DOI: http://doi.org/10.4038/ija.v2i2.46
INTERNATIONAL JOURNAL OF ACCOUNTANCY
ISSN 2738-2249
2022 Volume 2, Issue 2, December
https://ija.sljol.info/

Effect of Internal Audit on Fraud Management in the Financial Service Sector in Sri Lanka

[1]Sepala, P.H.N.H., [2]Herath, H.M.M.N. and [3]Munasinghe M.A.T.K.

[1,2,3] Department of Accountancy, University of Kelaniya, Sri Lanka.

[1]nimeshahansanisepala@gmail.com, [2]maher191@kln.ac.lk and [3]amila@kln.ac.lk

Abstract

This study aims to study the relationship between internal audits and fraud management. Accordingly, this study, examines the internal audit organizational status, internal audit capabilities, and the contribution of internal audit activities to the fraud management of financial services companies in the Sri Lankan context. The target population for this study was defined as the 80 currently traded financial service sectors firms in Sri Lanka and data collected from systemically important banks namely, Bank of Ceylon, Commercial Bank of Ceylon, Hatton National Bank, People's Bank, Sampath Bank, Seylan Bank and they hold 78 percent of the banking assets and get total of 235 responses were collected from a questionnaire survey. In terms of findings, the results show that internal audit competence, is important predictors of fraud management. Also highlighted is that each financial service sector's concern about internal audit and forensic accounting is a value-added function of an organization and gives more attention to that area in the modern era. Researchers hope that their findings will add to the existing body of work and help close a knowledge gap in regards to emerging countries. The results are important for internal audit managers, internal audit policymakers to empower internal audit function in their organization.

Keywords: Financial Service, Fraud Management, Internal Audit, Internal Audit Competence, Organizational Status

Introduction

According to globalization, each company is trying to be the greatest in this challenging industry. Organizations now require internal audits to have strong capabilities and professionalism and must deploy scarce resources more effectively to minimize and manage risks (Institute of Internal Auditors, 2021). Numerous high-profile cases of financial fraud spanning two centuries show that fraud is not a new phenomenon. As far back as recorded human history goes, men have been known to resort to underhanded means (such as lying, cheating, and stealing) to advance their financial, material, and social interests. Accounting and auditing have their origins in the necessity, notably on the part of the state, to limit and prevent financial misrepresentation and theft (Bogdan, 2005). However, during the Middle Ages, Western Europe's interest in controlling financial documentation and accounts, as well as verifying the use or misuse of funds, grew. The major goal was to find and prosecute those who evaded payment, usurped funds, or misappropriated money and property(JE Campos, 2007). The state represented by the reigning monarch, the Catholic Church, and universities especially those from Northern Italy were the three institutions that introduced the idea of verifying accounts and holding wrongdoers accountable as early as the 13th-14th centuries and employed functionaries or monks to keep the accounting of their respective structures (Le Goff,1977).

Forensic accounting is often equated with fraud examination or fraud auditing (DiGabriele & Huber 2015). "Forensic accounting is a challenging discipline that substantially interacts with auditing, economics, finance, information systems, and law" (Crumbley, 2009). The most comprehensive definition of forensic accounting is given by Huber and DiGabriele (2014), define it as "a multidisciplinary field that encompasses both a profession and an industry, where civil or criminal economic and financial claims, whether business or personal, are contested within established political structures, recognized and accepted social parameters, and well-defined legal jurisdictions, and informed by theories, methods, and procedures from the fields of economics, law, and psychology. According to Hendi (2013), the term "fraud related audit" is defined differently by different people. It further claims that words such as "forensic audit," "forensic accounting," "fraud examination," and "financial forensics" are frequently interchanged (Hendi, 2013). Litigation consulting, expert witnessing, and fraud examination are three common areas of forensic accounting practice in Anglo-Saxon countries (Rezaee et al. 2004).

Although fraud prevention and control plan disclosures and their effect have been extensively researched on, studies on the extent of these disclosures are recent and growing. Madi et al., 2021 identified that the disclosures of eight aspects of fraud prevention policies, responses, initiatives and mechanisms were not satisfactory. Possible reasons could be because of lack of awareness and appreciation on the institutional mechanisms and lack of formal pressure from the relevant authority. Further, (Herath & Perera, 2021) identify that the importance of disclosures related to the financial statements and recommended that companies should include in their financials as such at a "minimum the amount of the transaction, amount of the outstanding balances, provisions for doubtful debts related to the outstanding balance and the bad or doubtful debt expense during the year" should be disclosed.

