

THE ROLE OF INTERNAL AUDIT AND LEADERSHIP STYLE IN INCREASE OF FRAUD PREVENTION: A STEWARDSHIP THEORY PERSPECTIVE

Siti Noor Khikmah *, Abdul Rohman **, Indira Januarti **

* Corresponding author, Faculty of Economics and Business, Diponegoro University, Semarang, Indonesia
Contact details: Faculty of Economics and Business, Diponegoro University, Semarang 50241, Jawa Tengah, Indonesia
** Department of Accounting, Faculty of Economics and Business, Diponegoro University, Semarang, Indonesia



Abstract

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This research was conducted due to the prevalence of fraud, despite several preventative regulations. The phenomenon of fraud persists in all fields, including state university education. This is quantitative research with a population of 122 internal auditors at state universities to analyze the role of internal audit and transformational leadership style on fraud prevention from a stewardship theory perspective. Purposive sampling was conducted to obtain 65 auditors as samples, and the hypothesis test was analyzed by Statistical Package for the Social Sciences version 25 (SPSS 25). Based on the results, the first hypothesis indicates that internal audit positively affects fraud prevention. Internal audit is part of the organization and plays a role in detecting and preventing fraud. Meanwhile, the second hypothesis suggests that the transformational leadership style positively affects fraud prevention. Transformational leadership can reduce the fraud committed by subordinates because leaders have good vision, rhetoric, and special management skills, to build strong emotional relationships. For internal auditors and leaders, this research contributes to improving fraud prevention in the university environment by maximizing the role of internal audit and leadership. This can increase the impetus to achieve organizational goals efficiently and effectively. Further research can develop the control environment and manage risk for fraud prevention.

Keywords: Internal Audit, Transformational Leadership Style, Fraud Prevention, Stewardship Theory

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1. INTRODUCTION

Fraud is a law violation that consistently occurs when using money or valuables (Coderre, 2009), causing an annual increase of 5% in the organization's

profit margin (Association of Certified Fraud Examiners [ACFE], 2020). The preventive methods are proactive tactics organizations use to identify or confirm the occurrence. According to Karyono (2013), fraud prevention is the effort to narrow the space,

ward off potential perpetrators, and identify activities with a high risk. The methods to stop this unlawful activity are stated in Law Number 1 of 2004 concerning the State Treasury; Law Number 15 of 2004 concerning Examination of State Financial Management and Accountability, and Law Number 1 of 2020 concerning State Financial Policy and Financial System Stability, as well as Law Number 28 of 2009, which gives the mandate to realize a state administration that is free from corruption, collusion, and nepotism. These laws are expected to prevent fraud.

The practice of corruption in universities is not new, and from 2015 to 2019, one of the ten sectors that experienced the most corruption was education, with a national average annual growth rate of IDR41.09 million. About 10% of the 202 cases in the education sector occurred in colleges (Coderre, 2009), with state losses reaching IDR81.9 billion (Ramadhan & Rastika, 2020). In 2020, a university in Jakarta falsified holiday allowance (*Tunjangan Hari Raya* – THR) information worth about USD1.200 and IDR27.5 billion. In 2018, one of the universities in Riau committed a fraud case in constructing a building worth approximately IDR950 million. Besides Indonesian, university fraud cases also occurred in other countries such as China.

University serves as a place of higher education for educating the people, where phenomena that occur in educational institutions will contribute to unwanted suppression. Therefore, every organization needs to use resources to fully support a good university corporation, such as an internal audit. Furthermore, the organization is expected to have an effective internal monitoring system to detect irregularities and report to management on time (Belkaoui, 2010). It is the only method organizations employ to evaluate fraud prevention organizational operations (ACFE, 2020). An effective internal auditor technique for detecting organizational fraud uses an audit process (Nicolaescu, 2013). Every university is required to have an internal auditor or an Internal Supervision Unit for internal audit activities such as reviews and consultations to enforce the principles of good university governance (Larasati et al., 2018).

