Competency and Religiosity of Internal Auditor on the Fraud Mitigation in Indonesian and Malaysian Islamic Bank

Mohamad Heykal, Ismi Fathia Rachmi and Meiryani
Accounting Department, Faculty of Economics and Communication, Bina Nusantara University, Jakarta, 11480, Indonesia

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Abstract: In recent years, the occurrence of financial crimes have raised regulators' concern for the need to manage the consequences of these crimes. Particularly, in the context of the financial institution prior studies examining the relation between risk management, management support, religiosity and also internal auditor competence for fraud mitigation . This study is, therefore, made for mitigating fraud occurrence and mitigation in the Islamic banking that located in Malaysian and also Indonesia. From this research it can be concluded that risk management has a positive and significant effect on fraud mitigation. management support has a positive and significant impact on fraud mitigation at banks in Indonesia and Malaysia. Religiosity has a negative and insignificant effect on fraud mitigation in Islamic banks in Indonesia and Malaysia. Internal Auditor Competence has a positive effect on fraud mitigation but not significant, meaning that internal auditor competence does not always have a positive effect on fraud prevention in Islamic banking companies in Indonesia and Malaysia.

1 INTRODUCTION

Employees' fraudulent cases in such big corporations as Société Générale in 2008, UBS in 2011, Wells Fargo in 2016, and Punjab National Bank (PNB) in 2018 caused a loss of almost \$6.3 billion, \$2.3 billion, and \$189 million and \$1.7 billion worth of heavy fines, respectively. The Association of Certified Fraud Examiners (ACFE), the largest anti fraud institution in the world, reports fraud leave organizations in losses of almost 5 percent of their annual revenues. Computing the percentage into the 2009 Gross World Product (GWP) assessed results in a loss of more than \$2.9 trillion. Fraud cases burdened the 2012 global economy by the increasing loss to \$3.5 trillion, and the loss reached \$4 trillion in 2017. Fraud afflict not only conventional financial institutions but also Islamic financial institutions; Mandiri Syariah's 2012 fraud case, was an example. Mandiri Syariah is one of the largest Islamic banks in Indonesia, and it was the 2012 internal audit finding that its four officials working in Bogor branch were committed to criminal acts of disbursing fictitious financing. Such financial crime was ironic, for it was recorded by an Islamic banks whose sharia principles and religiosity are the foundation.

The fraud committed by officials of Islamic banks contradicts words of Allah SWT as stated in QS Al Baqarah verse 188: "And do not bring the affairs of your property (to) the judge by sipping it so that you can eat the property of others in a vanity even though you know". Indeed, QS Al Qasas verse 77 affirms fraud is an act to cause damages. Gold pawning fraud afflicting BRI Syariah and Mega Syariah were to name a few of flaws recorded by Islamic banks. Non-bank Islamic financial institutions were also in the grip of fraud as during 2014-2015, Jakarta and Kediri-based Islamic cooperative institutions were in the plight of fraudulent acts. Apart from Indonesia, Ihlas Finance House, a Turkey-based Special Finance House filed for bankruptcy in 2001 due to violation to prudent ethics. From 2007 to 2010, the Dubai Debt Crisis to involve financial malfeasance worth USD1 million whose USD500 million was incurred at Dubai Islamic Bank within one year was, and it is another example of Islamic bank's susceptibility to fraud. Islamic Bank of South Africa filed for bankruptcy in 1997 with debts worth of R50-R70 million. The lenient GCG made its officials in authority prone to fraud and ignored poor accounting system, thereby legitimizing the failure of sharia principles as the strong footing for Islamic bank.

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Violations to sharia principles within Islamic financial institutions implies that similar to their conventional peers, they are not immune to fraud. The lowest to the highest officials in authority abuse prudent ethics and leave fraud mitigation unimplemented. The fraud mitigation strengthens best practices of sharia principles, including to regulate the code of conduct of accountants working in Islamic financial institutions. Under sharia principles, Islamic financial institutions are well aware that they hold responsibility of their actions to the management, shareholders, and Allah Subhanahu Wa Ta'ala. Likewise, their accountants' awareness of sharia principles mitigate fraud. The obedience to sharia principles proves ones' religiosity as the professionals' religiosity is significant to the success of companies in taking fraud mitigation into practices. The research by Arwani claims within Islamic institutions, accountants' religiosity determine their self-consciousness about the importance of holding their jobs' responsibility to God. Thus, albeit the physical and metal pressures to perform internal auditing, they can thrive in demonstrating prudent ethics. The research by Pamungkas (Abdullah and Said, 2019) is one among other studies discussing religions and efforts to prevent fraud. Pamungkas elaborates the roles of religiosity and rationalization efforts in preventing accountants from committing to fraud. Likewise, whose research is relevant to Islamic banking and examines the significance of religiosity reasons characters and profiles of employees imply their potential for committing to fraud. Also, Pupung Purnamasari and Ima Amaliah (2019) argue religiosity is significant to fraud prevention.