It's only been a few years since one of Sri Lanka's largest financial scandals, the collapse of the Pramuka Bank, left thousands of depositors powerless and distraught after losing money put with the bank. The manner and scope of supervision done by the CBSL over the activities of banks and financial institutions in the country has been widely criticized (Sunday Times, 2018). Furthermore, the incident at the time had an impact on the public view of the effectiveness of statutory audits conducted by renowned audit companies (The Sunday Times, 2018). Pramuka Bank's operational and strategic flaws were highlighted by the fact that 80% of its asset portfolio was made up of non-performing loans when CBSL decided to suspend the bank. Over 75% of Pramuka Bank's loans and advances were non-performing as of October 2002, the bank disclosed in its financial statements. The company's negative net worth of Rs. 230 million as of 30 September 2002 and inability to fulfill the minimum statutory liquid assets ratio of 20% led to CBSL's decision to immediately cease banking operations in October 2002 (Arjuna,2020).

One of the most well-known Sri Lankan financial firms was The Finance Company (TFC), which was established in 1940 and was governed by a Board of Directors elected by TFC's shareholders. On May 24, 2020, the Deputy Governor of the Central Bank of Sri Lanka stated that 93% of TFC's domestic depositors will be compensated through the Central Bank's Deposit Insurance Scheme, and the remaining depositors will be paid when the company's assets are liquidated (Central Bank of Sri Lanka, 2019). While the Central Bank's Deputy Governor is pleased that 93% of local depositors have been paid out, this is not the case with TFC deposits. 135,100 of the 145,172 depositors (of 4, 693,690,017 total) had balances of less than 600,000, as reported by TFC. The combined balances of the remaining 10,072 account holders amount to Rs 22,567,744,770.00. The Deputy Director reports that only 17.22% of total deposits come from the 93% of customers whose issues have been resolved, or 135,100 customers. Other 10,072 depositors control 82.78 percent of the deposits, amounting to about Rs. 22 billion (Central Bank of Sri Lanka, 2019). CBSL reports that 600,000 rupees were paid out of the Liquidity Support Insurance Fund, resolving 39% of the deposits, leaving a total of 16 billion rupees to be resolved (Daily News,2020). There was a liquidity crisis in the closing weeks of 2008 due to the bankruptcy of the Golden Key Credit Card Company, a Ceylinco Consolidated subsidiary. The monetary board of Sri Lanka's Central Bank resolved to merge Seylan Bank with the state-owned Bank of Ceylon on December 28, 2008. (BOC). The Act No. 58 of 1949 on Monetary Law permits this action under Section 30(1). When the unsupervised Golden Key Credit Card Company, part of the Ceylinco group, defaulted on its customer repayments and went bankrupt, Seylan Bank was thrust into the middle of a crisis (Central Bank of Sri Lanka, 2019)).

As a result, it is critical for economic development and financial stability, and it can be thought of as the heart of the economy (Roman & Argu, 2013). As banks' effective functioning leads to rapid economic growth, there is a need for continual evaluation of bank internal audit and fraud management (Weersainghe et al., 2013). The considerable contribution of commercial banks pushes researchers to look for important factors of fraud management in financial intermediation (Bandaranayake & Jayasinghe, 2014). As a result, it is critical for economic development and financial stability, and it can be thought of as the heart of the economy (Roman & Argu, 2013). As banks' effective functioning leads to rapid economic growth, there is a need for continual evaluation of bank internal audit and fraud management (Weersainghe et al., 2013). The considerable contribution of commercial banks pushes researchers to look for important factors of fraud management in financial intermediation (Bandaranayake & Jayasinghe, 2014).

