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Forensic Accounting and Fraud: Capability and Competence Requirements in Malaysia

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The 2011 Global Economic Crime Survey instituted by PricewaterhouseCoopers confirms the economic crime in Malaysia to be on the increase and, therefore, requires immediate attention to stem the tides. In anticipation of the challenges occasioned due to a shift from the modified cash basis to the accrual basis of accounting, the Malaysian State's determination to move from a developing nation to a developed nation and to be ranked among the first 10 in 2020, this paper presents the need for forensic accountant and auditor capability (i.e., mindset and skills) on forensic accountant and auditor competence (i.e., task performance fraud risk assessment (TPFRA)) in the Malaysian public sector. It also draws the attention of the users of public sector accountants and auditors to the understanding of fraud mechanisms and how to deal with fraudsters. The population of this study comprised the accountants and auditors in the office of the Accountant General and Auditor General of Malaysia. The objective of this paper is to investigate the competence requirements of accountants and auditors in the effective and efficient utilization of capability requirements, which have the potentials to usher in the best global practices in fighting fraud in the Malaysian public sector.

Keywords: forensic accounting, auditing, fraud, fraud risk assessment, mindset, skills, Malaysia

Introduction

The 2011 Global Economic Crime Survey published by PricewaterhouseCoopers (PwC) International Limited confirms that the economic crime continues to be on the upsurge in Malaysia. Specifically, theft and asset misappropriation become the most common types of economic crime, followed by bribery, corruption, and accounting fraud (PwC, 2011).

To buttress, the Executive Director of PwC in Malaysia asserts that the fraud against governments or state-owned enterprises increased by 29% in comparison with the 2009 figure, that is, the 44% reported in the 2011 survey represents a 57% increase over the 28% reported in the 2009 survey. Mostly affected sectors as a target for crime are hospitality and leisure and financial services (PwC, 2011).

Similarly, the red flags emanating from the Auditor General's 2011 Audit Report on the government financial statements indicate the overspending of allocated budgets and public officials indulge in wasteful

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spending (Santiago, 2012).

The huge loss due to fraud in the public sector environment has a direct impact on the development of infrastructure, facilities, utilities, and building the public trust. It behooves management in any government ministry, department, and agency to design procedures primarily meant to detect and prevent fraud from internal and external activities that may be difficult for any fraud perpetrator to penetrate. No country is immune to fraud, since it can come in several ways, either through internal or external connivance.

The internal control framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) recognizes the responsibility of the management of any organization in the public sector environment, which faces both external and internal risks. COSO, therefore, suggests putting proper measures of control in place to reinforce management activities and adopting the best strategy to fraud detection, prevention and deterrent, and response (COSO, 2011).

Based on this development and for the purpose of ensuring sound systems of accounting and auditing, this study examines fraud and forensic accounting with a special emphasis on capability and competence of accountants and auditors in the Malaysian public sector.

Granting the most important transformation of the accounting and auditing systems in the history of Malaysian public sector through a shift from the modified cash basis of accounting to the accrual basis of accounting (full attainment, 2015) in accordance with constitutional, institutional, and regulatory frameworks, there is justification to create awareness among the public sector accountants and auditors of the understanding of the fraud mechanisms. These frameworks include the International Public Sector Accounting Standards (IPSAS, International Federation of Accountants [IFAC], 2012), International Financial Reporting Standards (IFRS), Federal Constitutions (revised 1972) (Federal Constitution of Malaysia [FCM], 1972), Financial Procedures Act 1957 (revised 1972) (Ministry of Finance, 1957), Audit Act 1957 (revised 1972) (Malaysian National Audit Department, 1957), Treasury Instructions and Circulars, Accountant General's Department Circulars, and Government Accounting Standards.

Prior research has shown that no government at any level is immune from the impact of fraud (National Fraud Authority Annual Fraud Indicator, UK [NFAAFI], 2011). There must be a need for reforms in the capability and competence of those responsible for accounting matters, systems, processes, and procedures relating to federal and state government accounts (Popoola, Ahmad, Samsudin, & Yussof, 2013; Selamah, 2011; Institute of Chartered Accountants of Nigeria [ICAN], 2009; Messier, Glover, & Prawitt, 2006).

The move from auditing and investigation to forensic accounting offers accountants and auditors, in the public sector, the great opportunities to pull themselves out from their somewhat dull and bookkeeping background. More importantly, this brings an enhancement to their public legitimacy through the acquisition of a new mindset and skills of forensic accounting specialized knowledge (Durkin & Ueltzen, 2009; Davis, Farrell, & Ogilby, 2010; American Institute of Certified Public Accountants [AICPA], 2008; DiGabriele, 2008; Mul & Molenaar, 2001; Pollitt, Gierre, Lonsdale, Mul, Summa, & Waerness, 1999).

