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The influence of internal auditor towards fraud on mining companies: Indonesia stock exchange

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Abstract

Financial statement fraud (fraud) is more difficult to detect than the error because the employee or management is trying to hide the fraud. The purpose of this study was to examine the influence of internal auditor experience and internal control disclosure on fraud. The dependent variable in this study was fraud, while the independent variable was the internal auditor experience and internal control disclosure. The result showed that the internal auditor experience variable had no influence on fraud, while the internal control disclosure had an influence on fraud. The result of the study was expected to be useful as input and additional empirical evidence regarding the influence of the internal auditor experience.

Keywords: Fraud, Internal control disclosure, Internal auditor experience.

La influencia del auditor interno sobre el fraude en las compañías mineras que cotizan en la Bolsa de Indonesia

Resumen

El fraude en los estados financieros (fraude) es más difícil de detectar que el error porque el empleado o la gerencia están tratando de ocultar el fraude. El propósito de este estudio fue examinar la influencia de la experiencia del auditor interno y la divulgación del control interno sobre el fraude. La variable dependiente en este estudio fue el fraude, mientras que la variable independiente fue la experiencia del auditor interno y la divulgación del control interno. El resultado mostró que la variable de experiencia del auditor interno no tuvo

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influencia en el fraude, mientras que la divulgación del control interno tuvo influencia en el fraude. Se esperaba que el resultado del estudio fuera útil como entrada y evidencia empírica adicional con respecto a la influencia de la experiencia del auditor interno.

Palabras clave: Fraude, Divulgación de control interno, Experiencia del auditor interno.

1. INTRODUCTION

Every company needs the audited financial statement for the interest of funding and indicator of management success in managing the company. Every financial statement presented must be free from material misstatement. However, it did not rule out the possibility of financial statement disclosure containing material misstatement. The auditor is responsible for designing and carrying out his audit to obtain adequate confidence that the financial statement is free from material misstatement, including misstatement arising from fraud, but because of the high level of fraud complexity, internal auditor is expected to provide absolute assurance that misstatement due to fraud will detected (HAUGEN & ROGER SELIN 1999).

The determination of financial statement has been presented fairly or not, generally carried out through testing on a number of samples and not testing the entire population. Sampling testing can cause the risk of misstatement (ASTUTIK, HARYMAWAN & NASIH 2018).

Fraud is more difficult to detect and control than the error, because fraud usually involves concealment. The concealment is related to accounting record and related document, and this also relates to the response of fraud perpetrator of the auditor's request in carrying out the audit. If the auditor request the transaction evidence containing fraud, the perpetrator of the fraud will provide false information or incomplete information (ZAKARIA, NAWAWI & SALIN 2016).

The ability of internal auditor to mitigate fraud risk also depends on the sophistication of fraud perpetrators, the frequency of manipulation, the level of collusion and the size of seniority involved, because the higher the level of fraud collusion and the higher the level of management involved in this fraud, the more difficult it is to prevent fraud by internal auditor (ASTUTIK et al. 2018: LAUREANO ET AL, 2018).

Fraud cases that occur within the company are caused by the differences interests experienced by the principal (owner/ investor) and agent (manager or management who manages the entire company). Both the agent and the principal are utility maximizer, so the agent has not necessarily act in accordance with the principal's interests. The agent has an interests to maximizing the bonus he receives (ASNAWI, SUKOCO & FANANI 2018). This is contrary to the interests which owned from the principal’s point of view who try to maximize the return of the resources he has issued, so that it can lead to a conflict of interest between the agent and the principal which is commonly called a conflict of interest (QOMARIYAH 2019).

The irregularities in the financial statement come from human error and/ or can originate from fraud intentionally performed by certain parties. Internal auditor has to understand the patterns of fraud in order to prevent and take further action early. Internal auditor experience is needed to prevent fraud (DYCK, MORSE & ZINGALES 2010). Sufficient experience is needed to assess and prevent the possibility of early fraud by internal auditor.

The auditor's experience is positively related to the auditor's expertise. Janvrin in his study concluded that the possession of special knowledge is a determinant of expertise, the knowledge of an expert obtained through work experience for years. It shows that the achievement of an auditor's expertise must have the high knowledge in the audit field. This knowledge can be obtained from formal education that is expanded and enhanced with auditor training and audit practice experiences. Experience provides sufficient expertise and work skills (JANVRIN 2003).

