



## Fraud Examination: Investigation and Audit Procedures in the Perspective of International Studies

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### **Abstract**

Financial statement fraud still becomes a significant threat in an organization. In the other hand, the auditor is the one who is responsible to reveal financial statement fraud. Therefore, auditor has to understand technical steps to prevent and detect financial statement fraud. The aim of this research is to study research findings related to investigation and audit procedures in several countries. Moreover, this study also analyzes the appropriate ways to prevent and detect financial statement fraud based on the findings. The method used in this research is systematic literature review. An article search was limited in the last 5 years from 2017-2022 on indexed international journals. Based on the method, from the research objects, the location of the research was in South Africa, Nigeria, Ghana, Jordan, Middle East, Australia, Canada, Ireland, Israel, Vietnam and Indonesia. Moreover, research finding showed that the prevention and detection toward financial statement fraud could be done in some ways; they are: external audit, investigative audit and forensic accounting, the use of information and technology and also key audit matters.

**Keywords:** *Audit; Investigation; Systematic Literature Review; International Journals*

### **Introduction**

Financial statement is an important communication tool for parties outside management; that is to decrease information asymmetry between management and parties outside management. Independent audit by the third party increases qualified information from the management. (Dopuch & Simunic., 1980; Johnson, Khurana, & Reynolds, 2002; Watts & Zimmerman, 1986). The increase of qualified information is needed by the investors (Ronnen, 1996); the more qualified the information, the more relevant information given to take decisions. De Angelo (1981) stated that audit quality is the probability of auditor in finding mistakes on management statements, and explain the findings in audit report.

The need of audit is important for the public companies in Indonesia. We can see from Attachment to the Decision of Bapepam Chairman and LK No: Keputusan Kep-431/BL/2012 about Statement of Annual Financial Statement of Issuers or Public Companies; on point 2 (I) about the form and contents of the annual statement. This point explained the registered companies in Indonesian Stock

Exchange have to submit their annual financial statement which has been audited and publish the statement as a form of information disclosure and transparency. Financial statement that has been audited by the public accountant will increase the trust of the users towards the information in the financial statement (Bellostas, Brusca, & Moneva, 2006; Boynton & R. Kell, 2001). Audit opinion which was issued by the accountant, not only reflected that financial statement which was reported by the management was in accordance to accounting principles in Indonesia. However, it indicated that the financial statement was clear from any frauds (Ball & Zimmerman, 2007).

Auditor is the one who is responsible to reveal financial statement fraud (Krambia & Kapardis, 2002). It is related to Statement on Auditing Standard No. 99 which stated that auditor has to communicate findings in form of misstatement material caused by fraud to the management, audit committee, and other parties (AICPA, 2002). However, the possibility of litigation risk and conflict of interest caused hope gap in detecting the fraud (Hassink et al., 2010; Rustiarini et al., 2020). KAP that was involved in the fraud of financial statement indicated that financial statement with reasonable audit opinion does not guarantee free from fraud (Arnold et al., 2005). Some of those KAPs are KAP Purwantono, Sungkoro, and Surja (members of Ernst & Young) which were involved in the case of PT Hanson International (Asmara, 2019).

Financial statement fraud still becomes a significant threat in an organization. The survey of Association of Certified Fraud Examiners (ACFE) in 125 countries in the world showed that the most loss was caused by financial statement fraud (Examiners, 2020). In Indonesia, financial statement fraud is the third most disadvantage fraud with the total loss Rp 242.260.000.000 from 22 cases found (Chapter, 2020). The latest case related to financial statement fraud was done by PT Asuransi Jiwasraya which finally failed to pay the insurance. The problem of failed payment caused loss Rp 16, 8 trillions for the country (Liputan6.com, 2020). Longer time taken to reveal financial statement fraud, the bigger loss suffered (Examiners, 2020). The big loss caused by fraud and the problem of revealing the fraud by the auditor needs advanced detection of financial statement fraud which can be used by the users.