Forensic accountants came into existence as indispensable allies in the fight against frauds and economic crimes. Forensic accountants with appropriate education, training, and experience can provide assistance to other agencies and departments charged with the responsibility of enforcement, regulation and recovery, audit committees, and financial statement audit teams to enhance their functions and responsibilities (Popoola, Ahmad, Samsudin, & Yussof, 2013).

In order to restore public trust in the auditing profession as a result of the scandals involving Enron, Adelphia, and others (Sarbanes-Oxley Act, Doering, 2002), the public accounting oversight board standing advisory group recognizes the issues facing the financial statement auditors in relation to fraud detection, prevention, and response. It, therefore, tasks the accounting researchers to determine whether forensic accountants can detect fraud in an organization significantly higher than auditors (Public Company Accounting Oversight Board [PCAOB], 2008).

Based on the challenges occasioned by fraud, the need for reforms and the establishment of several institutional, legal, and regulatory frameworks cannot be over-emphasized in the Malaysian public sector. The AICPA issued the Statement on Auditing Standards (SAS) No. 99 which deals with the consideration of fraud in a financial statement audit (AICPA, 2002).

Furthermore, the Malaysian Institute of Accountants (MIA, 2008) issued International Standards on Auditing (ISA) No. 240, the Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements. These standards were issued to address fraud-related issues that provoke public outcry on the financial statements auditors' ability and responsibility for fraud detection, prevention, and response.

One of the suggestions for consideration in SAS 99 and ISA 240 regarding the overall responses to the risk of material misstatement due to fraud is the assignment of personnel and supervision. The ISA recommends that the auditor respond to an identified risk of material misstatements due to fraud by assigning additional persons with specialized skills and knowledge such as forensic and information technology (IT) experts or specialists (MIA, 29 (a), para. A34, 2008a; AICPA, AU 316.50, 2002).

The government established the Malaysian Anti-Corruption Commission (MACC), which serves as an organ of accountability and transparency. The MACC has wide powers to enforce all applicable laws to arraign, prosecute, and confiscate on behalf of the state from any perpetrators of occupational fraud or white collar crimes (MACC, 2009).

Despite the introduction of these measures, loss due to fraud in the Malaysian public sector is increasing and hence, requires urgent measures to stem the tides. For instance, the National Fraud Authority, Annual Fraud Indicator (NFAAFI, 2011) in the United Kingdom reported a loss traced to the public sector of $21.2 billion (55% of the total losses) out of $38.4 billion. Other areas include private sector ($12 billion), individual ($4 billion), and charity organization $1.2 (NFAAFI, 2011). There is no statistical data in Malaysia to verify or confirm the level of fraud in the public sector, yet the researcher argues that the fraud has become endemic as echoed by PwC's (2011) survey and the Auditor General 2011 Audit Report on the government financial statements.

This paper agrees with the PwC's survey on the increase in economic crimes based on the purported fraudulent cases reported in the media and the Auditor General 2011 Audit Report (Santiago, 2012). They include: the alleged 3 billion ringgit cost overrun on a rail project in northern Malaysia; alleged government departments' spending much over the going rate for items including torch lights and billboards; alleged customs official shopping spree spending of more than 1 million ringgit without authorization; and alleged and unconfirmed government spending of over 3 million ringgit to set up just six billboards in Indonesia. Other cases include alleged opening cost of Malaysian venture restaurants in London and Tokyo that collapsed, but costing the state RM14 million; and alleged diversion of RM240 million loans by the state for cattle-rearing business to acquisition of high-end condominiums and expensive holidays (Santiago, 2012). More cases of fraud and economic crimes can be checked at the Malaysian organs of accountability websites.

This study, therefore, focuses on the accounting and auditing systems in the public sector of Malaysia, and the unit of analysis is the accountants and the auditors in the office of the Accountant General and the Auditor

General of Malaysia.

Research Objective

The objective of this paper is to investigate the competence requirement of accountants and auditors in the effective and efficient utilization of capability requirements, which have the potentials to usher in the best global practices in fighting fraud in the Malaysian public sector.

Literature Review

Public Sector and Public Sector Accounting

The public sector comprises organizations which are under the control of the public as against private ownerships (Bammeke, 2008; ICAN, 2006; Adams, 2004). They were created on behalf of the public and include federal government, state government, federal statutory bodies, state statutory bodies, local government, town, district councils and city halls, and the Islamic Council of Malaysia (Selamah, 2011). The main purpose of the public sector is the provision of services where maximization of profit is not a major motive (IPSAS, IFAC, 2012; ICAN, 2009; Hassan, 2001).