Recent corporate accounting scandal and outcry over transparency and honesty have led to two logical results. Internal audit skills are crucial for solving complex accounting operations that confuse financial statements. Second, public pressure and regulatory actions have changed corporate governance (Jarah et al., 2022). More executives and directors face ethical and legal scrutiny(Schwartz, Dunfee and Kline, 2005). Both trends aim to address investors' "worries about financial reporting systems." But due to a lack of understanding of assessment skills and procedures, identifying corrective actions and losing them out, and poor management decision making, there has been laxity in the execution of internal audit findings and recommendations. Because of this sloppiness, the researcher felt compelled to investigate the internal audit functions, organizational significance, relationship to asset management, and impact on fraud in the financial services sector (Abdelrahim and Al-Malkawi, 2022).

The main research question of this study is, what is the relationship between internal audit organizational status, competencies, activities and fraud management? Sub research questions are as follows;

1. What is the relationship between internal audit organizational status and fraud management?
2. What is the relationship between internal audit competencies and fraud management?
3. What is the relationship between internal audit activities and fraud management?

Based on the identified research questions, the main research objective is this study is to identify the relationship between internal audit organizational status, competencies, activities, and fraud management.

Annual global revenue loss due to fraud approximates $3.7tn (Association of Certified Fraud Examiners (ACFE), 2016), resulting in the organizations undertaking significant efforts to establish effective FM measures to reduce its increasingly undesirable consequences (Global fraud report, 2014).Occupational fraud around 2,504 cases from 125 countries the largest number of cases reported from the Banking and Financial Service sector (364 Cases). Occupational fraud causing total losses of more than $3.6 Billion, median loss per case was $125,000 in 2,504cases around 125 countries (Report to The Nation, 2020)

As anti-fraud controls, internal audits are74% most common in the world. The most significant fact is that 18% of occupational fraud was initially detected by Internal Audit in Southern Asia (Report to The Nation, 2020). Because of that, the purpose of this paper is to study the relationship between IA and FM. In the Sri Lankan context, financial sector businesses give a significant contribution to Gross Domestic Production and add more value to the service sector of Sri Lanka.

Due to the conflicting results of previous studies and the growing importance of Fraud Management, the goal of this study is to try to close the gap by looking at how the organizational status of internal audit, the competence of internal audit, and the activities of internal audit affect Fraud Management in financial services firms. As far as we know, there hasn't been a lot of research done on the individual effects of internal audit status, competencies, and activities as internal audit constructs on fraud management in Sri Lanka. So, it's important to do a full evaluation of how internal audit affects fraud management in the financial services sector.

This study will help in increasing the role and image of internal audit in financial Service sector to make it more effective and professional. This study will be benefited to the stakeholders like shareholders, managers, policymakers. It will assist shareholders in understanding the importance of internal audit as one of the most significant managerial control systems in a company that must protect their interests. The management of financial Service sector will be able to look for ways of making Internal Audit is a completely independent function from the management thus making it more effective. This study will help management predict how employees will act in the future and how important the internal audit function will be. It will also help prevent fraud and improve the company's performance. It will also help them find ways to do things, take advantage of opportunities, and reduce the chances of high-risk areas in the company by using good internal control. By following the suggestions in the Internal Audit reports, management will be able to improve how well the Banks do their jobs. Scholars will be able to understand internal audit better and learn more about it, which will help them follow the professional ethics that are required by the Internal Audit Standards. Researchers can use this research to do more studies in the same area or one that is related to it. It can be used as a theoretical basis for the new research.

Literature Review

Theoretical background

Agency theory and the internal audit as propounded by Adams (1994) is one of the theoretical frameworks that guided this study. In order to solve the problem between principle and principal subject, agency theory is applied. This issue emerges because the principal and the agent have competing goals; the principal has a hard time verifying the agent's real behavior; and the principle and the agent have divergent views on the acceptable level of risk. (Ondeiki, 2013). The agency theory, according to Anderson, Francis, and Stokes (1993), identifies a firm as a necessary structure for the maintenance of a contract. Control can be exercised through the corporation, and the agent's opportunistic conduct is reduced. A detailed agreement was created to address the interests of the agent and the principal in order to coordinate the interests of the agent and the principal; they also explained that the principal employed professionals to supervise the agent, which further cemented this relationship. In the contingency theory, it basically explained to one variable dependent on another variable. (L.Daft, 2010). A further explanation is given by Nancy (2013), Davoren, (1994) the main purpose of the audit is to maintain the reliability of financial information in the organization. Certain types of financial institutions are mandated by law to undergo independent financial audits, while other types of businesses may be expected to undergo audits based on industry standards in areas like security and technology. Therefore, various factors will affect the company's performance, so these factors should be considered in the internal audit process. Therefore, he concluded that contingency theory is included in internal audit. According to the (Volosin, 2007) in his book illustrated that the lending credibility theory and agency theory are similar theories. It describes that in order to enhance shareholders' confidence in management's management, it mainly affects the audited financial statements. The organization has appointed an internal auditor, so the purpose of the auditor is to express an opinion on the accuracy and performance of the company's financial presentation, and it related to fraud management of company (Letza, 1996).