2 LITERATURE REVIEW

2.1 Fraud Concept

Generally, the concept of fraud stems from Greek mythology narrating the personification of deceit, treachery, trickery and dishonesty embodying in one of the evils contained in Pandora's Box. The study of fraud involves auditing, accounting, criminology, management, and psychology. Because fraud is not a pure accounting notion, auditors and accountants consider fraud as a legal concept typically involving a criminal offense. For several decades, professionals and academicians have tried to better understanding on the causes of deviance behavior and find prevention and detection methods for curbing such behavior. These decades of research underline the popularity of "fraud examination" which combines two distinctive disciplines: accounting and criminology. Based on the definition from the Association of Certified Fraud Examiners (ACFE) cited in a book written by Tuanakotta, fraud is any of acts against the prevailing law and intentionally committed to specific purposes. Such acts are best define in any commitment to manipulation and providing inaccurate reports. Internal or external parties of an organization may benefit from such acts and harm others.

Islamic law states fraud as acts of cheating conducted intentionally, thereby causing misunderstanding (ghaban fahisy), imbalance or (gharar), and trickery. Islamic sharia prohibits such acts as mentioned in QS Al Baqarah verse 188 and QS Al Mutaffifin verses 1-6. Faith and belief are rarely considered when it comes to the discussion on cheating. Faith is hardwired consciousness determining humans' deeds and has profound impacts; humans' deeds of avoiding any fraud explains ones' adherence to the faith they hold.

Islamic law emphasizes that one holds responsibility of his job to himself and God, and the adherence to such principle is faith bound in religion and belief. Faith matters and may change over time as Abu al-Hasan al-Asy'ari, one of well-known scholars and the founder of the Ahlussunnah wal Jama'ah aqidah states one's faith experiences ups and down. Faith bears good deeds and keeps one from evil conducts, likewise good deeds strengthen one's faith. Surah Al-Qur'an Surah Al-Anfal verse 2 explains "Surely believers are only those who are thrilled when the name of Allah is called and increase their faith if the verses are recited, and to their Lord they are trust". The verse proves that one's activities may strengthen or weaken his faith.

2.2 Risk Management

The concept of risk management remains vague in light of its emphasis on how to manage uncertainty. Risk management received slight attention after the end of World War II in 1950, and it was applied for the purpose of protecting organizations against unexpected outcome. Although banks and other organizations fix achievable objectives, business environment undergoes continuous changes and faces various risks that might threaten the achievement of certain objectives. The high-profile scandals in the US of 2000 coupled with the financial crisis in 2008-2009 raised more concerns on how risk management can improve corporate governance. Risk management has become the agenda of both public and private sectors and developed into an area of interest among policy makers, academicians, managers, and professionals since then. Mainly, it explains about managing systematic and unsystematic risks.

2.3 Management Support

The top management in certain organizations, unfortunately, hold responsibility for employees' fraud regardless of its awareness of such misconducts. Indeed, organizations might unintentionally provide opportunities to such misconducts e.g., poor internal control giving rooms for internal or external parties who have motive to involve in opportunistic conducts. Thus, the crooks gains private benefit while leaving top management and certain organizations unaccountable and susceptible to risks. The rising bankruptcy caused by financial scandals, management has to cope with increasing pressures and take necessary procedures for managing stakeholders' interests. Furthermore, regulators have top management take more responsibilities for internal arrangements. For instance, Section 404 of Sarbanes-Oxley requires managers to monitor ICs and provide periodic reports containing assessments of the effective practices of IC structure.

2.4 Religiosity

Religiosity significantly influences attitudes and values as Abiola (2009) writes religion is a greater concept giving human a personal identity, and therefore humans must respond to religious dogmas established by the religion they embrace regardless of the consequences. Alleyne and Howard (2005) states religion, which is taken from the word religio, means something to regulate people's deeds, demand obedience from its believers, and bind its believers into certain community. Also, religiosity is a path and goal to achieve a sacred thing. One with strong religiosity as shown in his personal identity certainly has significant impacts on his surrounding environments. Al-Sawalqa (2012) explains people who excel in religious matters including their active engagement in religious gatherings build strong connection with others as well. Religiosity is sacred value to certain believers and powerfully shapes thought, emotion and characters of the believers. The studies of psychology and sociology acknowledges inextricable connection among religions, religiosity, and behavior of their believers. The study of psychology reasons that one's personality determines his religiosity and abilities.