According to previous research, public sector accounting can be defined as "the process of recording, communicating, summarizing, analyzing, and interpreting government financial statements and statistics in aggregate and details; and is mainly linked with the receipts, custody and disbursement and rendering of stewardship of public funds entrusted" (ICAN, p. 1, 2006; Adams, 2004). This definition is closely related to the universally accepted financial accounting definition.

Concept of Forensic and Forensic Accounting

According to the Merriam Webster Dictionary, the term "forensic" means "belonging to, used in or suitable to courts of judicature or to public discussion and debate". Therefore, any information or document which may be suitably used in courts of law or public discussions is regarded as "forensic information or forensic document".

Forensic accounting is sometimes referred to as the use of accounting knowledge and investigative skills for the purpose of ascertaining, recording, evaluating, interpreting, and communicating useful information on complex business issues so as to be able to resolve legal issues. Popoola (2011) defined forensic accounting as the application of accounting, information technology, investigative, and analytical skills for the purpose of resolving financial issues in a manner that meets the standards required by courts of law or public debate.

According to Popoola, Ahmad, Samsudin, and Yussof (2013) and Popoola, Ahmad, Samsudin, and Hartini (2013), forensic accounting is defined as the integration of specialized accounting knowledge and enhanced skills to solve complex business issues in any court of law or public domain. As noted by Wuerges (2011), forensic accountants would continue to exist for the same reasons as fraud and economic crimes perpetrators, prosecutors, and commercial branch investigators exist. This declaration may probably be traceable to the occurrence and likelihood of criminals in the areas of fraud, white collar crimes, corruption, and asset misappropriations.

Fraud

The word "fraud" consists of activities occasioned by theft, corruption, conspiracy, embezzlement, money laundering, bribery, and extortion and the legal definition varies from country to country save for the Fraud Act of the United Kingdom (Fraud Act of Parliament, 2006) that produces its legal definition in England, Wales, and Northern Ireland (Chartered Institute of Management Accountants [CIMA], 2008).

Prior study has shown that fraud is the consequence of misleading, intentional actions or inaction (including making misleading statements and omitting relevant information) to gain an advantage. Keshi (2011) described fraud as a means by which a person can achieve an advantage over another by false suggestions or suppression of the truth.

Fraud evolved from numerous court decisions around the world. In Fomento (Sterling Area) Ltd. vs. Selsdon Fountain Pen Co. Ltd., Lord Denning concluded that:

> "An auditor has to be suspicious"… and in order to perform his task properly, he must come to it with an enquiring mind, that is, not suspicious of dishonesty or fraud, but suspecting that someone may have made a mistake somewhere and that a check must be made to ensure that there has been none.[1]

The Association of Certified Fraud Examiners (ACFE, 2008) did reference three main categories of fraud that affect any organization(s). These include: (1) asset misappropriations—theft or misuse of an organization's asset (theft of plant, inventory, or cash, false invoicing, accounts receivable fraud, and payroll fraud); (2) fraudulent statements—falsification of financial statements (falsifying documents such as employee credentials); and (3) corruption—bribes or acceptance of kickbacks, improper use of confidential information, conflicts of interest, and collusive tendering. This category of fraud is also confirmed by the CIMA (2008) and summarized in Figure 1.