Internal audit organizational status

Internal audit organizational status focuses on the internal auditor's independence, objectivity, management support and adequacy of talent and capable staff (Ebaid, 2011). The internal audit function's current organizational standing should be enough for it to carry out the tasks outlined in its audit charter. Positioning the audit activity such that it may get cooperation from management and staff of the program or entity being audited, as well as unfettered, unrestricted access to all functions, records, property, and personnel (including those in charge of governance), is essential. Internal auditing is carried out in a context where there are intimate and sometimes dependent relationships with management; thus, objectivity and independence from management are debatable topics (Glascock, 2002). Internal audit independence is threatened, according to Christopher et al. (2009), when the internal audit function is used as a stepping stone to other positions; when the CEO or the CFO approves the internal audit function's budget; when the CEO or the CFO provides input for the internal audit plan; when the internal audit manager does not report functionally to the audit committee; and when the audit committee does not provide sole responsibility for appointing, dismissing, and evaluating the internal audit manager. Along with the audit committee, the management committee, and external audit, internal audit is considered to be one of the four pillars that support governance structures within financial services firms, namely banking governance structures (Naheem, 2016). Internal auditors, as workers of an organization and internal assurance providers, are in a unique position to help with fraud management (Stewart and Subramaniam, 2010). We agree with others (Khelil et al., 2016) that the internal auditor must report any irregularities or fraudulent acts to the audit committee. In this regard, Norman et al. (2010) discovered that internal auditors who should report to their management teams feel so threatened in the process; nevertheless, they discovered that internal auditors who report directly to the board felt even more threatened, because they generally tend to reduce their assessment of the risk of fraud when reporting to the audit committee rather than just the executive. Later, Norman et al. (2010) justifies this by recommending that, regardless of the reporting procedure, risk assessment results as well as other information be filtered through management before being disclosed to the audit committee, as personal attacks from the audit committee and management are lowered. On the contrary, Khelil et al. (2016) discovered that getting private access to the audit committee improves the chief audit executive's moral bravery.

As per the discussion above, the real effect of internal audit organizational state is uncertain. As a result, the organizational status of internal audit is essential in improving anti-fraud measures in the firm. As a result, we propose the following:

H1. Internal audit organizational status is positively related with fraud management.

