THE ASSOCIATION OF EXTERNAL AUDITOR`S ATTRIBUTES WITH MANAGEMENT FRAUD RISK ASSESSMENT IN FINAINCAL REPORTING: EMPIRICAL EVIDENCE FROM YEMEN

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By

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ABSTRACT

As stated by the International Standard of Auditing (ISA No. 240), the effectiveness of the external auditors' attributes is the primary process in management fraud risk assessment (*MFRA*). Therefore, the aim of this study is to examine the associations of external auditor effectiveness-related attributes and independent-related factors with *MFRA* in the context of Yemen. To achieve the objective of this study, questionnaires were distributed out to 410 external auditors working in private audit firms and the Yemeni Central Organization for Control and Accounting (*COCA*) for the year 2012. A total of 273 questionnaires were returned back out of which 19 were unusable. As such, the final sample of this study consists of 254 external auditors. Multiple regression analysis was used to test the study's hypotheses. This study finds positive associations of the external auditor's effectiveness score and external auditor's independence score with *MFRA*. Furthermore, questioning discussion ability, professional qualification, fraud detection experience, information technology (IT) skill, training on fraud detection, and social relationships are reported to have positive and significant associations with *MFRA*, while job position is found to have a negative association. The findings of this study indicate that Yemeni government and *COCA* should issue new regulations to increase the external auditors' awareness and effectiveness towards *MFRA*. This study also indicates that the audit profession in Yemen needs more control, regulations, laws and policies to enhance the structure of the external auditors' decision in issues related to *MFRA* in order to protect the interests of demand-supply sides of audit services and the related parties. Moreover, this study has implications for the Yemeni policy makers and government to enrich the external auditors' effectiveness and independence by issuing new regulations, new laws, and applying more control on the quality of auditing profession to protect the economy and the society stability.

Keywords: management fraud risk assessment, external auditor`s attributes, Yemen

ABSTRAK

Sebagaimana yang dinyatakan dalam Standard Pengauditan Antarabangsa (SPA No. 240), keberkesanan ciri-ciri juruaudit luar merupakan proses utama dalam penilaian risiko penipuan pengurusan (*PRPP*). Oleh yang demikian, kajian ini bertujuan untuk mengkaji hubungan antara ciri-ciri berkaitan keberkesanan dan kebebasan juruaudit luar terhadap *PRPP* dalam konteks negara Yaman. Bagi mencapai objektif kajian ini, soalan kajiselidik telah diedarkan kepada 410 juruaudit luar yang bekerja di dalam firma audit swasta dan Organisasi Pusat bagi Kawalan dan Perakaunan Yaman (*OPKP*) pada tahun 2012. Sejumlah 273 soal selidik telah dikembalikan semula yang mana hanya 19 daripadanya tidak dapat digunakan. Ini menjadikan sampel akhir kajian ini terdiri daripada 254 juruaudit luar. Analisis regresi berganda telah digunakan untuk menguji hipotesis kajian. Kajian ini mendapati wujudnya hubungan positif di antara skor keberkesanan juruaudit luar dan skor kebebasan juruaudit luar dengan *PRPP*. Selanjutnya, faktor-faktor kebolehan menyoal semasa berbincang, kelayakan profesional, pengalaman mengesan penipuan, kemahiran teknologi maklumat (TM), latihan berkaitan pengesanan penipuan, dan hubungan sosial dilaporkan mempunyai hubungan positif yang signifikan terhadap *PRPP*, manakala jawatan kerja mempunyai hubungan yang negatif. Dapatan-dapatan kajian ini menunjukkan bahawa kerajaan Yaman dan *OPKP* perlu mengeluarkan peraturan-peraturan baru bagi meningkatkan kesedaran dan keberkesanan juruaudit luar terhadap *PRPP*. Kajian ini juga menunjukkan bahawa profesyen audit di Yaman memerlukan lebih kawalan, peraturan, undang-undang dan dasar bagi meningkatkan struktur keputusan juruaudit luar dalam isu-isu yang berkaitan dengan *PRPP* bagi melindungi kepentingan permintaan-penawaran dalam perkhidmatan audit serta pihak-pihak yang berkaitan. Selain itu, kajian ini mempunyai implikasi terhadap pembuat dasar dan kerajaan Yaman bagi meningkatkan keberkesanan dan kebebasan juruaudit luar dengan mengeluarkan peraturan baru, undang-undang baru, serta mengaplikasikan lebih banyak kawalan ke atas kualiti profesyen pengauditan bagi melindungi kestabilan ekonomi dan masyarakat.