Auditor has to realize earlier about the probability of fraud depend on fraud signal. Auditor needs to understand the important signal in identifying the fraud because this signal is normally related to the strategy of hiding the fraud. Fraud perpetrator normally uses hiding strategy (concealment strategy) to hide fraud transaction. Auditor could find the fraud by observing the signal. For example, cash flow that showed negative cash flow from operation result or company inability to make cash from operation result when the company stated profit growth was probably an important signal that indicates fraud in financial statement. Some frauds were probably happened, for instance related to fictitious sales, revenue recognition, timing differences.

The aim of this research is to study research findings related to investigation and audit procedures in several countries. Moreover, this study also analyzes the appropriate ways to prevent and detect financial statement fraud based on the findings. In this study, we analysed manuscripts which were published from 2017 until 2022 and limit the research on international journals with good reputation. This research contributed on finding comprehensive review about audit procedure. The research is expected to add insight for the practitioners in formulating strategies and developing programs to prevent and detect fraud.

## ***Literature Review***

### **Financial Statement Fraud**

Fraud in financial statements is also known as management fraud (Kranacher, JR & Wells, 2011; Zimbleman & Albrecht, 2012). Another definition of financial statement fraud is when management uses accounting practices that are not in accordance with GAAP to change financial

reports and provide good company performance to stakeholders (Healy & Wahlen, 2016). Fraudulent financial reporting activities have had a rapidly increasing adverse impact on individual investors and global economic stability (Zhou & Kapoor, 2011). Financial statement fraud includes several financial reporting activities including fabricating fictitious income, low costs, and incorrect asset valuations (Omar et al., 2015). The reason for management to commit fraudulent financial reporting is to make the company look good and get what the company wants. Research on fraudulent financial reporting has been carried out several times in previous studies, including discussing the detection and prediction of fraudulent financial reporting. Beneish (1999) created a model for detecting manipulation of financial statements, while Spathis (2002) identified factors associated with fraudulent financial statements using financial ratios and compared a sample of non-fraudulent companies. Companies that manipulate financial reports for several years to increase revenue will tend to use fraud rather than earnings management to manipulate financial reports (Perols & Lougee, 2011). Financial statement fraud has a broad indirect impact on market participants by undermining the reliability of company financial statements and trust in financial markets (Perols & Lougee, 2011). Financial report fraud not only affects stakeholders but also endangers important officials. Like the Enron case, important officials such as accountants, company secretaries, and auditors were also investigated regarding the integrity of their work and responsibilities (Omar et al., 2015). Previous research stated that the reason for fraudulent financial reporting was one of the reasons for weak governance mechanisms (Lara et al., 2009). In addition, it was also disclosed that the remuneration of directors might be related to the occurrence of fraudulent financial statements (Erickson et al., 2004). Using an external audit of the big 5 firms has less likelihood of being involved in financial statement fraud (Lennox & Pittman, 2010). Companies that outsource internal audit services can increase the risk of fraudulent financial statements (P. Coram et al., 2008).

### **Audit Financial Report**

In auditing financial statements, the auditor gathers evidence and provides high assurance that the financial statements follow generally accepted accounting principles or other appropriate accounting principles (Nataliia, 2021). The audit searches for and verifies the accounting records and examines other evidence to support the financial statements. After obtaining an understanding of the company's internal controls, examining documents, observing assets, asking internal and external questions of the company, and carrying out other audit procedures, the audit will issue an audit report. The audit report contains the auditor's opinion regarding whether the financial statements have followed generally accepted accounting principles or not. The auditor gathers evidence on the income statement and demands evidence that reported sales actually occurred and were actually shipped to customers so that the costs and expenses recorded for the period have been recognized. If the evidence gathered is sufficient to support all significant assertions, the auditor concludes that the financial statements are presented in accordance with general accounting principles. In addition to external and internal auditors, audit committees play an essential role in corporate governance mechanisms to help detect fraud in financial statements (Goodwin and Kent, 2006). Auditing financial statements integrated with ICFR audits produce information about the quality of internal controls and the risk of material misstatement (Bhaskar et al., 2019). The value of financial statement audits is less researched and less theorized so there are geographical and methodological gaps between public sector audit research and the private sector where many public sector audit studies do not make reference to more detailed explanations about audit values.