Research on internal audit has contributed to fraud prevention (Briffa, 2018; Othman et al., 2015; Widilestariningtyas & Karo, 2016), where audit has a positive effect on fraud detection and prevention (Halbouni, 2015). Internal audit can improve fraud prevention (Muslimat & Hamid, 2012; Onoja & Usman, 2015; Nurlaela et al., 2021; Putri et al., 2022; Adliana et al., 2022). The internal audit, which serves as a critical and effective control function in higher education administration, is responsible for detecting fraud (Aresteria, 2018). Different results are shown in research conducted by Akbar (2020). Lonto et al. (2023) found that internal audit has no effect on fraud prevention. Lestari and Bernawati (2020) show that internal audit is negative towards the tendency of fraud. Internal audit cannot influence fraud (Mardani et al., 2020; Fernando & Sitorus, 2020). This shows that the research results are not consistent, so it is still important to research.

Several parties, such as the company's leaders, can prevent fraud, and in this context, the attitudes and actions of the leadership will be imitated by

employees; hence, it is expected that a leader can be honest and responsible. Fraud prevention to realize a good corporate university, organizational sustainability, and running the organization's wheels are controlled by leadership styles (Aji, 2018). Even though a fraud prevention system has been established, certain circumstances can weaken the system. The most notable circumstances are leaders who do not have role models but can modify existing systems. The leadership style applied will be adjusted to the needs, situations, and conditions in the organization or company. Every organization should have sufficient human resources to carry out effective work. Therefore, a leader who can successfully aid in reaching its objectives is required. In this situation, the company needs exemplary leadership to function. The failure of superiors to set an example is the primary factor in the 27.6% weakening of the control system and affects fraud (ACFE, 2020).

Based on the stewardship theory perspective, this research differs from the previous study using agency theory. Internal audit and organizational leadership are important tools to prevent fraud in organizations. As agents, they have the same goal as the principal to create efficient, effective, and economic organizational governance (Ebimobowei & Binaebi, 2013). Organizations that adopt a stewardship approach will produce a high accountability mechanism due to mutual trust between principals and agents, as realized in the activities in creating the strategic goals (Cribb, 2006). This theory has a significant effect on describing internal audit procedures. Internal auditors are committed to optimizing performance by following the principal's objectives and interests. Another difference in this research — it is carried out at a state university because there is still a phenomenon of fraud and only a little research on this topic. This is based on the results that out of 77 papers, only 2 studied the universities (Sari et al., 2019).

This research does analyze the correlation between the role of internal audit and transformational leadership style in fraud prevention based on the stewardship theory perspective, and moving from the consideration above, we address the following research questions:

RQ1: Does the internal audit have a positive effect on fraud prevention?

RQ2: Does the transformational leadership style have a positive effect on fraud prevention?

This study is expected to contribute to giving an understanding that the role of internal audit and transformational leadership style can be implemented in universities to increase fraud prevention and operational performance so that company performance can be achieved efficiently and effectively.

The structure of this paper is as follows. Section 1, as an introduction, includes several key elements: relevant background on the topic details of the research problem, the phenomena gap and research gap, and the research questions. Section 2 reviews the relevant literature. The literature is reviewed and hypotheses are developed. Section 3 analyses the methodology including the sample, variable measurement, and data analysis. Section 4 presents the results of the data analysis. Section 5 discusses the research results. Finally, Section 6

concludes this paper by providing a clear interpretation of the results of the research in a way that stresses the significance of the paper.

2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

2.1. Stewardship theory

Stewardship is an attitude and behavior that places other people or groups above personal interests in the long term (Hernandez, 2008). This theory views management as a party that can be trusted and well in the public interest to achieve organizational goals and interests (Donaldson & Davis, 1991; Davis et al., 1997). The smoothness of organizational collaboration needs to emphasize the importance of trust and organizational opportunities for growth (Davis et al., 1997). According to stewardship theory, executive leaders exhibit steward behavior by placing the organization's interests ahead of their own and behaving in the best interests of the actors (Davis et al., 1997). As an alternative, employees will be motivated and persistent because of ethics and morals (Donaldson & Davis, 1991).

