CHAPTER II

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

2.1. Capability to Detect Fraud

According to the Black Law Dictionary (2004) in Priantara (2013: 3), fraud is an act of deliberate deceiving or lying, a deception or means who are dishonest to take or lose money, property, legitimate rights belonging to people others either due to an action or the fatal impact of the act itself.

Fraud is a scope of counterfeiting and untruths characterized by premeditated or deliberate fraud (Islahuzzaman, 2020). Actions that can be categorized as fraud are those that in the identification of profit, found extra ordinary benefit for a particular group or an individual at the cost of several aggrieved parties as a result of unlawful acts and non-laws. An example is the presence of deliberate misstatements in financial statements, so that it can be classified as a misstatement arising from treatment undue to assets and as a form of fraud in reporting finance. Indications of fraud and corruption have undergone a transformation in the era of digital, so there is a need for the latest competencies to detect fraud and the growing potential for corruption.

Another definition according to the Black Law Dictionary (2004) in Priantara (2013:4) which relevant for fraud reporting (fraudulent reporting) i.e., conscious misrepresentation against a truth or concealment of material facts to influence others commit an act or act that harms him, usually a mistake. However, in some cases, especially intentional ones, may: misrepresentation/misrepresentation made

carelessly/without calculation and without being trusted to be correct to influence or cause others to act or do; and a loss arising from wrongdoing conscious presentation, concealment of material facts, or careless/unbiased presentation calculation for others to do or act to harm them.

Recent case of Ernst & Young's (EY) partner public accounting firm in Indonesia, namely KAP Purwantono, Suherman &; Surja,where they fail to provide accurate audit. The results of the audit of the telecommunications company were not supported by accurate data, namely in terms of renting more than 4 thousand cellular tower units. "However, EY's affiliate in Indonesia released an audit report with fair status without exception,", resulting in doubt of the auditor capabilities. In the case of PT Garuda Indonesia Tbk, shows a failure of auditor. There had been a violation of the Audit Standards (SA) – Professional Standards of Public Accountants (SPAP) SA 315, SA 500, and SA 560 carried out by Auditors from KAP which influenced the opinion of the Independent Auditor's Report (LAI), resulting in a question of the auditor compliance to audit standards.

Auditors need to possess a wide range of capabilities that collectively enhance their ability to detect fraud. These capabilities are fundamental in safeguarding the integrity of financial information and play a crucial role in maintaining transparency and accountability in organizations, thereby protecting the interests of stakeholders and the public.

1. Professional Skepticism is a cornerstone of an auditor's toolkit. It involves approaching the audit process with a critical mindset, a healthy dose of doubt, and a readiness to question the information presented. Auditors do

not take financial statements at face value; instead, they maintain professional skepticism, which enables them to uncover potential fraud or misstatements.

2. Risk Assessment is another key capability. Auditors assess the risks associated with each audit engagement, identifying areas of financial statements that are more susceptible to fraud or error. This understanding allows auditors to allocate their resources effectively and focus on high-risk areas.
3. Data Analytics is an increasingly important tool in the auditor's arsenal. Auditors use data analytics techniques and tools to analyse vast amounts of financial data. These analyses help identify irregular patterns or anomalies, which can be indicative of fraud. Data analytics can uncover irregular transactions, inconsistencies in financial statements, and hidden fraud schemes.
4. Forensic Techniques are employed when necessary to investigate financial irregularities and fraud. Auditors may use forensic methods to gather evidence, trace financial transactions, and identify individuals or entities involved in fraudulent activities. These techniques are crucial for conducting in-depth investigations and uncovering complex fraud schemes.
5. Industry Expertise is invaluable for auditors working in specific sectors. Industry-specific knowledge allows auditors to understand the unique challenges and risks associated with a particular industry. This expertise

helps auditors identify industry-specific red flags and potential fraud schemes that might be less evident to those without specialized knowledge.

Research conducted by Kalbers (2008) stated that working experience has a positive relation to the auditor job performance, In addition to this research, auditor's need to have intention to train and continuously developing their skills and staying updated with emerging fraud risks and techniques, auditors remain at the forefront of fraud detection and prevention especially in the era of digital transformation. The ever-evolving business landscape presents new challenges and risks, making these capabilities essential for auditors to adapt to changing circumstances. The key difference between the non-digital era and digital era in detecting fraud is that they used to be only using manual method and identifying hard file documents, while in the present auditors can use many types of software that can help with the works of auditing like ACL, IDEA, Excel. Auditors' dedication to honing their skills and knowledge ensures that they continue to play a vital role in maintaining trust and confidence in financial reporting, protecting the interests of stakeholders and the public trust. Their commitment to these capabilities reinforces the importance of vigilance and accountability in the corporate world.