### **Method**

This research was systematic literature review that analyzing articles from several countries which were published in the last 5 years (2017-2022). The articles analyzed were articles that were published in international journals with good reputation. The choice of the articles was based on the

relevancy of the title of the articles towards the aim of the research related to investigation procedure and audit. Systematic review is systematic approach based on the evidence to do literature review. In doing systematic literature review, it is important to limit research area and set protocols to identify, choose, study and synthesis the literature (Seuring & Müller, 2008). This article followed 5 steps for systematic literature review (Denyer & Tranfield, 2009); they are 1) stating research questions; 2) study identification; 3) study selection and evaluation; 4) analysis and synthesis; and 5) presentation of the results.

## ***Result and Discussion***

### **Result**

Based on literature review, the explanation related to audit procedure in several countries were found; they were:

#### **1. South Africa**

A. An innovative approach in combating economic crime using forensic accounting techniques (Pretoria, South Africa, 2020).

Forensic accounting was able to see numbers in the process of investigation to collect reliable information. This information could be used as the evidence in the court. The outline developed for forensic accounting was divided into 5 main aspects; they were preliminary survey, detailed investigation, comprehensive data analysis, report and expert witness. Forensic accounting was used to fight financial crime by financial institutions around the world. Through conceptual outline that was developed, detection, investigation, and fraud prosecution were expected to help the process of forensic accounting that was done.

B. A generic investigation process for South African commercial forensic practitioners (South Africa, 2020)

The aim of this research was to analyze critically and discuss identification of investigation process which would be followed by practitioners of commercial forensic in South Africa. Generally, investigation process was done in several steps. They were planning, collecting information, logic application, and reasoning execution. The design used in this research was cross-sectional. From this research, we can know that many respondents applied investigation process to resolve reputation risk and control the quality of investigation process. Moreover, by applying investigation process, it could increase productivity and give financial benefits. By sub-processes in formal investigation process, it could give benefits related to client acceptance, risk management procedure, and findings report.

#### **2. Nigeria**

A. The Role of Accounting in Conflicts Resolution (Nigeria, 2018)

Audit in electronic data processing environment does not change the function of audit. Nevertheless, the auditor also becomes computer expert using tools, software, and Computer Assisted Audit Techniques (CAAT) to do the work. Technology used to give independent opinion about how financial statement of an entity represents truth and fairness. Audit in electronic data processing environment maintained important steps as well as audit in manual system. Approach adopted by the auditor in electronic data processing environment includes audit planning, risk assessment, and testing. The result stated audit in electronic data processing environment has significant influence towards audit planning, audit risk assessment, and audit testing.

## B. Audit Procedures in an Electronic Data Processing Environment: A Study of Selected Audit Firms in Nigeria (Nigeria, 2018)

Accounting technology can be an important tool in making sure the accountability of public fund. This is mainly in identifying area that needs supervising in confirming the mistakes. However, although accounting technology is beneficial in the process of accountability, it is part of infrastructure of accountability in public organization. Basically, accounting technology could help in creating accountability but it cannot do all by itself. Accounting technology can give guidance about accountability but will not ensure the accountability of financial statement independently.

### 3. Ghana

Investigating the conditions under which internal auditing is carried out in selected local governments in the Central Region of Ghana (Ghana, 2022)

The aim of this research was to explain the importance of internal audit function in supporting organization management. Organization that used internal audit achieved valuable benefits effectively. Internal audit is a part of reformation to increase financial management in regional government area. In the other hands, internal audit which was done in Central Region of Ghana did not help to stop the fraud. The obstacle of the process of internal audit in Ghana was the incompetence of internal auditor, no sanctions for violators, inadequate resources, poor accomodation, and low incentives. Based on the result, we can conclude that quality improvement of internal auditor is needed to prevent amd detect fraud.