Leader, under the stewardship theory, is far from an opportunistic thinking pattern. He/she wants to do his job well, becoming a good servant of his/her company. This theory was established above the philosophical assumption about human character, that essentially, humans are trustworthy, able to act responsibly, and have integrity and honesty. This is implied in the human relationship required by the shareholders and the stakeholders. In other words, stewardship theory views management as the trusted party to act as well as possible for the public interest generally and for the shareholders specifically (Donaldson & Davis, 1989).

Internal auditors as employees and parties that should be independent will work for the principal's interests. Furthermore, wise decisions will be created by providing maximum service to principals to achieve organizational goals. The leader or manager also functions as a servant and continues to interact with the principal.

2.2. Internal audit and fraud prevention

Internal audit is an independent and assurance activity designed to add value and improve the organization's operations. The duties through audits and investigations play a role in detecting, preventing, and monitoring fraud and overcoming risks. The risk of fraud in the business should also be considered by conducting an audit. The findings are anticipated to be submitted to the organization's top management, who would then offer solutions. Thus, internal auditing has gained considerable acceptance as a crucial element of good corporate governance (Eulerich & Lohmann, 2022; Eulerich et al., 2022).

The purpose of an internal audit is to improve the efficiency of the operational objectives. This requires an independent and objective agency of consultation and review. An organization faces an integrity risk, namely the risk of fraud, unlawful acts, or other irregularities by the managers or employees to reduce the reputation in the business world. This can affect the ability to use internal

audits (Handoyo & Bayunitri, 2021). Fraud can be reduced and eliminated by increasing the frequency of internal audits. Furthermore, internal audit assists the organization by implementing organizational controls to achieve efficiency and effectiveness. Internal audit strives to discover, contain, and decrease the risk of fraud in corporate operations by conducting audits and investigations of controls, assessing probable fraud, and identifying organizational risk through risk assessment and audit methods (The Institute of Internal Auditors [IIA], 2019). It evaluates the activities carried out by the organization, identifies weaknesses, and becomes a resource for the organization. This is committed to assisting management in preventing fraud. Internal and external auditors are crucial in the public sector to detect and eradicate corruption (Othman et al., 2015). According to Hamilton and Gabriel (2012), these auditors conduct fraud investigations using their skills to develop a good control system. Based on the explanation above, this research proposed a hypothesis as follows:

H1: Internal audit has a positive effect on fraud prevention.

2.3. Transformational leadership style and fraud prevention

Leadership style is an important characteristic that can help the organization take action. Mansor et al. (2018) explained that every organization or business has a different leadership culture with inherent weaknesses and risks. This style affects fraud prevention by reducing its occurrence. This means that the leadership style has been carried out well, where superiors provide good examples to subordinates, and there has been good communication to receive subordinates' opinions. Workers or subordinates will feel pressure when the leadership style is very unpleasant, leading to fraud (Handoko et al., 2019).

Leadership style is a method of communication between leaders and employees. The behavioral patterns are the words and actions of a leader not felt by others. Several leadership styles can be applied to achieve organizational goals. However, the rapid changes in communication technology and the development of community paradigms require using leadership styles following these changes. The two main constructs of this theory are transformational and transactional leadership (Bass, 1985).