2.2. Theory of Attributions

In his book "The Psychology of Interpersonal Relations," Fritz Heider developed attribution theory. According to Heider (1958), humans frequently behave like amateur scientists attempting to explain behaviour. Attribution theory is essentially a cause-and-effect examination of behaviour. Furthermore,

Attribution theory demonstrates that information received can influence perceptions and causality conclusions.

In assessing the behaviour of others, there is often a bias due to the tendency to underestimate the influence of external factors and overestimate internal factors. Attribution theory greatly enhances the understanding of others' perceptions and can help identify the causes of other people's behaviour. After understanding people's perceptions, the next step is to create shortcuts that will be used to simplify handling other people's behaviour.

In the context of detecting fraud, attribution theory can be relevant in understanding how auditors and investigators assess and attribute the causes of fraudulent activities. Because researchers will consider many factors that affect auditors' behaviour in fraud detection, attribution theory is used as a main theory. Factors within the individual auditor influence an auditor's competence in terms of their professional ethics. The auditor's working place is the example of external causes. The hardness of the task causes the auditor to be not consistent and irresponsible (Kelley and Michela, 1980).

According to Lubis (2014), There are three behavioural roles what shapes a person's attitude, namely distinctiveness, consensus, and consistency. (Distinctiveness) refers to whether a person acts the same in various issues. Consensus considers how the behaviour of an individual compared to other individuals in the situation same. While consistency refers to an action that is repeated all the time.

Internal auditors who have different competencies will usually have differences in carrying out their audit duties. In this study, internal auditors who have more knowledge and experience, then will have the ability to understand the effectiveness of control better internals. Differences in competence will also lead to differences in assessing fraud risk and capability to detect fraud. This is in accordance with the consensus aspect.

2.3. Previous Research

Previous studies using independent technological development variables, compliance, ethical judgment, and working experience to be tested on Auditor's capability to detect fraud have been conducted but have never been studied simultaneously. Nasution and Fitriany (2013) uses variables of workload, audit experience, and personality type to determine the auditor's capability to detect fraud, as well as professional skepticism as a mediating variable. The results of the study were conducted on the external auditor in Jakarta showed that workload, audit experience, and personality type influence professional skepticism. In addition, workload variables, audit experience and professional skepticism affects the capability to detect fraud, while the personality type variable has no influence on the variable capability to detect fraud.

Based on research conduct by Molina & Wulandari, S. (2018) working experience, and time pressure has positive effect to Auditor's capability in detecting fraud, while workload has negative effect to Auditor's capability in detecting fraud. This research is supported by Faradilla et al., (2021) this research uses variables of

audit experience, independence, and professional skepticism to determine the effect on fraud detection. The results of the study conducted on 90 Auditors showed that audit experience has positive effect and not significant on fraud detection, independence has positive effect and significant on fraud detection, and lastly Professional Skepticism has negative effect and not significant on fraud detection. However, results in another study conducted by Muntasir & Maryasih, L. (2021) working experience has no partial effect on Auditor's Capability in detecting fraud.

Table 2.1

Previous Research Table

Researcher	Variable	Subject	Result
Patel, C., Harrison, G. L., McKinnon, J. L. (2002) Cultural Influences on Judgments of Professional Accountants in Auditor–Client Conflict Resolution	Auditor–Client Conflict Resolution (Y) Professional Judgment (X1) Cultural Influence (Mediation)	Australian, Indian and Chinese Malaysian professional accountants	1. Australian respondents were less likely to accede to clients than Indian and Chinese Malaysian respondents held regardless of whether the test question was phrased in the form of the respondent's or their colleagues' likely behaviour. 2. Australian accountants would see the decision of the auditor in the scenario as