### 4. Jordan

Strengths and weaknesses of forensic accounting: an implication on the socio-economic development (Middle East Jordan, 2021)

When fraud increased and the auditor failed to detect fraud perpetrator, forensic accounting has got legitimation as a profession that propose a device to detect fraud perpretator. Things that can be done to increase the quality of forensic accounting are: (a) increasing professionalism of forensic accounting by establishing association; (b) preserving the quality service of forensic accounting by controlling the acknowledgement of profession of forensic accounting; (c) increasing the quality of forensic accounting study trough consistent curriculum development; and (d) increasing the output of the research which is relevant to forensic accounting.

### 5. Middle East

The Impact of Big Data Analytics on Audit Procedures: Evidence from the Middle East (Middle East, 2021)

It is important by audit profession to keep up the development about the use of Big Data Analysis (BDA) pro-actively in using lasetst technology and the impact towards audit procedure. This research showed that BDA impact on each audit process. BDA contributed on auditors understanding about internal and eksternal environment of the clients, which help them to decide to accept or continue the audit. By giving relevant information, BDA help the auditor to do analytical procedure, analysing clients risk and ynderstanding and evaluating internal controlling system. Therefore, auditors have to develop their ability to use BDA.

## 6. Australia, Canada, Ireland and South Africa

Forensic accounting: a blend of knowledge (Australia, Canada, Ireland, South Africa, 2017)

The increase of the needs of forensic accounting experts has required the application of formal approach for forensic accounting study. As an accounting tool, forensic accounting has to understand well about country accounting convention, accounting standard and relevant assumption. Accounting knowledge is important to analyze the historical financial statement effectively and the projection during business assessment by forensic accounting. As an audit tool, forensic accounting looked for mistakes that were recorded in purpose. The increase of fraud cases in business area required companies to have a forensic accountant. Therefore, professional accountant institution has to be able to increase creativity of forensic accounting so forensic accountant can apply audit skill, accounting, statistic, information technology, law and human behavior in the process of giving the service to the users. Moreover, the increase of the fraud based on the technology requires forensic accountant to utilize technology in giving the service. "Computer Check" allow forensic accountant to detect cyber crime.

## 7. Israel

The Impact Generated by the Key Audit Matters on the Application of Audit Procedures (Israel, 2019)

The work which was done by independent auditor is a form of autonomous from the organizational management interest, because the result of audit procedure applied is substantially complete, accurate and without any confusing interpretation. Research finding showed that independent auditor, after the reveal of Key Audit Matters paragraph, basically plan and do more audit procedures during field work on audited financial account. Moreover, it was also found that auditor become more sceptical and wiser in evaluating formalization procedure, trough the reveal of Key Audit Matters paragraph.

## 8. Vietnam

Audit Firm Size, Audit Fee, Audit Reputation and Audit Quality: The Case of Listed Companies in Vietnam (Vietnam, 2017)

External audit helped to decrease information asymmetry between the manager and the principal by giving credible financial statement. Teh result showed that companies that were audited by *Big 4* auditors generally do less profit management than the companies that were audited by non-*Big 4*. It means that *Big 4* auditors in Vietnam give better audit quality than non-*big 4* auditors. Better audit quality from *Big 4* auditors in Vietnam was also explained in the context of institutional in Vietnam that ther is a wide gap in the quality of control system to ensure good quality from *assurance* service between audit *Big 4* in Vietnam and audit companies in Vietnam. The result showed that the size of audit company significantly correspond negatively towards audit quality. The finding showed that smaller audit companies gave better audit quality than the bigger audit companies.