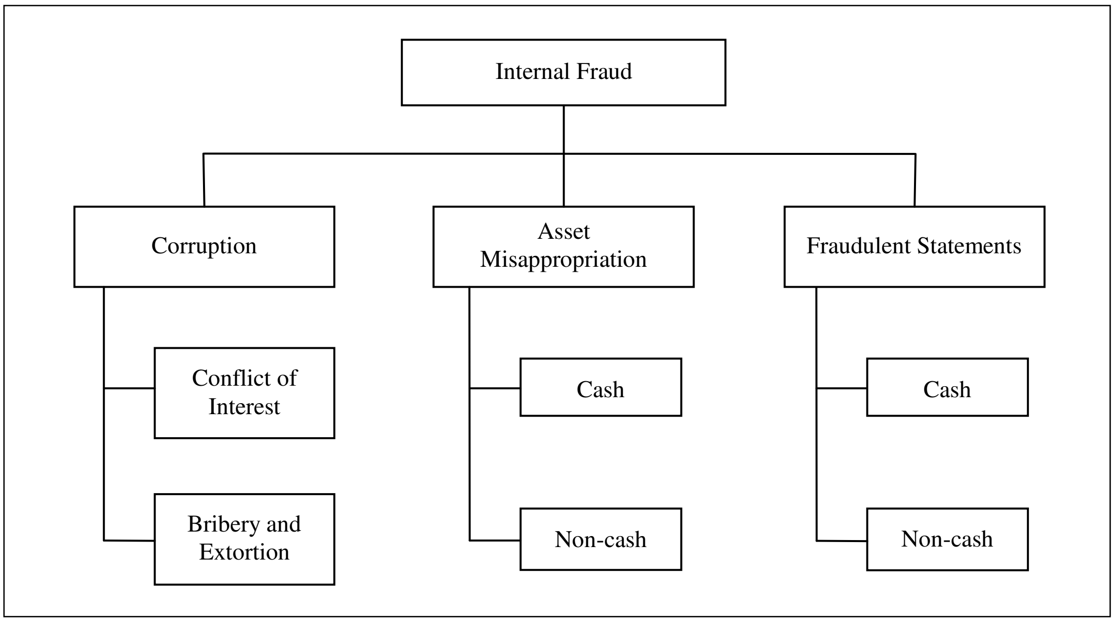

Figure 1. Key categories of internal fraud. Source: Adapted from the CIMA (2008).

Task Performance Fraud Risk Assessment (TPFRA)

Fraud risk assessment sets the tone of the audit, and it involves a firm and an iterative process for identifying and assessing risks to the attainment of organizational objectives (COSO, 2011). The financial statement auditor is required to plan relevant and appropriate audit procedures that will assess the risk of

[1] Retrieved from http://swarb.co.uk/fomento-sterling-area-ltd-v-selsdon-fountain-pen-co-ltd-1958/.

material misstatements due to fraud or error.

The management is required to consider the impact of external and internal conditions which may impair or impugn on the effectiveness of the internal control established in the organization. In achieving the organization's objectives that comprise operating objective, reporting objective, and compliance objective, five components of internal control were identified as significant to potential and actual fraud in any state establishment (COSO, 2011). These components include control environment, control activities, risk assessment, monitoring activities, and information and communication (COSO, 2011).

According to the ISA No. 330 and the MIA-ISA No. 330, The Auditor's Response to Assessed Risk, it is the responsibility of the auditor to select appropriate procedures based on the auditor's judgment, including the assessment of the risks of material misstatements of the financial statements, whether due to fraud or error. However, in making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control (IFAC, 2009; MIA, 2008; PCAOB, 2007; ICAN, 2005a).

Similarly, SAS No. 82, Consideration of Fraud in a Financial Statement Audit (AICPA, 1997), requires documentation of fraud risks by the auditor during the planning stage of the audit and update of the initial assessment as obligatory throughout the course of the engagement. SAS No. 99 discusses relevant fraud risk factors that might indicate the presence of an intentional material misstatement, that is, fraud (AICPA, 2002). The fraud risk factors identified are incentive/pressure, opportunity, and attitude/rationalization. In essence, fraud risk assessment has a direct effect on the effectiveness of auditors' fraud detection in an audit.

It is, therefore, apparent that fraud risk assessment has a direct influence on the auditors' ability to detect fraud, since it is the bedrock of the audit as it helps the auditors to determine the organizational environment and the nature of subsequent audit procedures (Popoola, Ahmad, Samsudin, & Hartini, 2013; Chui, 2010; Wuerges, 2011).

Forensic Accountant Mindset and Auditor Mindset (MR)

The term "mindset" represents a state of mind, experienced as a powerful, but subtle and yet mostly unacknowledged feeling as distinct from the emotion held as core assumptions forming the principal motivations for participation (Falconer, 2012). Popoola, Ahmad, Samsudin, and Yussof (2013) described mindset as "a positive mental attitude which influences individual's cognitive behaviour towards a task performance fraud risk assessment". Mindset has been a source of state intelligence policy failures for decades (Feder, 2000). One of the most promising methods for overcoming mindset is the evidence-based multiple scenario analyses.

Based on critical issues (such as education, training, experience, skills, and exposure), there is no doubt that differences exist between forensic accountant mindset and auditor mindset. A forensic accountant mindset represents a distinguishing way of thinking about accounting records. Whereas auditors think about the company's recorded transactions in terms of the availability, reliability of supporting documentation, and an audit trail, they are not legally bound to authenticate accounting documentation (Chui, 2010; Wuerges, 2011; PCAOB, 2007). On the contrary, forensic accountants presume that a perfect audit trail does not mean that the recorded transactions are free from fraud, since fraud perpetrators often try to deceive auditors by leaving behind a seemingly legitimate audit trail. Needless to say that the auditor has immunity from the auditing standard which states that, "An audit rarely involves the authentication of documentation, nor is the auditor trained as or expected to be an expert in such authentication" (PCAOB, 2007, p. 16).