			more unethical than Indian and Chinese Malaysian accountants, and hence be less accepting of acceding to clients in conflict situations.
Kalbers, L. P. (2008) The Impact of Exercised Responsibility, Experience, Autonomy, and Role Ambiguity on Job Performance in Public Accounting	Job Performance in Public Accounting (Y) Exercised Responsibility (X1) Experience (X2) Autonomy (X3) Role Ambiguity (X4)	Partners at five regional and five national accounting firms, located in and around a large midwestern city in the US	1. Exercised Responsibility has positive relation to Job Performance. 2. Experience has positive relation to Exercised Responsibility. 3. Experience has negative relation to Job Performance. 4. Experience has positive relation to Autonomy. 5. Exercised Responsibility has positive relation to Autonomy. 6. Autonomy has positive relation to Job Performance. 7. Experience has no significant relation to Role Ambiguity. 8. Exercised Responsibility has negative relation to Role Ambiguity. 9. Autonomy has negative

			relation to Role Ambiguity. 10. Role Ambiguity has negative relation to Job Performance.
Nasution & Fitriany (2013) Pengaruh Beban Kerja, Pengalaman Audit, dan Tipe Kepribadian Terhadap Skeptisme Profesional dan Kemampuan Auditor dalam Mendeteksi Kecurangan	Auditor's Capability to detect fraud (Y) Workload (X1) Audit Experience (X2) Personality type (X3) Professional Skepticism (Mediation)	External Auditor in Jakarta	1. Workload has significant effect on Auditor's capability to detect fraud. 2. Audit Experience has significant effect on Auditor's capability to detect fraud. 3. Personality type has no effect on Auditor's capability to detect fraud. 4. Professional Skepticism has significant effect on Auditor's capability to detect fraud.
Payne, E. A. & Curtis, M. B. (2016) Factors Associated with Auditors' Intention to Train on Optional Technology	Optional Technology (Y) Intention to Train (X1)		1. Intentions to train are greater when training is available earlier. 2. Intentions to train are influenced by various factors such as intentions to use the technology, ease of use, confidence in memory, task

			experience, gender, and position in the firm.
Molina & Wulandari, S. (2018) Pengaruh Pengalaman, Beban Kerja Dan Tekanan Waktu Terhadap Kemampuan Auditor Dalam Mendeteksi Kecurangan	Auditor's Capability in detecting fraud (Y) Working Experience (X1) Workload (X2) Time Pressure (X3)	External Auditor at Public Accounting Firm in Jakarta	1. Working experience has positive effect to Auditor's capability in detecting fraud. 2. Workload has negative effect to Auditor's capability in detecting fraud. 3. Time pressure has positive effect to Auditor's capability in detecting fraud.
Muntasir & Maryasih, L. (2021) Pengaruh Independensi, Pengalaman, Skeptisme Profesional Auditor Dan Kompetensi Terhadap Kemampuan Auditor Dalam Mendeteksi Kecurangan (Studi Pada Inspektorat Aceh)	Auditor's Capability to detect fraud (Y) Independence (X1) Working Experience (X2) Professional Skepticism (X3) Competence (X4)	48 Auditors Working in the Aceh Provincial Inspectorate.	1. Independence partially affects the Auditor's Capability in detecting fraud. 2. Working experience has no partial effect on Auditor's capability in detecting fraud. 3. Professional Skepticism partially affects Auditor's capability to detect fraud. 4. Competence partially affects the Auditor's capability in detecting fraud.
Faradilla, E., Tjan, J., Pramukti, A. (2021) Pengaruh Pengalaman	Fraud Detection (Y) Audit Experience (X1) Independence	90 Auditors	1. Audit experience has positive effect and not

Auditor, Independensi, Dan Skeptisme Profesional Auditor Terhadap Pendeteksian Kecurangan	(X2) Professional Skepticism (X3)		significant on fraud detection. 2. Independence has positive effect and significant on fraud detection. 3. Professional Skepticism has negative effect and not significant on fraud detection.

2.4. Hypothesis Development

2.4.1. Technological Development

Technological development has brought about significant transformation in various industries, and the field of auditing is no exception. Auditors play a vital role in ensuring the accuracy and reliability of financial information, and the emergence of new technologies has greatly improved their ability to detect fraud. With data analytics, AI, continuous monitoring, blockchain, and specialized software, auditors are better equipped to identify and address fraudulent activities. However, auditing in an IT environment presents several unique challenges and issues that auditors need to address (Bierstaker et al., 2013). These challenges stem from the rapidly evolving nature of technology, the complexity of IT systems, and the increasing dependence of organizations on digital infrastructure. Some common problems that can occur when auditing in an IT environment include rapid technological changes, cybersecurity threats, complexity, data privacy and compliance, cost of it auditing, etc.

