



**FACTORS INFLUENCING INTENTION FOR FRAUD IN  
FINANCIAL REPORTING AMONG MUSLIM  
ACCOUNTING PRACTITIONERS IN THE MALAYSIAN  
BANKING INDUSTRY**

**BY**

**YUNITA BINTI AWANG**

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International Islamic University Malaysia**

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## ABSTRACT

Fraud is a global business problem causing significant ethical dilemmas for businesses and harmful to capital market participants. Fraud gives rise to severe financial losses. Fraud in financial reporting is the intentional misstatement of financial information to mislead the financial statement's users. It threatens investors' confidence in published financial statement. Fraudsters are commonly involved in finance or finance-related functions for reasons of unattainable high earnings projection, personal gain and weakening moral values. Fraud is indeed a very difficult misconduct to prove as it is normally concealed, not easily measurable or detectable. The main objective of this study is to examine the factors influencing intention for fraud in financial reporting among Muslim accounting practitioners in a highly regulated Malaysian banking industry. The intention rather than actual occurrence of fraud in financial reporting is examined, as the likelihood of performing behaviour depends on the level of behavioural intention. This study adopts a mixed method approach that employs aspects of both quantitative and qualitative procedures involving self-administered questionnaire and semi-structured interviews. A total of 121 respondents were involved in the survey and partial least square structural equation modelling was used in analysing the quantitative data. The results indicate that attitude, subjective norm and ethical judgments are influential factors, whereas perceived behavioural control, Islamic religiosity and adherence to Islamic professional ethics are not influential factors in the intention for financial reporting fraud. Meanwhile, twenty interviewees participated in the semi-structured interviews that provide supports to all significant survey findings but partially support the results on perceived behavioural control and contradict the findings on the Islamic religiosity and adherence to Islamic professional ethics. The input gathered from the semi-structured interviews was analysed and categorised into meaningful perspectives, which led to three new emerging themes of high regulation, the tone at the top and secular worldview. This study contributes in testing the extended Theory of Planned Behaviour that incorporates ethics factor and religious values based on Rest's four component model and Hunt and Vitell's model. Although the theories are developed in the west, the variables such as attitude, subjective norms, perceived behavioural control and ethical judgment are applicable to the Islamic environment. However, the variables of Islamic religiosity and Islamic professional code of ethics are specifically tailored for the Muslims due to the differences between the Western and Islamic environment. This study specifically highlights the influence of Muslim accounting practitioners' Islamic worldview on fraud intention. The emerging factors that influence intention provide new perspectives to auditors, top management and regulators within the industry in developing strategies to curb the intention for fraud in financial reporting.