Forensic Accountant Skills and Auditor Skills (SR)

Skills can be defined as an attribute that relates to competences in the areas of knowledge and ability in addition to those that relate to performance in fraud risk assessment task in the public sector environment (International Education Standard (IES) 3, IFAC, 2005).

Forensic accountant skills represent exceptional skill sets and techniques developed for the purpose of detecting the proof of fraud (Davis et al., 2010; DiGabriele, 2008) amongst other specialized knowledge areas of forensic accounting. In contrast, financial statement auditor skills are intended to provide reasonable assurance that the reported financial statements taken as a whole are stated fairly, in all material respects, in accordance with the ISAs issued by MIA and are, therefore, free of material misstatements (MIA, 2008; Davia, 2000).

Specifically, forensic accounting requires persons who are experts in the application of investigative and analytical skills related to the areas of accounting records to gather and evaluate financial statement evidence, interview all parties related to an alleged fraud situation, and serve as an expert witness in a fraud case (Hopwood, Leiner, & Young, 2008; Rosen, 2006; T. W. Singleton, A. J. Singleton, Bologna, & Lindquist, 2006). On the contrary, the skill requirements of professional accountants are intellectual skills, technical and functional skills, interpersonal and communication skills, and organizational and business management skills (IES 3.3, IFAC, 2005).

It is noteworthy to explain that as per SAS No. 99, the standard setters merely require auditors to be conscious of the possibility of fraud in a financial statement audit (AICPA, 2002), and by extension, this is not a guarantee that the auditor's responsibility includes fraud detection, prevention, and response.

However, the public sector accountants require specialized skills to look at the evidence from different standpoints in order to recognize different possible interpretations of that evidence and the implications of those interpretations of the subject at hand. The forensic accounting literature that has arisen since the 1990s reflected the shifting scope of concerns about the characteristics, traits, and skills of the forensic accountant (Davis et al., 2010; DiGabriele, 2008).

Conceptual Framework

The assessment of fraud risks by applying the forensic accountant mindset and skills may have the tendency to stimulate higher task performance than the auditor mindset and skills in the public sector environment. The conceptual framework of TPFRA on mindset and skills (forensic accountant and auditor) in the Malaysian public sector is represented in Figure 2.

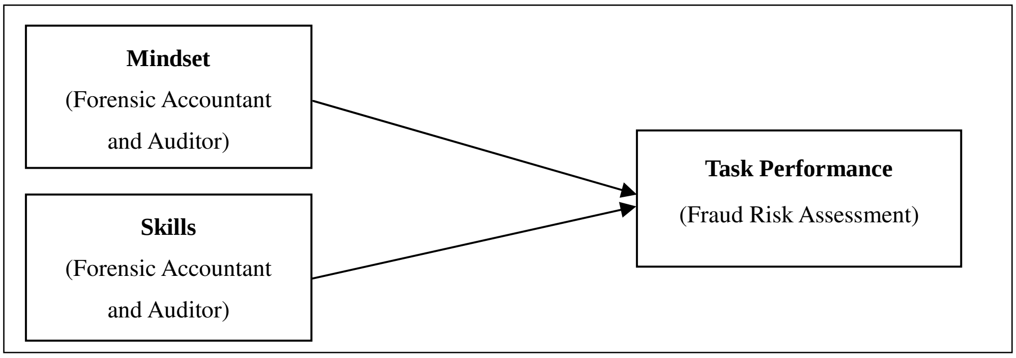

Figure 2. Framework of mindset and skills (forensic accountant and auditor) on TPFRA.

Conclusions

This paper has discussed forensic accountant and auditor capability (i.e., mindset and skills) and forensic accountant and auditor competence (i.e., TPFRA) towards a reduction in fraud in the Malaysian public sector. Furthermore, it heeds to the clarion call of PwC's survey that fraud issues must be given a priority attention by the state.

Specifically, this paper has the potential to resolve PCAOB (2008) challenges on who has the capability to detect fraud between the forensic accountant and the auditor. This paper has the possibility to create awareness to the users of public sector accountant and auditor on the mechanisms of fraud scheme significance. These users include the regulatory and enforcement agencies, courts, ministries, departments, and agencies. Finally and most importantly, the ability to prevent, detect, and respond to fraud requires a holistic approach through the adoption of the forensic accounting mindset and skills on TPFRA in the Malaysian public sector.

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