2.5 Internal Auditor Competency

Competence is defined differently, but it basically takes in forms of skills fit with certain requirements. Competence is significant to one's performance and determines one's capability for achieving certain goals set by the organization. Both internal and external auditors are expected to master theory and excel the application whenever they carry out auditing duties with set guideline and standard. Based on the etymological definition, competency is defined as a set of skills, abilities, and authority. Meanwhile, English dictionary defines competence as skills shown by people having certain expertise or high knowledge in a particular subject, and therefore skills are obtained from learned knowledge and experiences. In the accounting discipline, Akra (2016) state that competence is an expertise sufficiently exploitable and applicable for performing audit process objectively. Meanwhile, Spencer defines competence as basic characteristics possessed by individuals, and such characteristics are needed by individual to meet certain criteria required by a position. Furthermore, Spencer argues competence basically consists of 5 characteristics: existence of motives, factors, self-concept, knowledge in a particular field, and skills in performing tasks.

3 RESEARCH METHODOLOGY

The study techniques employed in quantitative research include randomization, protocols, and highly structured and administrated survey with a limited range of predetermined responses to the sample of the study. Having learned other research using quantitative approach for studying Libya-based banks' governance on mitigating fraud, this research also applies quantitative approach for collecting data, analysis, accomplishing research's objectives, and formulating hypotheses. In addition, the quantitative approach has higher degrees of external validity than the qualitative approach. It means the result derived from quantitative approach is applicable to generalize other circumstance. Since this research applies quantitative approach, the design of its structured questionnaire is suitable for gathering information given by large number of participants. This research uses questionnaire survey to collect data, and therefore the data can be analyzed using such advanced and complex statistical software as SPSS or PLS.

H1: Risk Management has significant effects on fraud mitigation in Indonesian and Malaysian Islamic Banks.

H2: Management Support has significant effects on fraud mitigation in Indonesian and Malaysian Islamic banks.

H3: Religiosity has significant effects on fraud mitigation in Indonesian and Malaysian Islamic banks.

H4: Internal auditor competency has significant effects on fraud mitigation in Indonesian and Malaysian by Islamic banks.

4 DISCUSSION AND RESULT

This research applies qualitative approach to examine the relationship between different organizational governance and fraud mitigation. The objects of this research are the analysis of Indonesian and Malaysian Islamic banks. The primary data of this research is obtained through a survey where questionnaires are distributed to several Islamic banks in Indonesia and Malaysia.

The survey to involve 65 respondents results a sample consisting of 34 Indonesian respondents and 31 Malaysian respondents. Most of the respondents to constitute 31% of the total number are employees in private-owned banks, 23% of employees in state-owned banks (SOE), 20% of employees in joint-venture banks, 18% of employees in state-owned subsidiaries banks, and the remaining 8% of employees in foreign banks. Of note, this survey involves foreign banks whose 87% of the total number are banks with more than 500 employees and the remaining 13% to have less than 500 employees. Furthermore, 54% of the respondents are male employees in varied age ranges. Most of them or equal to 37% are in the 25-30 age range, 25% of the 31-40 age range, 23% of the 41-50 age range, and the remaining 16% male respondents categorized into different age ranges: those who are less than 25 years old and those who are more than 50 years old. The respondents are professionals with varied level of formal education. Most of the respondents earn their bachelor degree (S1) and master degree (S2). Of note, 86% of them have more than 5-year working experience in the banking sector; 62% of them are in the supervisory level; and 72% of them are in the executive level. The respondents' education, working experience, and official level prove their competency in succeeding the assessments and providing inputs related to the research's topic.

Analysis of the outer model is carried out to ensure that the measurement used is valid and reliable. This research uses three indicators namely convergent validity, Discriminant validity and unidimensionality to test the outer model. The data processed using smart PLS results in indicators as following R11, R12, R13, R14, R15, R16, R17, R18, R19, R110, R11, R12, R13, R14, R15, R16, R17, R18, R19, R22, IAC6, and FM7 with a factor loading value below 0.7. Thus, the 22 indicators should be removed from the model. Here are 26 indicators with a factor loading value higher than 0.7.

Table 1: Factor Loading Indicator.

Indicator	Fraud Mitigation (FM)	Religiosity (R)	Risk Management (RM)	Management Support (MS)	Internal Auditor Competence (IAC)
R20		0.890			
R21		0.942			
RM1			0.852		
RM2			0.905		
RM3			0.863		
RM4			0.899		
RM5			0.813		
RM6			0.933		
RM7			0.883		
MS1				0.849	
MS2				0.879	
MS3				0.880	
MS4				0.939	
MS5				0.856	
MS6				0.715	
IAC1					0.882
IAC2					0.889
IAC3					0.858
IAC4					0.763
IAC5					0.831
FM1	0.782				
FM2	0.886				
FM3	0.788				
FM4	0.862				
FM5	0.842				
FM6	0.757				

Table 2: Construct Reliability and Validity.