Technological advancements have revolutionized the auditing profession by introducing tools and systems that automate many aspects of the audit process. Key developments include data analytics, artificial intelligence (AI), blockchain technology, and cloud computing. These technologies have transformed how auditors collect, analyze, and interpret data, leading to more comprehensive and efficient audits (Brown-Liburd et al., 2015).

The adoption of advanced technologies in auditing has expanded the scope of auditor responsibilities. Auditors must not only possess traditional accounting and auditing skills but also be proficient in using technological tools and understanding their implications for the audit process (Byrnes et al., 2018). Technological development imposes new responsibilities on auditors to stay updated with technological advancements, maintain ethical standards, and enhance their risk assessment and fraud detection capabilities. By understanding the relationship between technological development and auditor responsibilities, auditors can leverage technology to improve the quality of their audits and better serve their clients and stakeholders (Earley, 2015).

It cannot be denied that technological development has impacted the auditor's capability to detect fraud. Previous research conducted by Al-Fehaid & Higson (2008) stated that the problems encountered by the external auditors related to the unsuitability of clients' accounting software and the lack of competence of clients' staff in dealing with IT-based accounting systems. There were also perceived weaknesses of clients' internal control systems. Therefore, it could be concluded that the increasing use of IT by their clients has complicated the work of the external auditor. However, despite the new

challenges posed by the digital age, the impact positive. As technology continues to evolve, so too will the auditors' capability for fraud detection, providing essential safeguards against financial misconduct and promoting trust and transparency in the world of finance. In the process of digital transformation, IT audits must constantly improve and adjust to complex environments (Alles, 2015). To address these challenges, auditors in IT environments often require specialized training, certifications, and a deep understanding of both technology and business processes (Bierstaker et al., 2013). They also need to collaborate closely with IT professionals and management to ensure effective risk management and compliance in an ever-evolving digital landscape.

Ha1: Technological development has a positive impact on auditor's capability to detect fraud.

2.4.2. Compliance

The auditing standards determined by the Indonesian Institute of Accountants require the auditor to express whether in his opinion the reported financial statements comply with generally accepted accounting principles in Indonesia. This aims to indicate if there is an inconsistency in the application of accounting principles in the preparation of financial statements for the current period compared to the application of accounting principles in the previous period (Indonesian Institute of Accountants, 2001). Auditing standards are a guideline to support auditors in fulfilling their professional responsibilities when auditing historical financial statements (Arens, 2008).

Auditor compliance with audit standards is a critical factor in their capability to detect fraud. Audit standards provide a structured framework and guidelines for auditors to follow when conducting their examinations (AICPA, 2002). While audit standards primarily focus on ensuring the accuracy and completeness of financial statements, they indirectly influence the auditor's ability to detect fraud. Research by Rezaee (2005) emphasizes that strict adherence to audit standards improves the likelihood of identifying material misstatements and potential fraudulent activities. Audit standards require auditors to assess fraud risks and evaluate internal controls, which are essential procedures in the era of digital transformation.

Auditor compliance with audit standards sets the baseline for conducting an audit, which includes assessing fraud risks and evaluating internal controls (Public Company Accounting Oversight Board, 2007). Auditor needs to maintain the use of technology to detect fraud is inline with the legal standard. Detecting fraud requires auditors to exercise professional scepticism, employ a range of auditing techniques, and use their experience and judgment to identify indicators of fraud beyond what is outlined in the standards. According to Asare and Wright (2004), auditors who strictly follow audit standards are more likely to detect fraudulent activities due to their rigorous assessment procedures and professional skepticism.

Furthermore, the complexity of fraud detection in the digital age necessitates that auditors adhere to established standards to effectively navigate the challenges posed by sophisticated fraud schemes. A study by Brazel et al. (2014) found that auditors' compliance with standards, coupled with their use of

technology and professional judgment, significantly enhances their ability to detect fraud. This underscores the importance of compliance not only for maintaining audit quality but also for improving fraud detection capabilities.

Ha2: Compliance has a positive impact on auditor's capability to detect fraud.