## 9. Indonesia

The Comprehensive Model of Whistle-Blowing, Forensic Audit, Audit Investigation, And Fraud Detection (Indonesia, 2018)

In this research, there were several points as the result of literature review; they are Agency Theory, Fraud, Fraud Triangle, Forensic Audit, and Investigation Audit. Agency Theory is a theory related to principal and agen. Agency problem occurs when principal and agen have different purpose, so agen acts to fill the needs by leaving the task given by principal. The second is fraud. Fraud is an action of

breaking the law in purpose to take advantage individually or in group. The third is fraud triangle. Fraud triangle is a tool to analyse 3 causes that someone do fraud; they are stress, chance and rasonality. Forensicaudit is a process to find evidence including certain steps by utilizing special investigation skill and the result can be used in the court. In order to make forensic audit and investigative audit effective, support factors are needed. It is whistleblowing. Based on the explanation, a research model can be purposed to detect fraud by using possessive method; that is forensic audit and investigative audit as methods to detect fraud effectively, and whistle blowing as a factor to support audit process.

## **Discussion**

Based on previous article study, we can conclude that prevention and detection of financial statement fraud can be done in some ways; they are:

### **1. External Audit**

External Audit is the third party outside that company that work based on work order letter and work under Public Accountant Office independently and objectively (Arief, 2016). *Certified Accounting Public* (CPA) or public accountant is also called as external auditor who responsible for published company financial statement inspection and give opinion regarding to the information. External audit can decrease the risk of applied profit management by management and increase the quality of accounting information regularly to br communicated to *stakeholders* (Manita et al., 2020). External audit has 2 roles in stock exchange. The first as an information provider and the second as an *insurance* (Hakim & Omri, 2010). External audit also focus on giving guarantee towards financial statement (Mat Zain et al., 2015).

In its system, external audit monitors important things that can help to align manager interest and share holders and decrease potential opportunistic behaviour of the manager. External audit can replace time and energy of the unternal auditor as well as the cost (Prawitt et al., 2011). External audit prepares report to board of directors about internal control of the company and other findings (Arief, 2016). Assessment of auditor quality is conditionally and depend on the competence and auditor independency (Nasrollah Ahadiat, 2011). External auditor investigates financial statement. Therefore, external auditor needs to get reasonable assurance that the job of internal auditor is sufficient by observing and studying the characteristic, time and investigation procedures (Arief, 2016).

### **2. Investigative Audit and Forensic Accounting**

The term “forensic investigation” refers to the use of technology or applied science in investigation and fact or evidence determination which is used in criminal justice or other process (Nortje & Bredenkamp, 2020). Investigation process is systematic and comprehensive activities by involving planning, collecting information, applying logic and reasonable reasoning. The final result of investigation is factual explanation about what is going on; something that has happened but become the latest issue that investigation has to reveal what is actually going on (Nortje & Bredenkamp, 2020). According to Singleton et al. (2006), the process on forensic accounting involves the application of financial skill and investigation mentality for unsolved problems and it is done in the context of evidence rule. Investigation process has to include skill application and investigation mentality for unsolved problems (Singleton et al., 2006).

The practice of forensic does not operate in an industry or certain investigation, but in different investigation and evaluated based on the competence (Alshurafat et al., 2021). Therefore, forensic practice has to follow the process to minimize the risk and ensure investigation success (Alshurafat et al., 2021). According to the previous study, there were some steps of investigation; they were inisiation,

planning, prosecution and reflection (Nortje & Bredenkamp, 2020). Forensic investigation must have a clear goal and must be done well according to the legislation. Then the result will be documented accurately. The practice of forensic give various services depend on assignment characteristic. Therefore, it is important to have investigation process which is planned well and managed actively by the employee with various levels of responsibilities.

The main goal of forensic accounting is to support someone, organization or government in one of challenging times by providing services for its existence (Howieson, 2018). Forensic accounting service is wide and including multidiscipline specialist. A forensic accountant plays an important role to detect, prevent and prosecute individual involved in crime activities such as financial misstatement, money laundry and identity skimming (Sanchez, 2012). Moreover, forensic accounting also act as an advisor who gives professional help to the attorney in the process of financial lawsuit litigation (Hegazy et al., 2017). Forensic accounting practitioners can take a big role in cyber crime such as credit card fraud, online drug sales, telecommunication fraud and computer skimming (Pearson & Singleton, 2008).