Variable	Cronbach Alpha	RhoA	Composite Reliability	AVE
Fraud Mitigation (FM)	0.901	0.912	0.927	0.717
Religiosity (R)	0.813	0.847	0.913	0.841
Risk Management (RM)	0.905	0.953	0.926	0.714
Management Support (MS)	0.925	0.932	0.942	0.732
Internal Auditor Competence (IAC)	0.950	0.954	0.960	0.801

Table 3: Discriminant Validity.

Variable	Fraud Mitigation (FM)	Religiosity (R)	Risk Management (RM)	Management Support (MS)	Internal Auditor Competence (IAC)
Fraud Mitigation (FM)	0.821				
Religiosity (R)	0.279	0.916			
Risk Management (RM)	0.373	0.332	0.846		
Management Support (MS)	0.813	0.249	0.366	0.856	
Internal Auditor Competence (IAC)	0.880	0.368	0.340	0.815	0.879

Inner model evaluation can be done by looking at the value of the coefficient of determination (R2), Predictive Relevance (Q2) and Goodness of Fit Index (GoF).

Table 4: Inner Model.

Construct	Fraud Mitigation (FM)
Coefficient of determination (R2)	**0.724**
Predictive Relevance (Q2)	**0.486**
Goodness Fit (GoF)	**0.637**

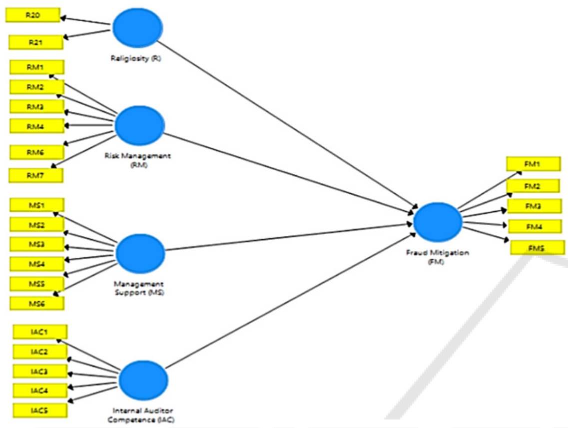

Figure 1: Hypothesis testing.

Table 5: Path Coefficient.

Variable	Fraud Mitigation (FM)
Religiosity (R)	-0,072
Risk Management (RM)	0.084
Management Support (MS)	0.269
Internal Auditor Competence (IAC)	0.606

Source : data is processed in 2020

From table 6 of the Path Coefficient, it is known that religiosity (R) is in the range from 0 to -1, meaning that Religiosity (R) has a negative effect on Fraud Mitigation (FM). Meanwhile, Risk Management (RM), Management Support (MS) and Internal Auditor Competence (IAC) have positive impacts on Fraud Mitigation (FM) because the path coefficient value is in the range 0 to 1 or positive.

Table 6: T Statistic.

Variable	Original Sample (O)	Sample Mean (M)	Standard Deviation (STERR)	T statistic O/STERR	P-value
Religiosity (R)	-0.072	-0.065	0.091	0.790	0.430
Risk Management (RM)	0.084	0.103	0.080	1.051	0,294
Management Support (MS)	0.269	0.266	0.127	2.111	0.035
Internal Auditor Competence (IAC)	0.606	0.599	0.134	4.517	0.000

The findings of this research explain that risk management (RM) has positive and significant effects on fraud mitigation, the findings support the research conducted by Bento & White (2018) and Bhasin (2015). Backed by other research' findings, this research strengthens the risk management (RM) theorized by Bierstaker et al (2006), Cresswell (2014); Gordon et al., (2009), and Hassan, (2009). The findings of this research indicate that management support (MS) has positive and significant effects on fraud mitigation applied in Indonesian and Malaysian Islamic banks. Also, the findings imply the top management plays an important role in mitigating fraud by means of auditing and support the findings of research by Holmes et al. (2002), Iffah et al. (2017), Kanagaretnam et al. (2015); Kutluk (2017); Law (2011); Rae et al. (2008).

The findings show that religiosity has negative and insignificant effects on fraud mitigation in Indonesian and Malaysian Islamic banks. In addition, the findings opposing the research's findings by Tack and Kposowa (2019) explain internal auditor competence (IAC) has positive effects on fraud mitigation, but such effects are insignificant. It means internal auditor competence does not necessarily have positive effects on fraud mitigation in Indonesian and Malaysian Islamic banks because such factor as risk management (RM) and the role of management have more significant effects on fraud mitigation.

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