2.4.3. Ethical Judgment

Ethical judgment is a fundamental aspect of the auditor's role in ensuring the integrity of financial reporting. Auditors are responsible for providing an independent and objective assessment of an organization's financial statements. Ethical judgment is not just a theoretical concept but a practical necessity for auditors when it comes to detecting and addressing fraud. It underpins the principles of professional skepticism, independence, and objectivity that are vital in the audit process. Ethical auditors are entrusted with the responsibility of providing assurance to stakeholders that financial statements are accurate and reliable. Their commitment to ethical principles safeguards the public interest, strengthens market stability, and fosters confidence in financial markets (ICAEW, 2018). In an era where transparency and accountability are paramount, ethical judgment remains a cornerstone of the auditing profession. Ensuring the privacy of clients are critical to building trust in the technology, protecting individuals' rights, and ensuring that the benefits of fraud prevention are achieved without causing undue harm.

Arsendy (2017), the results of this study indicate that auditors have high skepticism professionals will be better able to detect fraud and vice versa if an

auditor who have low professional skepticism will be less able to detect cheating. Prasetyo's (2015) research shows the higher the professional skepticism owned by an auditor, the higher the ability of an auditor in detect fraud. However, research conducted by Faradilla (2021) shows that the Auditor's Professional Skepticism negatively influences and insignificant to Fraud Detection.

The result of previous research have different opinion about Auditor's ethical judgment, whether ethical judgment has positive or negative impacts their capability to detect fraud. Generally, auditors who lack ethical judgment or succumb to ethical lapses may compromise their ability to detect fraud. They might be less inclined to challenge management's representations, ignore red flags, or fail to report their findings when they suspect fraud (Tepalagul & Lin, 2015). Such behaviour can have serious consequences for both the auditor's professional reputation and the financial well-being of stakeholders.

The disparity in research findings highlights the complex nature of ethical judgment in auditing. While some studies suggest a positive relationship between ethical judgment and fraud detection, others indicate potential negative impacts, suggesting that the context and individual auditor's characteristics may play significant roles.

Cohen and Simnett (2015) highlight that auditors who uphold high ethical standards are more diligent in their work, more likely to identify inconsistencies, and more committed to reporting fraudulent activities. Additionally, Abdolmohammadi and Boss (2010) emphasize that ethical training and

awareness can significantly enhance auditors' ethical judgment, leading to improved fraud detection capabilities.

Ethical judgment encompasses an auditor's ability to remain unbiased and skeptical, maintain independence, and adhere to professional standards, even under pressure. By integrating ethical considerations into their audit processes, auditors can better navigate the complexities of modern financial environments and effectively identify and address fraudulent activities.

Ha3: Ethical judgment has a positive impact on auditor's capability to detect fraud.

2.4.4. Working Experience

Working experience is the auditor's experience in conducting report checks finances both in terms of length of time, as well as the number of assignments that have been done. And in this research researchers focus more on working experience as the intention of the auditor to train and the auditor's competence. Experience is an important consideration for hiring and promotion. The concept of experience includes time in a job or an organization, the amount of work (for example, repetition of tasks), and the type of work (Quinones et al., 1995).

Anggriawan (2014) found that work experience positively affects an auditor's capability to detect fraud. This suggests that more experienced auditors possess the necessary skills and knowledge to identify fraudulent activities effectively. Noviyani and Bandi (2002) corroborate this, stating that experienced

auditors have a deeper understanding of errors and fraud, which enhances their fraud detection capabilities compared to less experienced auditors.

In the digital era, auditors face new challenges that require specialized training and certifications, particularly in IT environments. Auditors must have a profound understanding of both technology and business processes to navigate the complexities of modern auditing (Jenkins et al., 2018). This is especially crucial as technology continues to evolve rapidly, introducing new risks and opportunities in the audit process.

Research by Knechel et al. (2013) highlights that experienced auditors are better equipped to handle complex audit situations and make informed judgments about potential fraud risks. Additionally, Maksymov et al. (2016) found that auditors with extensive experience are more adept at identifying and responding to fraud indicators, leveraging their accumulated knowledge and practical insights.

The importance of experience in enhancing an auditor's ability to detect fraud is further supported by Glover et al. (2015), who emphasize that experienced auditors are more likely to exhibit professional skepticism and possess the analytical skills required to uncover fraudulent activities. Their familiarity with various fraud schemes and internal controls enables them to conduct more thorough and effective audits.

In summary, working experience significantly contributes to an auditor's capability to detect fraud. By continuously gaining experience and undergoing

relevant training, auditors can improve their competence and remain vigilant in identifying and addressing fraudulent activities, particularly in the digital era.

Ha4: Working experience has a positive impact on auditor's capability to detect fraud.