Besides the experience of internal auditor, another factor that can be used as a tool to prevent fraud is the disclosure of internal control. Internal control is a policy process that has been created and implemented by the company to provide adequate confidence regarding the reliability of financial statement, compliance to the applicable laws and regulations, effectiveness and efficiency of operation and also to ensure the security of company assets (ZAKARIA ET AL. 2016).

2. METHODOLOGY

This study used explanatory approach and associative research. Based on the analysis and hypothesis model, the variable used in this study was the dependent variable (fraud), and the independent variable (the internal auditor experience and internal control disclosure).

Internal control disclosure was only in the form of expressions that convey whether the internal control process has been carried out properly. Internal control disclosure in this study was measured using the Internal Control Disclosure Index to replace the testing of Internal Control Disclosure (ICD) or disclosure of internal control. The Internal Control Disclosure Index is determined by observing the existence of information criteria specified in the company's annual report. If there was specified information criteria in the company's annual report, a score of 1 (ASTUTIK ET AL. 2018) will be given. If there was not specified information criteria included in the company's annual report, then it will be given a score of 0. Each of these criteria will be added up to obtain the company's overall score.

The type of data used in this study was the type of quantitative data. Secondary data used in this study was the financial statement and annual report of mining sector companies listed on the Indonesia Stock Exchange (IDX) within three years: 2013, 2014, and 2015. The data will be used was information on the list of listed mining sector companies on the Indonesia Stock Exchange during the period of 2013-2015 obtained from www.sahamok.com, and annual report of mining sector companies listed on the Indonesia Stock Exchange during the period of 2013-2015 obtained from www.idx.co. Id.

Data collection procedure used in this study was documentation. The secondary data in this study was financial statement and annual report of companies listed on the Indonesia Stock Exchange (IDX) obtained from the www.sahamok.com and www.idx.co.id sites, which then were selected based on the provision of the appropriate criteria and subsequently processed in the study.

The population of this study was all companies running in the mining sector which listed on the Indonesian Stock Exchange (IDX) with the study period from 2013 to 2015. The sample of this study was selected using the purposive sampling method, namely sampling technique with specific consideration (HARYMAWAN & NOWLAND 2016). The sample criteria of this study are in the table below:

Table 1: Sample Selection. (Processed by the author, 2017)

No.	**Sample Criteria**	**Year**		
		2013	**2014**	**2015**
1.	The mining companies listed on the IDX in the period of 2013-2015 continuously	39	40	41
2.	Mining companies are delisted so there are no financial and annual report on the IDX	(0)	(2)	(4)
3.	Mining companies that do not have completeness data in the financial statement and annual report	(12)	(10)	(7)
Total Sample		**27**	**30**	**30**

The study used logistic regression analysis to test 2 (two) hypotheses in the study with fraud as the dependent variable, the experience of internal auditor and the disclosure of internal control as an independent variable. The use of logistic regression analysis was caused by the dependent variable, namely fraud, was a dummy variable. The score of 1 (one) was given to a mining sector company that was indicated fraud and the score of 0 (zero) was given to a non-fraud mining sector company (ASTUTIK et al. 2018). Statistical calculation and hypothesis testing with logistic regression analysis were carried out with the help of SPSS version 24.

The hypothesis of 0 stated that the independent variable (x) has no effect on the response variable that was considered (in the population). The decision to accept hypothesis H0 and H1 was based on the criteria if the probability value (sig.) <A = 10%, then H0 was

rejected, and if the probability value (sig.)> A = 10%, then H0 was accepted.

This study used quantitative analysis technique. The analytical tool used to test the hypotheses was by using logistic regression because the dependent variable tested was a dummy variable that was a variable with a value of 1 or 0. Besides that reason, the logistic regression was used because the assumption of multivariate normal distribution was not fulfilled. The assumption of multivariate normal distribution cannot be fulfilled because the independent variable of the study was a mixture of continuous (metric) data and categorical (non-metric) data. That caused the change of function to be logistical and did not require the data normality assumption on the independent variable (SUKOCO, SUPRAYOGI & HIDAYATI 2018).

In the regression model feasibility test, Hosmer and Lemeshow's Goodness of Fit Test can be used. Hosmer and Lemeshow's Goodness of Fit Test tested the null hypothesis that empirical data matched the model (there was no difference between the model and the data so the model can be said to be fit). If the value of Hosmer and Lemeshow's Goodness of Fit Test was equal to or less than 0.05, it meant that the null hypothesis was rejected, which showed there was a significant difference between the model and its observation value so that the Hosmer and Lemeshow's Goodness of Fit Test was not good because the model cannot predict its observational value. If the statistical value of Hosme and Lemeshow's Goodness of

Fit Test was greater than 0.05, then the null hypothesis cannot be rejected and meant that the model was able to predict its observational value or the model can be accepted because it matched the observational data.