Kata kunci: penilaian risiko penipuan pengurusan, ciri-ciri juruaudit luar, Yaman

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LIST OF ABBREVIATION

AASB	Auditing and Assurance Standards Board
ACFE	Association of Certified Fraud Examiners
AICPA	American Institute of Certified Public Accountants
ACPA	Arabic Certified Public Accounting
AM	Auditor Partner
AP	Auditor Manager
AS	Accounting System
CFEs	Certified Fraud Examiners
COCA	Central Organization for Control and Accounting
CISA	Certified Information Systems Auditor
CMA	Certified managerial accounting
DSS	Decision Support System
DS	Database System
DFID	Department for International Development
EAES	External Auditor Effectiveness Score
EAIS	External Auditor Independent Score
FSAB	Financial Standards Accounting Board
GIS	Global Integrity Scorecard
ISA	International Standard on Auditing
IAASB	International Auditing and Assurance Standards Board
IFAC	International Federation of Accountants
IC	Investment Commission
IT	Information Technology
ICPA	International Certified Public Accounting
LAN	Local Area Network
MFRA	Management Fraud Risk Assessment
MSWG	Minority Shareholder Watchdog Group
MIT	Ministry of Industry and Trade
OECD	Organization for Economic Cooperation and Development
OSS	Office Support System
OTI	Organization Transparency International
PWC	Price Waterhouse Coopers
PCAOB	Public Company Accounting Oversight Board
SAS	Statement Auditing Standard
SEC	Securities and Exchange Commission
WB	World Bank
TO	Taxes Organization
YCB	Yemeni Central Bank
YACPA	Yemeni Association of Certified Public Accountants
YCPA	Yemeni Certified Public Accounting
YNIC	Yemeni National Information Center

CHAPTER ONE

INTRODUCTION

1.1 Research Background

Recently, management fraud has become a crucial issue, especially at the time when the consequence of this fraud is reflected in the collapse of many giant companies around the world. These collapses occurred in the U.S. (Enron, WorldCom, and Xerox), France (Vivendi Universal), Italy (Parmalat), Switzerland (Adecco International), UK (Bank of Credit and Commerce International and Barings Bank), and Australia (HIH Company) (KPMG, 2002; Dillon & Hadzic, 2009; Krambia-Kapardis & Zopiatis, 2010).

Management fraud has become the source of major costs for many organisations (Bierstaker, Brody, & Pacini, 2006). It occurs in almost all types of organizations and causes expensive, persistent, and increasing problems for businesses (Zahra, Korri, & Yu, 2005). The average estimated loss per organization from economic crimes globally is $2,199,930 U.S. over a two-year period (Price Waterhouse Coopers [PWC], 2003). Organizations around the world lose an estimated five percent of their annual revenues to fraud, according to a survey of Certified Fraud Examiners (CFEs) conducted between January 2008 and December 2009. Applied to the estimated 2009 Gross World Product, this figure translates to a potential total fraud loss of more than $2.9 trillion U.S. (Association of Certified Fraud Examiners [ACFE], 2010). Between 2002 and 2010, losses in terms of the U.S. Gross Domestic Product, have risen from $600 billion to $994 billion U.S., and the percentage of annual revenue lost to management fraud has risen from 5 percent to 7 percent (ACFE, Report to the

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