Internal audit Competence

Competence is defined as having the intelligence, education, and training to contribute value to an organization via performance (Chambers, 2014). Internal audit competency is the result of an extensive training, which includes guidance in the fundamental understanding, skills, and methodologies, as well as academic principles, as well as a commitment to ongoing work (IIA, 2013). Internal auditors must engage in services for which they have the necessary knowledge, skills, and experience; perform duties in accordance with the Standards; and continually improve their proficiency and effectiveness. The IIA's Code of Ethics Standards requires internal auditors and the internal audit activity to have the necessary knowledge, skills, and other competencies. Competent, professional internal audit staff who follow the Standards can help ensure success. The IIA's Internal Audit Competency Framework provides a clear professional development plan for all internal auditors. The framework includes four knowledge categories focused on Standards, situational functions, and core proficiencies, as well as three separate competencies from basic awareness to knowledge application to professional practitioner. The comprehensive and parallel strategy focuses on best practices and practical applications to define and offer the knowledge and skills needed for a successful career in internal auditing. Internal auditor certification is seen as an indication of significant skill and is vital for progression within internal audit departments, according to Gramling and Myers (1997). Education, experience, and professional certification, as well as computer and communication skills, are all qualities that firms should look for when recruiting internal auditors (Harrington, 2004. As a result, the quality of internal auditors' audits is determined by their level of expertise and capabilities (Gramling and Hermanson, 2009; Zain et al., 2006). Internal auditors, from the other hand, can refuse to comply with several key parts of fraud standards since they only come across corporate crime by chance (Hassink et al., 2010). As a result, identifying and prioritizing the core competencies of internal auditors is critical in enhancing their fundamental capabilities to improve fraud control in a business (Chambers and Odar, 2015). Internal auditors' objectivity, competency, and quality of work, according to Jordanian auditors, seem to be very essential criteria influencing their fraudulent reliance determinations (Suwaidan and Qasim, 2010). Internal audit competence in fraud management can really be understood within the context of effectiveness, which Chambers (1992) defines as "doing the right thing." Because contemporary internal audit is built on the three E's of effectiveness, efficiency, and economy (Ridley, 2008), internal audit competence in fraud management can be understood in the context of effectiveness. That expect high - quality fraud management activity just if internal auditors' profiles match stated criteria, as Roussy and Brivot (2016) advise as technical competence. As a conclusion, we propose the following hypothesis:

H2. Internal audit competence is positively related with fraud management

Internal Audit Activities

Internal auditors deal with issues crucial to a company's survival and growth. They also analyze the company's reputation, growth, environmental impact, and employee treatment, unlike external auditors. Internal auditors aid businesses. Internal auditing improves a company's risk management, control, and governance systems. Internal auditors do much. Internal audit's risk management responsibilities span the mailroom to the boardroom. Internal auditors assess and report on management policy implementation. Internal audit activities, particularly those described in the IIA's new definition of internal audit, have been the subject of previous research. According to Leung et al. (2003), a substantial majority of internal auditors in Australian companies consider risk management to be an important internal audit aim. In practice, most of their auditing was done with a focus on risks. Internal auditors at large Italian enterprises benefit to risk management, according to Allegrini and D'Onza (2003). Evidently, internal auditors at major Italian corporations have an impact on risk management. Involvement in tailoring risk management approach to the organization, consulting services in risk management activities, or facilitation of control and risk self-assessments are all examples of what they did. Gramling and Myers (2006) found that American businesses reported allocating less than 10% of their audit department's time and resources to risk management-related tasks. How do internal auditors in American and Belgian companies compare on their view of their job in risk management? That's the question addressed by Beelde (2006). It demonstrates that internal auditors in large Italian companies assist to risk management. They contributed to the customization of risk management methodologies for the organization, provided risk management consulting services, and facilitated control and risk self-assessments. In a poll performed by Gramling and Myers (2006), nearly half of chief internal audit executives in US corporations stated that risk management-related activities accounted for 10% or less of their audit department's hourly and budgetary budgets. Sarens and De Beelde (2006) evaluate how internal auditors in the United States and Belgium view their current role in risk management According to the researchers, internal auditors are pioneering the development of a higher level of risk and control awareness, as well as a more formalized risk management system, in Belgian firms. Internal auditors can immediately discover elements that may lead to fraud, according to Church et al. (2001). Therefore, internal auditors are more likely to develop tests to detect fraud when they meet such symptoms, thereby raising the possibility of discovery. Along with financial transactions, internal audits can also look at other factors that contribute to fraud management, such as the procedures of individual departments and whether or not they are in line with applicable laws and regulations (Rae and Subramaniam, 2008). According to Asare et al. (2008), internal auditors who do self-assessment and/or due diligence are aware of variations in management performance incentives, prompting them to increase fraud risk assessments by tailoring audit plans. According to Ebaid (2011), however, Egyptian listed businesses have not yet advanced the internal audit function to the expanded new role outlined in the Institute of Internal Auditor's revised definition of internal auditing. To better the internal auditor's position in fraud management, it is necessary for the function to expand into the realm of corporate governance auditing. This will allow for more reliable assurance to be provided to boards regarding the efficacy of risk management and controls (Chambers and Odar, 2015). Therefore, hypothesize that:

H3. Internal audit activities are positively related to fraud management.