## ملخص البحث

يعد الاحتيال مشكلة تجارية عالمية يتسبب في الكثير من المعضلات الأخلاقية الكبيرة للشركات، والضرر برؤوس أموال المشاركين في السوق. يؤدي الاحتيال إلى خسائر مالية حادة. والاحتيال في التقارير المالية هو إعطاء معلومات مالية خاطئة متعمدة لتضليل بيانات المستخدمين المالية. لأنه يهدد ثقة المستثمرين في القوائم المالية المنشورة. يشارك المحتالون عادة في مجال التمويل أو الأمور المتصلة بالتمويل لأسباب كثيرة لتحقيق أرباح عالية غير قابلة للكشف، وتحقيق مكاسب شخصية، وإهدار للقيم الأخلاقية. الاحتيال في الواقع سوء سلوك من الصعب جدا إثباته فهو عادة أمر مخفي، لا يمكن قياسه أو كشفه بسهولة، الهدف الرئيسي من هذه الدراسة هو دراسة العوامل المؤثرة في نية الاحتيال لدى المحاسبين المسلمين الذين يمارسون إعداد التقارير المالية في المصرفية الماليزية عالية التنظيم. تقوم الدراسة بفحص نية الغش في التقارير المالية بدلا من الوقوع الفعلي للغش، حيث إن احتمال أداء السلوك يعتمد على مستوى النية السلوكية. تعتمد هذه الدراسة على المنهج المختلط الذي يوظف جوانب الإجراءات لكلا المنهجين الكمي والنوعي التي تشمل على استبيان يعد ذاتيا، وإجراء المقابلات شبه المنظمة. شارك في الاستطلاع، 121 فردا تم توزيع الاستبيان عليهم، لتحليل البيانات الكمية تم استخدام نمذجة المعادلة الهيكلية للمربعات الصغرى الجزئي. وتشير النتائج إلى أن الاتجاهات، والمعيار الشخصي، والقيم الأخلاقية هي العوامل المؤثرة، على حين يعتبر التحكم السلوكي، والتدين الإسلامي، والتمسك بأخلاقيات المهنة الإسلامية ليست من العوامل المؤثرة في نية تزوير التقارير المالية. وفي الوقت نفسه، أيد عشرون مشاركا ممن تمت مقابلتهم في المقابلات شبه المنظمة جميع نتائج الدراسة المهمة، ولكنهم أيدوا بصورة جزئية النتائج المتعلقة بالتحكم السلوكي، وهم يتعارضون مع النتائج المتعلقة بالتدين الإسلامي والتمسك بأخلاقيات المهنة الإسلامية. تم تحليل المدخلات التي تم جمعها من المقابلات شبه المنظمة وتصنيفها إلى تصورات ذات معنى، شكلت في مجموعها ثلاثة محاور جديدة مدمجة عالية التنظيم، كانت نعمة العلمانية على قمتها. وتساهم هذه الدراسة في اختبار النظرية الممتدة للسلوك المخطط الذي يشتمل على دمج العامل الأخلاقي، والقيم الدينية التي تقوم على نموذج العناصر الأربعة لرست، ونموذج هانت و *Vitell*. على الرغم من أن هذه نظريات وضعت في الغرب، إلا أن المتغيرات مثل الاتجاهات، والمعايير الشخصية، والسيطرة السلوكية المتوقعة، والحكم الأخلاقي قابلة للتطبيق في البيئة الإسلامية. ومع ذلك، فإن متغيرات التدين الإسلامي، ودستور وقوانين الأخلاقيات الإسلامية صممت على وجه التحديد للمسلمين بسبب الاختلافات بين البيئة الغربية والإسلامية. هذه الدراسة تسلط الضوء على وجه التحديد على تأثير النظرة العالمية على المحاسبين المسلمين ونية الاحتيال. توفر العوامل المدمجة التي تؤثر على نية الاحتيال آفاقا جديدة للمدققين، و الجهات الإدارية العليا، والجهات التنظيمية في هذه الصناعة لوضع استراتيجيات للحد من نية اللجوء إلى الاحتيال في التقارير المالية.

## **APPROVAL PAGE**

The thesis of Yunita Binti Awang has been approved by the following:

---

Suhaiza Binti Ismail  
Supervisor

---

Abdul Rahim Abdul Rahman  
Co-Supervisor

---

Nazli Anum Binti Mohd. Ghazali  
Internal Examiner

---

Ku Nor Izah Ku Ismail  
External Examiner

---

Norman Bin Mohd Salleh  
External Examiner

---

Mizan Bin Hitam  
Chairman

## DECLARATION

I hereby declare that this thesis is the result of my own investigation, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Yunita Binti Awang

Signature.....

Date .....

INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA

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Date

*To my loving and supportive husband, Abdul Rahman Bin Muhammad.*

*To my beloved daughters, Intan Nor Amnani, Intan Nor Aisyah and Intan Nur Ain.*

*To my parents, Wan Hasnah Binti Ismail and Awang Bin Mohamed.*

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## LIST OF ABBREVIATIONS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
AAER	Accounting and Auditing Enforcement Releases
ACFE	Association of Certified Fraud Examiners
ATT	Attitude
AVE	Average Variance Extracted
BAFIA	Banking and Financial Institutions Act
BNM	Bank Negara Malaysia
CB	Covariance-based
CEO	Chief Executive Officer
CFE	Certified Fraud Examiners
CFO	Chief Financial Officer
CMD	Cognitive Moral Development
CMV	Common Method Variance
CPA	Certified Public Accountant
CR	Composite Reliability
CV	Coefficient of Variation
DIT	Defining Issues Test
EDM	Ethical Decision Making
EJ	Ethical Judgment
FBI	Federal Bureau of Investigation
FSA	Financial Service Act
GAAP	Generally Accepted Accounting Principles
HCM	Hierarchical Component Model
HOC	Higher-order Component
IBA	Islamic Banking Act
IFI	Islamic Financial Institution
IFSA	Islamic Financial Service Act
IUM	International Islamic University Malaysia
INT	Intention
IPE	Islamic Professional Ethics
IR	Islamic Religiosity
IRPA	Intensification of Research Priority Areas
ISA	International Standards of Auditing
KPMG	Klynveld, Peat, Marwick and Goerdeler
LOC	Lower-order Component
MARS	Moslem Attitude towards Religion Scale
MCAR	Missing Completely at Random
MIA	Malaysian Institute of Accountants
MRPI	Muslim Religiosity-Personality Inventory
PBC	Perceived Behavioural Control
PLS	Partial Least Squares
SDB	Social Desirability Bias
SEC	Securities and Exchange Commission
SEM	Structural Equation Modelling

