni (2015) finds empirical support that external auditors are expected to increase the degree to which they seek to detect and report incidents of fraud as well. While the role of auditors in detecting fraud became increasingly demanding after the introduction of ISA240, investigation of auditors' perceptions towards their role in assessing, preventing and detecting fraud are still in infancy and need to be pursued (Rydzak, 2010).

Research Method

A questionnaire has been adapted from Farrell and Franco (1999) which is used as the main research instrument for this study. The questionnaire elicits data on auditors' perceptions towards their role in assessing, detecting and preventing the business risk of fraud. The adapted questionnaire includes four parts. The first part consists of 20 questions that require ranking on a five-point Likert scale (1 – is strongly disagree, while 5 – is strongly agree) to investigate the perceptions of respondents towards being proactive in assessing the business risk of fraud. The second part consists of 7 questions also require ranking on a five-point Likert scale to investigate the perceptions of respondents towards their role in preventing and detecting fraud. The third part consists of 4 questions regarding additional work required in audit and the fourth part consists of 8 questions to capture relevant information on the respondents' profile.

300 questionnaires were hand-distributed to auditors of selected firms by students who were attached to audit firms for six months' compulsory internship in February 2015. In distributing the questionnaires to the respondents, an official letter issued by the researcher institution was attached. Anonymity was assured to all respondents that participated in the survey. The respondents were given three (3) months to complete and return the questionnaire to the researcher. A total of 146 completed questionnaires with a response rate of 48.7% were collected by the same students. The collected data was analysed using the Statistical Package for the Social Sciences (SPSS) version 17.0. Table 1 below presents this demographic information.

Results and Discussions

Table 1: Demographic information

Descriptive items	Frequency	Percent
Position		
Partner	8	5.6%
Director	1	0.7%
Manager	13	9.0%
Senior staff	53	36.8%
Junior staff	67	46.5%
Other	2	1.4%
Years of work experience		
Below 5 years	89	69.0%
5 years and above	40	31.0%
Company size		
Big 4	3	2.1%
Large	2	1.4%
Medium	57	40.1%
Small	80	56.3%
Years of work in current firm		
5 or below	94	69.1%
5 or above	42	30.9%
Qualification		

	Bachelors	118	82.5%
	Masters	0	-
	Doctorate	0	-
	Others	25	17.5%
Professional qualification			
	MIA	26	45.6%
	MICPA	1	1.8%
	ACCA	19	33.3%
	CPA Australia	3	5.3%
	IIA	1	1.8%
	Etc.	7	12.3%
Gender			
	Male	38	26.4%
	Female	106	73.6%
Age			
	30 or below	113	78.5%
	31 - 40	23	16.0%
	41 - above	8	5.6%
Race			
	Malays	111	77.1%
	Chinese	31	21.5%
	Indian	1	0.7%
	Others	1	0.7%

Based on Table 1 above, summary statistics about the individual characteristics of respondents indicate that 53.5% are senior staff and above, the average years of work experience of respondents is less than 5 years with 56.3% of them working in a small sized firm. Most of the respondents have worked in the current firm for less than five years. The results reveal that 82.5% of the respondents get the highest educational qualification in bachelor’s degree and 45.6% of their professional qualification is as chartered accountants from the Malaysian Institute of Accountants (MIA). In addition, 73.6% of the respondents are female and the rest, 26.4% are male. The average age of respondents is 29 years of age, 77.1% of the respondents are Malays followed by 21.5% who are Chinese while 0.7% are Indian and other nationalities respectively. Therefore, the respondents can be seen as appropriately representing auditors in Malaysia.

To investigate the perception of auditors regarding their proactivity in assessing the business risk of fraud, the respondents were asked to answer 20 questions using a Likert-type rating scale: (5) strongly agree, (4) agree, (3) do not know, (2) disagree, and (1) strongly disagree. Table 2 below shows the results.

Table 2: The auditors' perception towards being proactive in assessing the business risk of fraud

No.		Mean	Percentage Rating 1 or 2	Percentage Rating 4 or 5
1	Actively search for illegal acts.	3.71	11.9%	58.7%
2	Work to uncover related party transactions.	3.58	13.4%	55.6%
3	Evaluate whether there is 'substantial doubt' about a company ability to continue as a viable concern.	3.96	2.1%	69.3%
4	Not inform management of possible illegal acts.	1.87	79.4%	10.6%
5	Assure that my findings are conveyed to the audit committee of the board of directors.	4.05	2.1%	76.1%
6	Furnish the SC with a copy of my report if management does not.	3.43	9.9%	44.7%
7	The MIA has no right to impose penalties upon auditor if reporting requirements are not met.	2.75	40.9%	31.7%
8	Assess management characteristic, to determine if they may lead to fraudulent financial reporting.	3.97	4.2%	76.2%
9	Include an industry analysis is to determine if industry conditions may lead to fraudulent financial reporting.	3.89	3.5%	72.7%
10	Examine factors such as pressure to obtain additional capital to determine if such pressures may lead to fraudulent financial reporting.	3.84	3.5%	69.0%
11	Determine if assets are susceptible to misappropriation.	4.03	1.4%	76.9%