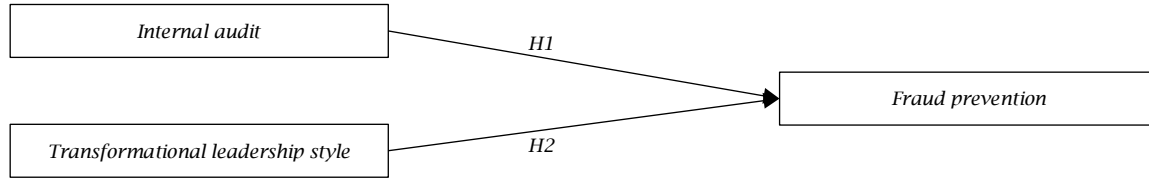
Transformational leadership style shows charismatic behavior, motivating inspirational, intellectual, and changing subordinates to achieve the potential to produce higher performance levels (Keller, 1995). Transformational leaders assess the potential of all subordinates based on their capacity to fulfil existing obligations and foresee the assignment of additional responsibility in the future. This style calls for an increase in moral values to increase awareness of ethical issues and mobilize resources to reform institutions, hence they can improve fraud prevention (Yukl, 2009). It has a good vision, rhetoric, and management skills that are easy to remember and are used to build strong emotional relationships with subordinates (Bass, 1985). Transformational leaders are believed

to be more successful in directing organizational change because of the high emotional level of subordinates and the willingness to work following the leader's vision (Hughes et al., 2015). Referring to

the explanation above, the hypothesis is formulated as follows:

H2: Transformational leadership style has a positive effect on fraud prevention.

Figure 1. Research model



3. RESEARCH METHODOLOGY

3.1. Research design

This research used quantitative methods, and the population was all internal auditors at state universities registered on the Indonesian Ministry of Education and Culture website. In this empirical research model, the equation was used to measure the role of internal audit and transformational leadership style in fraud prevention:

$$FP = \alpha + \beta_1 IA + \beta_2 TLS + \epsilon \tag{1}$$

where,

α : regression constant;

β : a regression coefficient, where $i = 1, 2, \dots$ (independent variable);

FP: fraud prevention;

IA: internal audit;

TLS: transformational leadership style;

ϵ : error.

3.2. Population and sample

The research population is all state universities in Indonesia. The total population is 122 universities. The sampling technique used purposive sampling, which means the sample was selected based on specific criteria (Table 1). The university sample is 65 universities. Questionnaires were sent for 5 months — from November 2021 to March 2022. Questionnaires were distributed through email and Google Forms to each university. A 7-point Likert scale was applied with answer options “Strongly agree”, “Agree”, “Quite agree”, “Neutral”, “Quite disagree”, “Disagree”, and “Strongly disagree” with scores of 7, 6, 5, 4, 3, 2, and 1, respectively.

A scale of 1-7 was selected, where each answer was scored 7 points (Ghozali, 2018). Furthermore, this research used Statistical Package for the Social Sciences version 25 (SPSS 25) to test H1 and H2.

Table 1. Selection of sample criteria

Criteria	Total	%
The questionnaire distributed	122	100%
The questionnaire was not returned	(49)	40%
The questionnaire returned	73	60%
The questionnaire cannot be processed	(8)	11%
Processed questionnaire	65	89%

Source: Primary data processed, 2022.

Table 1 shows that of 122 (100%) questionnaires distributed, 49, or 40%, were not returned. Questionnaires that cannot be processed were 8, or 11%, while 65, or 89%, were processed.

3.3. Variable measurement

3.3.1. Independent variables

Internal audit and variable measurement using instruments were developed from research (Halbouni, 2015). Variable indicators were described in 20 statement items with 7 scales referring to the Likert scale from 1 = “Strongly disagree” to 7 = “Strongly agree”. The multifactor leadership questionnaire (MLQ) instrument measured the variable transformational leadership style adopted from research (Keller, 1995). The indicators include individual considerations, ideal influence, inspirational motivation, and intellectual stimulation, as described in 10 statement items. Each respondent was asked to answer one statement using a 7-point Likert scale.

3.3.2. Dependent variable

Fraud prevention variable, which was measured by 8 statement items and adopted with modifications from Mihret (2014), Archer (2011), Albrecht et al. (2011), Hassink et al. (2010), and Bierstaker et al. (2006). A high or low score indicates that fraud prevention is very high or low.

4. RESEARCH RESULTS

4.1. Descriptive statistics

Table 2 presents a description of the variables used in the model, namely the relationship between the independent variables in the form of internal audit and transformational leadership style with the dependent variable.