3. RESULTS and DISCUSSION

Table 2: Descriptive Analysis. (Processed Data 2017)

	N	Minimum	Maximum	Mean	Std. Deviation
FRAUD	87	0	1	.03	.184
Experience	87	0	38	14.64	9.137
PPI	87	.3889	1.0000	.788247	.1654726
Valid N (listwise)	87				

Table 1 explained the total of all companies that become the samples were 87 company sample data for the period of 2013-2015. Based on the table it was known that fraud has the lowest value of 0 (zero) and the highest value of 1 (one). Value of 0 (zero) and 1 (one) were the value used as a dummy variable, where the value of 0 (zero) was intended for non-fraud companies and the value of 1 (one) was intended for companies that were indicated fraud. The mean or average value of the fraud variable was 0.03 while the standard deviation was 0.184. This showed the distribution level of fraud variable data has a variation level of 613.33%, it meant that the data was heterogeneous or has the sample data characteristic that tend to be different for all companies. This showed that the sample data used mostly came from non-fraud mining companies. This provided evidence that *go- public* mining companies in Indonesia have tried to comply with the regulations of the Indonesia Stock Exchange, so that fraud was limited.

Table 3: Model Feasibility Tests. (Processed Data 2017)

Step	Chi-square	df	Sig.
1	3.884	7	.793

The result from Hosmer and Lemeshow's Goodness of Fit Test above showed that the chi-square value of 3.884 with a significance value of 0.793. The significance value was greater than α = 1% (0.01), which meant there was no difference between the prediction of the logistic regression model and the observation result. From these results it can be concluded that the logistic regression model used was feasible for further analysis because the model can predict the value of its observation.

Table 4: Overall Fit Model Test Result. (Processed Data 2017)

Condition	**-2 Log Likehood**	**Result**	**Explanation**
Block 0	26,099	Decrease -2 Log Likehood from block 0 to the block 1 as much as 4,836	Mo is feasible to use
Block 1	21,173		

In table 3 there was a block number 0 which indicated that the value of -2 Log Likelihood before the independent variable was entered into the model of 26.099 and block number 1 which indicated that the value of -2 Log Likelihood after the independent variable was entered into the model became 21,173. This showed that there was a decrease in Log Likelihood value of 4,836 from 26,099 to 21,173, so it can be concluded that the logistic regression model in this study overall was fit with the data. This showed that the logistic regression equation with the variable of internal auditor experience, fraud, internal control disclosure can be used.

Table 5: Determination Coefficient Test Result. (Processed Data 2017)

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	21.713[a]	.049	.190

Based on table 4, the Cox & Snell R Sqluare value was 0.049 with the Nagelkerke R Square value of 0.190. Nagelkerke R Square value was 0.190, it meant that fraud can be explained by the independent variable used in the study by 19%. Meanwhile, 81% of fraud was explained by other variables beyond those used in the study.

Table 6: Estimated Parameter and Interpretation.
(Processed Data 2017)

		B	Wald	Sig.	Exp(B)
Step 1a	Experience	-.086	1.173	.279	.917
	PPI	-5.853	3.166	.075	.003
	Constant	1.857	.617	.432	6.405

Based on the estimation result in table 5, the constant coefficient value of 1.857 was positive, which meant that if PAI, PPI, was constant or unchanging, then, the probability of fraud detection will increase by 86.49% due to other variables beyond those used in the study. The internal auditor experience variable coefficient (PAI) value of 0.086 was negative, which meant that if there was an increase in internal auditor experience of 1 (one) year, then the probability of fraud will decrease by 24.75% with the assumption that the value of the other independent variables were considered constant or unchanging.

The regression coefficient value of the internal control disclosure variable (PPI) of 8.338 was negative, which meant that if there was an increase in internal auditor experience of 1 (one) year, then the probability of fraud will decrease by 0.02% with the assumption that the value of the other independent variables were considered constant or unchanging.

Based on the logistic regression test result in table 5, the regression coefficient value of -0.086 was obtained with a significance value of 0.279. This figure showed a significance level greater than 0.1 so that it can be concluded that the internal auditor experience variable has no influence to the fraud. Regression coefficient value as much as 5.853 with a significance value of 0.075. That number showed that the significant level was smaller than 0.1, so it can be concluded that the internal control disclosure influenced the fraud.