SN	Subjective Norm
SPSS	Statistical Package for Social Science
TPB	Theory of Planned Behaviour
TRA	Theory of Reasoned Action
UiTM	Universiti Teknologi MARA
UKM	Universiti Kebangsaan Malaysia
UPM	Universiti Putra Malaysia
US	United States
VIF	Variance Inflation Factor

# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1 BACKGROUND OF STUDY**

Fraud is believed to be the most serious corporate problem in the present business environment (KPMG, 2009; Palshikar, 2002; M. Smith, Normah, Syed Iskandar Zulkarnain, & Ithnahaini, 2005) and continues to be a growing problem, particularly in a tight budget situation (KPMG, 2011). Fraud causes huge losses to organizations, including investigation costs, staff sickness or suspension costs, internal disciplinary costs, external sanction costs, permanent staff replacement costs and intangible costs of a damaged reputation (Button, Lewis, Blackbourn, & Shepherd, 2015). Fraud is defined as “a deliberate deceit planned and executed with the intent to deprive another of property or rights directly or indirectly, regardless of whether the perpetrator benefits for his/her actions” (KPMG, 2013: 2).

By its very nature, fraud is not accurately observable or measureable as it is commonly hidden. Fraud is not condoned by society as it reflects the decline in people’s moral values. Fraud reflects an abuse of trust by employees towards their respective employers, and can occur in large or small corporations, privately-owned companies, publicly traded companies, not-for-profit organizations or government organizations (ACFE, 2012, 2014). It is committed not only by top management but also by middle to lower level employees (Treadway Commission, 1987), at management and non-management level (KPMG, 2009), either willingly or due to pressure from top management for the personal benefit of certain individuals or for reasons such as greed for an excessive lifestyle and personal financial pressure

(KPMG, 2009, 2013). Fraud may involve collusion between employees and management (KPMG, 2009). The instructions from middle managers explicitly can exert strong organizational pressures on more junior managers to perform actions that are questionable, unethical or sometimes illegal (Badaracco & Webb, 1995). The key underlying factors for fraud are opportunity, incentive pressure, and rationalization; these are referred to as the fraud triangle (Wells, 2004). In fraud survey reports produced by the Association of Certified Fraud Examiners (ACFE), a median time lag of eighteen months is needed before fraud cases can be detected for the reported survey period between January 2010 to December 2011 (ACFE, 2012), and between January 2012 to December 2013 (ACFE, 2014), respectively. Association of Certified Fraud Examiners (ACFE), founded in 1988, is the world's largest anti-fraud organization and its published report covers the occupational fraud cases as investigated by the Certified Fraud Examiners (CFEs) around the globe.

As reported in the New Straits Times, fraud has increasingly become a major problem in Malaysia, with more than 60 per cent of the Malaysian listed companies surveyed had experienced some form of fraud and almost a quarter of companies surveyed have lost more than RM 1 million each to fraud (Management Times, 2001). Additionally, in the fraud survey conducted by the KPMG Malaysia based on the responses received to a survey questionnaire that was distributed to a representative sample of Malaysia's companies across the public and private sectors covering the period from January 2006 to December 2008, 61% of the respondents indicated that fraud against Malaysian business is set to rise in the next two years (KPMG, 2009). In a more recent fraud survey covering the period from January 2010 to December 2012, 89% of the respondents believed that fraud dramatically increased over the past three years (KPMG, 2013).

In Malaysia, the country's business community is significantly affected by the local fraud cases such as Transmile Group Berhad, Megan Media Holdings Berhad, and Tat Sang Berhad (Normah & Katerina Maria, 2012). The value of reported fraud in Malaysia between January 2006 and December 2008 was RM63.95 million (KPMG, 2009). Twenty out of 204 (ACFE, 2012) and ten out of 129 (ACFE, 2014) occupational fraud cases in Asia region occurred in Malaysia during the period between January 2010 and December 2011, and January 2012 and December 2013 respectively.