The statistical tests showed the average value of the *Internal audit* variable was 6.09, and the *Transformational leadership style* was 6.02. Therefore, respondents strongly agreed with

the internal audit and transactional leadership style an average value of 5.79, close to 6, implying that statement. The *Fraud prevention* variable has respondents strongly agree with the statement.

Table 2. Descriptive statistics

Variable	N	Minimum	Maximum	Mean	Std. deviation
Internal audit	65	3.00	7.00	6.09	0.80473
Transformational leadership style	65	2.00	7.00	6.02	1.12489
Fraud prevention	65	2.00	7.00	5.79	0.96002
Valid N (listwise)	65				

Source: Primary data processed, 2022.

4.2. Correlation analysis

The validity test showed the *Internal audit* variable instrument and *Transformational leadership style* all values of Sig. are below 0.05. An instrument is said to be reliable when Cronbach’s alpha value is more

than 0.07 (Ghozali, 2018). The Cronbach’s alpha of the *Internal audit* was 0.950, and the *Transformational leadership style* was 0.964. Meanwhile, the *Fraud prevention* was 0.953, showing that all variable values were > 0.7 and were said to be reliable, as presented in Table 3.

Table 3. Reliability test

Variable	Cronbach’s alpha	Criteria
Internal audit	0.950	Reliable
Transformational leadership style	0.964	Reliable
Fraud prevention	0.953	Reliable

Source: Primary data processed, 2022.

4.3. Regression

Table 4 on the multiple linear regression analysis tests shows that the regression equation is with the following formula:

$$FP = 0.099 + 0.516IA + 0.423TLS \quad (2)$$

The t-test for *Internal audit* was 4.921 with a significance of 0.000 < 0.05, and *H1* is accepted since internal audit has a positive effect on fraud prevention. The *Transformational leadership style* has a t-value of 5.638 with a significance of

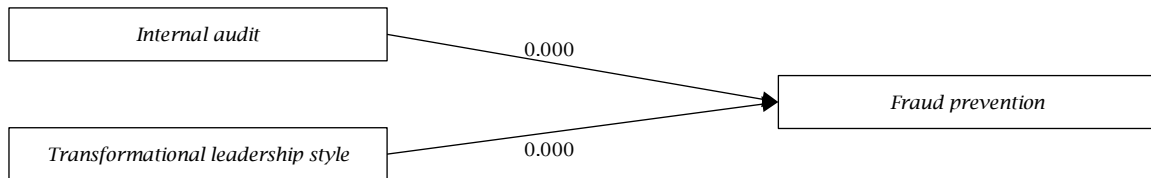
0.000 < 0.05, therefore, *H2* is accepted since the transformational leadership style has a positive effect on fraud prevention. The F-test was 64.605 with a significance of 0.000 < 0.05, stating that the *Internal audit* research model and *Transformational leadership style* on *Fraud prevention* are declared fit or good. The adjusted R-square value was 0.665, or 67%, meaning that the internal audit and leadership style significantly increased the number of frauds measured. In comparison, only 33% of the data was affected by other factors in the analysis model.

Table 4. Regression analysis

Model	Coefficients	T-statistic	Prob. (p-value)
	B		
Constant	0.099	0.184	0.855
Internal audit	0.516	4.921	0.000
Transformational leadership style	0.423	5.638	0.000
Adjusted R-square		0.665	
F-statistic		64.605	
Prob. (p-value)		0.000	
N		65	

Source: Primary data processed, 2022.

Figure 2. Result



5. DISCUSSION

The results show that *Internal audit* has a positive effect on *Fraud prevention*. The internal audit process is directly related to fraud prevention. An internal audit is a unit or part of an organization that detects and prevents fraud (Khan et al., 2020), and in universities, monitoring activities plays

an important role in this prevention. Internal auditors create work programs and audit plans to meet organizational goals and programs during monitoring activities. There are procedures to monitor financial and procurement activities within the organization, from initial planning to final reporting.