### 3. Utilisation of Information and Technology

Utilisation of information and technology in audit is mostly under data analysis. Auditing using the computer means involving evaluation directly toward computer process, software and hardware. Audit process using electronical data auditor to plan the audit process, access the risk of material misstatement, testing system to collect audit evidence to form independent opinion which means that auditor audits through the computer and using the computer (Efiang et al., 2018).

The use of analytical audit data can increase audit effectiveness, understanding entity operation and related risk, increasing potency in detecting fraud and misstatement as well as increasing communication with parties who are responsible for the audited entity management (Appelbaum et al., 2017). *Big data* give a chance to use new device in audit process. Moreover, previous study about the increase of mining data value as a tool for the audit of financial statement and as a main part of *e-discovery* in the lawsuit (Gray & Debrecey, 2014). Al-Hashedi dan Magalingam (2021) in their research found that there are 34 data mining techniques used to identify fraud in various financial applications.

Several researches regarding scope and efficiency of the use of information technology toward the audit of data analysis have been done. Salijeni et al., (2019) stated that there were bigger dependencies toward data analysis tool in audit process and concern whether the change gives substantial effect to audit characteristic and quality. Financial Reporting Council from the U.S (FRC 2017) observed that six biggest audit companies in England invested massively on the ability of *audit data analytics* (ADA) which encourage ADA ability. CPA Canada (2017) in the survey of 394 auditors of big, middle and small companies found out that the use of ADA were found in all main audit phases. International Public Accountant Office in Norway gave positive feedback towards the use of ADA and recommend further development. The latest research found the use of data analysis as a tool by the auditors for the clients and stakeholders. Auditors used audited data analysis were influenced by competition, clients/management and stakeholders and audit using more complex tools.

### 4. Key Audit Matters (KAM)

Entities are required to give further explanation about their audit opinion which is called *key audit matters* (KAM). *Key Audit Matters* (KAM) discuss the most significant audit scope that requires auditor attention. KAM report responds the request from the investors towards specific information of the company that is relevant and useful to take decision (Coram & Wang, 2021). Sirois et al., 2018 in



the study by Coram and Wang (2020) evaluated information gained using technology that direct to the users attention towards KAM disclosure and communicates in auditor report. According to the previous study, it was found that auditor who reveals KAM related to undetected misstatement would be considered irresponsible than others (Brasel et al., 2016).

KAM is able to decrease default assessment and does not have bad impact towards increased damage (Brown et al., 2020). KAM does not increase auditor requirement and considered as part of auditor responsibility. Moreover, the previous research about KAM limit auditor control in terms of financial statement so they consider that the responsibility is less for the auditor, but only in the scenario if the appropriate accounting standard applied (Gimbar et al., 2016). Auditors were more neglectful when revealing KAM which is related to undetected misstatements (Backof et al., 2018). One of the application of KAM is to decrease hope gap by increasing communicative audit report (Coram & Wang, 2021).

KAM ensure that annual financial statement of an entity is presented in reasonable material. The clear audit report concluded that reasonable presentation without material misstatement has been done (Segal, 2019). As a result of KAM, auditor will be required to give and strengthen the opinion and explain the findings (Cordo & Fülöp, 2015). *Key audit matters* is such a personalized language for specific entity situation audited (Kassem & Higson, 2015). Reformed audit report not only needs the reveal of *key audit matters*, but also explanation about the reason to identify them as *key audit matters* and the audit feedback procedure from the auditors. In other words, the process of professional consideration and competence of the auditor will be represented to the public as reference for the public in further understanding about audit process and evaluate the work of the auditors (Kassem & Higson, 2015).

## **Conclusion**

The method used in this research was systematic literature review. The articles studied took the articles which were published during the last 5 years (2017-2022) on indexed international journals. Based on the articles as the objects of the research, the location of the research was in South Africa, Nigeria, Ghana, Jordan, Middle East, Australia, Canada, Ireland, Israel, Vietnam and Indonesia. Research finding showed external audit, investigative audit and forensic accounting, the use of information and technology and also key audit matters were effective to prevent and detect the fraud.

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