12	Look for signs of financial stress among employees that may result in the misappropriation of assets by the employees.	3.76	9.8%	65.7%
13	Examine employee relations to discern whether the risk of asset misappropriation exists.	3.66	9.8%	55.2%
14	Investigate controls used by the company to prevent or detect the theft of assets.	4.24	2.1%	86.0%
15	Determine whether any discrepancies they uncover are "intentional" or "unintentional."	3.99	2.1%	70.4%
16	Focus only on intentional errors.	2.73	43.7%	24.7%
17	Question management, to determine how they deal with fraud risk.	3.99	2.8%	72.5%
18	Confirm more receivables, to be better able to detect fraud.	3.69	9.1%	59.4%
19	Verify more shipments and sales of goods, to be better able to detect fraud.	3.73	7.7%	62.9%
20	Visit factories more frequently, to be better able to detect fraud.	3.37	17.6%	40.1%
	Overall perceptions of the procedure followed to detect fraud.	**3.61**		

The results show the 20 constructs related to the procedure that need to be followed by auditors to search for fraud. The results are ranked based on the overall mean of each construct. The results show that investigating controls used by the company to prevent or detect the theft of assets is the most common procedure followed by the auditors to detect fraud (Q14). It has the highest overall mean (Q14, average = 4.24), with 86% recorded a rating of 4 or 5 (agree or strongly agree), followed by assuring that findings are conveyed to the audit committee of the board of directors (Q5, average = 4.05), with 76.1% recorded a rating of 4 or 5, and to determine if assets are susceptible to misappropriation (Q11, average = 4.03), with 76.9% recorded a rating of 4 or 5.

Table 2 also shows that the case study group of auditors did not inform management of possible illegal acts (Q4, average = 1.87), with 79.4% recorded a rating of 1 or 2 (disagree or strongly disagree) in addition to focusing only on intentional errors (Q16, average = 2.73), with 43.7% recorded a rating of 1 or 2 followed by the MIA has no right to impose penalties upon auditor if reporting requirements are not met (Q7, average = 2.75), with 40.8% recorded a rating of 1 or 2 are the least common procedures followed by auditors. The low overall mean for the three constructs revealed that the auditors are highly aware of their responsibility to inform the management of illegal acts that may well give importance due to both intentional and unintentional acts.

The results tabulated in Table 2 further show that the respondents agreed that the auditors evaluate whether there is 'substantial doubt' about a company's ability to continue as a viable concern (Q3, average greater than 3), with 69.3% recorded a rating of 4 or 5, followed by assessing management characteristic, to determine if the auditors may lead to fraudulent financial reporting (Q8, average greater than 3), with 76.2% recorded a rating of 4 or 5, and include an industry analysis is to determine if industry conditions may lead to fraudulent financial reporting (Q9, average greater than 3), with 72.7% recorded a rating of 4 or 5. Table 2 shows that most respondents said examining factors such as pressure to obtain additional capital to determine if such pressures may lead to fraudulent financial reporting (Q10, average greater than 3), with 69% recorded a rating of 4 or 5, and looking for signs of financial stress among employees that may result in the misappropriation of assets by the employees (Q12, average greater than 3), with 65.7% recorded a rating of 4 or 5. Further, the table shows that the respondents also agreed to determine whether any discrepancies they uncover are "intentional" or "unintentional" (Q15, average greater than 3), with 70.4% recorded a rating of 4 or 5 and question management, to determine how they deal with fraud risk (Q17, average greater than 3), with 72.5% recorded a rating of 4 or 5.

Table 2 shows that furnishing the SC with a copy of the report if management does not (Q6, average = 3.43) as well as visiting the factories more frequently would enable auditors to better detect fraud (Q20, average = 3.37) however these factors were not given due importance by auditors during the process of an audit, the overall mean of the two constructs are near 3 (do not know). The table above shows that the respondents have a neutral attitude in the search for illegal acts (Q1, average = 3.71) followed by working to uncover related party transactions (Q2, average = 3.58) and examined employee relations to discern whether the risk of asset misappropriation exists (Q13, average = 3.66). The results also show that the respondents say it is a neutral attitude to confirm more receivables, to be better able to detect fraud (Q18, average = 3.69) and verifying more shipments and sales of goods, to be better able to detect fraud (Q19, average = 3.73).