Table 1 showed the internal auditor experience has the lowest value of 0 (null) and the highest of 38 (thirty eight). The lowest value of internal auditor experience was owned by several companies in the same year and the highest value of internal auditor experience was owned by PT. Energi Mega Persada, Tbk (ENRG) in 2015. The mean or average internal auditor experience variable was 14.64 while the standard deviation was 9.137. This showed that the data distribution level of internal auditor experience variable has a variation level of 62.41%, which meant that the data was homogeneous or has the sample data characteristic that tend to be the same for all samples of mining sector companies. It indicated that the mining company used as a research sample has a relatively similar policy in choosing internal auditor based on their experience.

Internal control disclosure (PPI) has the lowest value of 0.3889 and the highest value of 1.00. The lowest and highest values for internal control disclosure were owned by several companies in different years. The average disclosure of internal control that owned by all sample companies were 0.7882 with a standard deviation of 0.1654. This showed the distribution level of internal control disclosure data has a variation level of 20.99% which meant that the data was homogeneous or the sample data characteristic that tend to be the same for all mining sector companies used. It indicated that the tendency of mining sector companies try to disclose their internal control widely to give the public confidence in the process of control within the company.

The result showed that the internal auditor who has high experience was expected to be able to limit the management behavior to commit fraud in order to fulfill personal expectation such as getting bonuses and compensation from the resulting performance. The presence of an experienced internal auditor will provide high pressure on the company's management through more accurate supervision provided by the auditor with high experience (CARPENTER 2007). However, the presence of internal auditor with high experience cannot fully provide meaningful correction for suppressing management fraud (MOHAMMAD & SHAHWAN 2013). Internal auditor with high experience only has more value in the speed of performing supervision in internal control, not in the stages to prevent the occurrence of fraud committed by management which lead to the fraud committed by the company in general (HARYMAWAN & NOWLAND 2016). Inexperienced internal auditor was more careful in performing correction of the financial statement compared to more experienced internal auditor.

The result of this study also showed that internal control was an important thing that must be carried out by the company, where the efforts to performed good internal control can minimize the possibility of fraud committed by company management or minimize the possibility of company experienced financial distress. The efforts to performed good internal control can be conveyed to the principal through internal control disclosure which was in the company's financial statement (ZAKARIA ET AL. 2016). The more extensive the internal control disclosure, the more open the internal control process by the company, so that there was confidence in the supervision mechanism that occurred within the company (QOMARIYAH 2019).

This study was also in accordance with the study conducted by HAUGEN AND SELIN (1999) which explained that the more effective internal control function was needed to be able to mitigate fraud and corruption that often occurred. The data taken indicated that the strong internal control can help the company to deter, prevent, and detect fraud and corruption (HAUGEN & ROGER SELIN 1999).

Based on agency theory, the information gap that occurred between the principal and agent will cause an agency conflict within the company. The conflict will impact loss to one party and it can be possible that the company's operational activities not to run effectively and efficiently. To overcome this conflict, the company was required to disclose the internal control that was carried out as widely as possible (Verfaillie 2000). The extensive of internal control disclosure carried out by the company will provide information to the principal about how much internal control was carried out by the company (CARPENTER 2007).

This study still has many shortcomings. Limitation of this study was the number of samples used that was relatively small. This was due to the companies used were only companies in the mining sector. This study was also limited to the rules made by the Financial Services

Authority (OJK) as a reference in the company criteria to commit fraud or not. Limitation of this study was the number of samples used that was relatively small. The result of the study was expected to be useful as input and additional empirical evidence regarding the influence of the internal auditor experience and internal control disclosure to the fraud. Moreover, this study was expected to add and contribute to the science, especially related to the auditing.

4. CONCLUSION

Based on the study result discussion previously described, it can be concluded that the high experienced internal auditor was expected to be able to limit the management behavior to commit fraud in order to fulfill personal expectation such as getting bonuses and compensation from the resulting performance. The testing and analysis result prove that the internal control disclosure was an important thing that must be carried out by the company, where the efforts to performed the good internal control can minimize the possibility of fraud committed by company management. The efforts to performed the good internal control can be conveyed to the principal through internal control disclosure in the company's financial statement.

This study process does not involve participants, but using statistic and digital research that had been permitted by IDX as the object of the stud. The present study was carried out in accordance with the study principles. This study implemented the basic principle ethics of respect, beneficence, non-maleficence, and justice.

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