When internal auditor perform their duties according to standards, can make practical plans, find material errors, and communicate effectively the resulting recommendations, it shows that internal auditors are performing their roles effectively as confidants and consultants in fraud detection and prevention (Lonto et al., 2023).

The internal audit aims to assist organizational leaders in conducting their duties more effectively and generate added value. Internal auditors are tasked with helping the government in handling budget management. They have a role in providing good service by carrying out monitoring functions and preventing fraud (Fitriyah & Fauziah, 2020). This research is consistent with Petraşcu and Tieanu (2014) that internal auditors significantly affect fraud prevention and detection (Kharie & Darwis, 2020). Organizational fraud prevention measures can be carried out by internal auditors and top management (Dewi & Apandi, 2012). This finding supports Alazzabi et al. (2020), that internal audit has an important role in achieving a better level of fraud management. However, this study contradicts Kabuye et al. (2017), who found that internal audits do not predict fraud management significantly. This study does not support Lonto et al. (2023) that internal auditors' professional competence and skills have no effect on preventing fraud.

Transformational leadership style has a positive effect on *Fraud prevention*. To build a strong emotional connection between superiors and subordinates, this leadership has a good vision, clear rhetoric, and understandable management practices (Bass, 1985). It is more successful in ensuring that organizational change is conducted according to the leader's vision and with a high emotional level of subordinates (Hughes et al., 2015). Transformational leaders coordinate and provide opportunities for subordinates to participate in decision-making (Lau, 2014). According to Jyoti and Dev (2015), empathy, support, and behavior help subordinates reduce the perception of the status quo to increase participation. Consequently, there will be an increase in prevention, and the top management can play an important role in detecting fraud by conducting reviews of international controls.

Transformational leadership positively affects subordinates in the fundamental aspects of values, independence, identity, motives, and other cognitive and affective aspects of life (Hoffman et al., 2011; Hannah et al., 2016). Furthermore, it can reduce the severity of any deviation at the bottom. To maximize the benefits for the business and the community, leaders should always pay attention to innovative, profitable, and ethical business practices (Podrug, 2011).

The leaders are stewards who automatically connect actions with the principal's objectives (Davis

et al., 1997; Pastoriza & Ariño, 2008). According to stewardship theory, leaders will act as servants and will not stop pursuing the principal's interests. This theory also emphasizes the importance of managers' commitment to the organization and loyalty to principles (Pastoriza & Ariño, 2008; Van Puyvelde et al., 2013). These results are consistent with Meiryani et al. (2018), Handoko et al. (2019), Fitriyah and Fauziah (2020), and Suharto (2020) that leadership style has a positive effect on fraud prevention.

6. CONCLUSION

In this research, we emphasized the role of internal audit and transformational leadership style in fraud prevention in Indonesia. The results show that internal audit and transformational leadership styles have a positive effect on preventing fraud. Meanwhile, internal auditors have the motivation to conduct the supervisory function and detect irregularities in providing good service. Internal auditors as employees and parties that should be independent will work for the principal's interests. To manage governance effectively, organizational leaders should work hard to act as role models and positive motivators. This can positively contribute to stewardship theory by raising standards for fraud prevention. Furthermore, wise decisions will be created by providing maximum service to principals to achieve organizational goals. The leader or manager also functions as a servant and continues to interact with the principal.

Practical advice can be provided to all state university personnel related to fraud prevention. The involvement of all personnel, especially internal audit and leadership, will increase motivation in achieving organizational goals efficiently and effectively. To properly identify risks and provide improvement strategies, the management should maximize the use of internal auditors as consultants and analysts.

There are some research limitations. Firstly, only state universities were covered so it could not be generalized to all universities. Secondly, respondents' time and data collection are not maximized due to their business. Further research should use private universities and consider the timing and technique of distributing questionnaires tailored to the respondents' activities. This can also be developed by adding variables of the role of external audit and risk management to determine the extent of the role of external audit and risk management on fraud prevention comprehensively.

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