Table 2 also shows that the overall mean of the 20 constructs is 3.61, varying between 4.03 and 2.75 in a range of 1.28 scores, which show a positive attitude towards being proactive to search for fraud by auditors. The results of this study are inconsistent with a prior study by Farrell and Franco (1999) that found disagreement from CPAs towards their roles and responsibilities in searching for fraud. Perhaps, the rise of fraud cases around the world and the introduction of ISA240 have changed the perception of auditors towards their role in assessing the business risk of fraud, especially in Malaysia.

Table 3: Auditors' perceptions towards their role in preventing and detecting fraud

No.		Mean	Percentage Rating 1 or 2	Percentage Rating 4 or 5
1	I think that the auditing profession is moving in a more conservative direction.	3.43	16.2%	54.9%
2	I agree that auditors should act as 'police' or 'detective' when conducting an audit.	3.58	6.9%	13.9%
3	Auditors are responsible to work to uncover fraud and report such findings to the appropriate authorities.	3.70	11.9%	62.9%
4	Auditors are responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatements, whether caused by fraud or error.	4.31	0.7%	84.7%
5	The MIA should not be able to impose penalties if reporting requirements are not met.	2.82	34.0%	25.0%
6	ISA 240 considerably impacts the firm's effort recruit new clients.	3.22	14.6%	35.4%
7	ISA 240 impacts the firm's recruitment of students at colleges by significantly increasing the number of staff level personnel required.	3.37	9.0%	37.5%
	Overall perceptions towards auditors' role in preventing, detecting, and reporting fraud.	3.49		

The results tabulated in Table 3 above show that the respondents strongly agreed that auditors are responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatements, whether caused by fraud or error (Q4, average greater than 3), with 84.7% recorded a rating of 4 or 5 (strongly agree or agree), while they disagree with MIA should not be able to impose penalties if reporting requirements are not met (Q5, average less than 3), with 34% recorded a rating of 1 or 2 (strongly disagree or disagree).

Table 3 also shows that the respondents have a high awareness of their responsibilities to work to uncover fraud and report such findings to the appropriate authorities (Q3 average greater than 3), with 62.9% recording a rating of 4 or 5. However, the table shows that the respondents had a neutral attitude toward their auditing profession moving in a more conservative direction with the intention to prevent fraud (Q1, average = 3.43) or towards the idea that auditors should act as ‘police’ or a ‘detective’ when conducting an audit (Q2, average = 3.58). Respondents also have a neutral attitude towards ISA 240 considerably impacts the firm’s effort recruit new clients (Q6, average = 3.22) or the ISA 240 impacts the firm’s recruitment of students at colleges by significantly increasing the number of staff level personnel required (Q7, average = 3.37) where the overall mean of the constructs are near 3 (do not know).

Table 3 also shows that the overall mean of the 7 constructs is 3.49, varying between 4.31 and 2.82 in a range of 1.49 scores, which showed a positive attitude towards their role in prevention and detection of fraud.

Table 4: Additional Audit Procedures

No.		**Mean**
1	Confirm of receivables.	64.2%
2	Verify of the shipments of goods.	61.2%
3	Visit client location during the audit.	6.2 times
4	Increase audit fees.	27.2 %

In addition, as a result of IAS 240 which deals with the auditor’s responsibilities relating to fraud in an audit of financial statements, respondents agreed that a significant amount of additional audit procedures is required. Table 4 above shows that based on the respondents’ experience with their clients and the level of risk on an average engagement, most of them ask for confirmation from receivables in average of 64%, verify 61% of the shipments of goods, visit client location in average 6 times during the audit and increase audit fees by 27%.

Conclusion

Auditors, being an independent gatekeeper for the sound financial reporting practices, face real challenges to detect material misstatement due to fraud. This study investigates auditor perceptions towards their role in assessing business risks, detection and prevention of fraud. The study findings show that auditors have placed great emphasis on understanding and examination of the related internal controls. It is important to understand the controls that management has designed, implemented and maintained to prevent and detect fraud because it is useful in identifying fraud risk factors that may affect the auditor's risk assessment. Besides investigating fraudulent financial reporting, auditors have also shown high susceptibility in detecting misappropriation of physical assets. Both types of fraud are serious threats to compay health.

In conclusion, auditors perceive that they are highly responsible in detecting, preventing and reporting of fraud. This positive attitude perhaps, could be a good indicator as a future deterrent to the series of fraud and financial scandals in Malaysia. Thus, the findings from this study could be useful as a guide for external auditors in their fraud risk assessments. As well as with the private sector, the Malaysian government should also strengthen the system and its' implementation in curbing fraud at the national level. Apart from a legislative framework, the regulators in Malaysia could also place emphasis on commitment towards ethical conduct, which could lead to corporate financial sustainability (Abidin et al., 2017). Future research is needed to explore the link between ethical commitment and fraud prevention within the audit team setting. In order to combat fraud, a concerted effort must be exercised by all teams in the organization including management, external auditors, and all business stakeholders.

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