It is almost impossible to devise laws and regulations that would eliminate fraud in total because fraud is initiated by people. Those who intend to commit fraud will find possible alternatives to manipulate the rules to achieve their targets. However, fraud deterrence is possible through effective internal controls systems, well-composed audit committees, strong functioning regulatory authorities and external auditors to detect fraud as well as through high commitment of top management to embed an ethical culture within their organization (Azham, 1994).

Occupational fraud occurs in the form of corruption, asset misappropriation or financial statement fraud (ACFE, 2012, 2014). Corruption involves conflicts of interest, bribery, illegal gratuities, and economic extortion; assets misappropriation involves cash, inventory and all other assets; and financial statement fraud involves asset or revenue overstatements and understatements (ACFE, 2012, 2014). Fraudulent financial reporting represents,

the intentional material misstatement of financial statements or financial disclosures or the perpetration of an illegal act that has a material direct effect on the financial statements or financial disclosures (Beasley, Carcello, & Hermanson, 1999 : 11)

In this study, the term “financial reporting fraud” is used interchangeably with “financial statement fraud”, “fraud in financial reporting” and “fraudulent financial reporting”. This study specifically examines the intention for fraud in financial reporting in a banking industry, considering the significant consequences of fraud to the banking industry is much greater than in other types of industries the nature of its business, which involves managing depositors’ money.

## **1.2 MOTIVATIONS FOR THE STUDY**

The on-going phenomenon of fraud in financial reporting is not new. Numerous corporate scandals involving financial fraud have created concern, particularly for their negative impact on global capital markets and on investors’ confidence. The collapse of one of the five largest auditing firms in the world, Arthur Anderson, was also due to fraud in financial reporting. In light of this collapse, the business community and the accounting profession are “keeping an eye” on fraud in financial reporting activities (Rezaee, 2005), because investors and other users of financial reports need to be assured of the ethics of management and other participants in the final reporting process (Kalbers, 2009). The people who are entrusted with a company’s sensitive information and controls, especially those dealing with finance functions or finance-related role, are those who are more frequently implicated in fraud (KPMG, 2011; Rezaee, 2005). This is an indication of ethical failure among those who have been given the trust to run financial matters and to safeguard the internal control systems of organizations. The level of reported earnings can be influenced by accountants either directly through their impact on the choice of accounting methods or indirectly through monitoring the actions of managers who influence reported earnings (Rosenzweig & Fischer, 1994). As managers typically

control financial reports, the incentive exists for them to deceptively manipulate accounting procedures solely to increase their bonus (*The Daily Record*, 2003 in T. L. P. Tang & Chen, 2008).

Although contributing to a low percentage of about 8% of occupational fraud, financial statement fraud represents the greatest median loss at \$1 million (ACFE, 2012, 2014). The KPMG Fraud Survey has also indicated that 31% (KPMG, 2009) and 12% (KPMG, 2013) of the type of fraud perpetrated is in the form of financial reporting fraud. Most common activities leading to financial statement fraud include concealment of liabilities and expenses, improper revenue recognition, and inadequate disclosures (Beasley et al., 1999; Weld, Bergevin, & Magrath, 2004). Others include fictitious revenue recognition, revenue recognition of products and services which are undelivered, incompletely delivered or delivered without customer acceptance (Deloitte, 2009). KPMG fraud survey lists the type of financial reporting fraud to include, among other examples, the deferring of expenses to a future financial period, failure to provide for a bad and doubtful debts, inadequate or inappropriate omissions or disclosures, creating fictitious revenue, and inconsistent application or interpretation of accounting policies or standards (KPMG, 2009, 2013).

Similar to the findings in year 2010, the ACFE report indicated that the vast majority that is, 77% of occupational fraud was committed by the employees in one of six departments: accounting, operations, sales, executive or upper management, customer service and purchasing (ACFE, 2012). Similarly, the employees in these departments, together with the finance department, were collectively responsible for approximately 77% of occupational frauds (ACFE, 2014). Accounting departments, representing 22% and 17.4% of all reported cases, had the highest incidence of fraud with a median loss of \$183,000 and \$150,000 in fraud survey for years 2012 and 2014