Empirical studies

Fraud losses continue to be a problem for almost every firm. Every year, the insurance sector loses around $67 billion in the United States due to fraudulent claims. (The Federal Bureau of Investigation [FBI] published a report in 2003.) According to Frank et al. (2017), internal audit organizational status and internal audit competence are significant predictors of fraud management. Contrary to common opinion, the results of an internal audit have zero impact on the administration of fraud. Therefore, once internal auditors have attained an appropriate level of status and competence within an organization, they are more likely to take part in actions that enhance fraud management. For a company to run smoothly, it needs an internal audit to ensure that its assets are being managed well, that costs are being cut in a methodical manner that still allows profits to grow, and that its medium- and long-term goals are being met. Also, the benefits it delivers in terms of fraud protection and, most significantly, future additional value should be considered, rather than the fact that it generates costs (Daniela & Tieanu ,2014). Sourour Hazami-Ammar (2017) observed a positive correlation between the amount of activities conducted by the function, the company's size, the function's independence and impartiality, and the function's adoption of a systematic approach to evaluating the success of risk management.

Moon, HoYoung, and Park (2014) discover that their findings on the relationship between the qualities of statutory internal auditors and operating efficiency differ from those of others. There is no indication that mandated internal auditors have a favorable influence on operating efficiency, according to the findings. It demonstrates that statutory internal auditors' salary data may not accurately reflect their capabilities and potential to increase corporate efficiency in Korea. Based on a sample of 1,340 enterprises, they investigated three characteristics that affect statutory internal auditors, namely compensation, activity, and expertise. The observations were made between 2009 and 2010, utilizing publicly available disclosure data for Korean publicly traded companies. The findings also reveal that when statutory internal auditors are freshly appointed, operating efficiency suffers.

Internal audit functions boost business operating efficiency, according to Ying, Lizhen, and Gaoguang(2019) China provides evidence. The effectiveness of an internal audit function is linked to the efficiency of a company's operations. They also show that internal audit function competency improves firm operational efficiency, while the link between internal audit function independence and firm operational efficiency is negligible. They also discovered that the quality of the internal audit function can only significantly increase the company's operational efficiency if there is efficient corporate governance and competent provincial institutions. Stakeholder expectations of the internal audit role have altered dramatically in recent years, according to Thornton (2004). The focus has shifted from compliance and financial control functions to enabling businesses to actively identify, assess, and manage risks. At the empirical level, a survey conducted by KPMG (2014) found that the internal audit function in the existing organization is thought to be of great importance in improving performance and assisting fraud management, particularly financial fraud, which has always proven the link between weak governance and financial fraud. Internal audit protects the organization from fraud and irregularities by acting as a supervisor, allowing it to achieve its goal of high production, profit, and fraud management. The fraudster wants to reroute an overdue payment. This type of fraud can come from an outside source, such as a dishonest person or company, or a dishonest employee. Fraudsters impersonate providers by sending fake emails and using social engineering. The fraudster wants to reroute an overdue payment. This type of fraud can come from an outside source, such as a dishonest person or company, or a dishonest employee. External fraudsters seek to imitate a provider by sending fraudulent emails and using social engineering. Hundreds of thousands of dollars were paid to the fraudster as a result (KPMG, 2021).

Methodology

This section describes the approach taken to conduct this study. The Central Bank of Sri Lanka is included in the study's designated population. In Sri Lanka, the Financial Service Sector includes all Commercial Banks, Specialized Banks, Finance Companies, Registered Finance Leasing Establishments, Authorized Primary Dealers, Authorized Money Broking Companies, and Authorized Microfinance Institutions that hold appropriate licenses. (CBSL, 2021). As a result, the study's population was 88 financial institutions as of June 30, 2021 (CBSL, 2021).

With the largest market share of the financial sector's assets, LCBs dominate the financial system (CBSL, 2021). The well-being of the Sri Lankan financial system is dependent, to a significant degree, on the stability of the local commercial banks (LCBs), and more specifically, on the profitability and stability of the six largest LCBs, which are collectively referred to as the Systemically Important Banks (SIBs). Because it does not play a significant intermediate function in the payment cycle, the relevance of the LSB sector to the financial system is relatively low in compared to that of the LCBs. This is true in terms of both their size and the impact they have on the system as a whole.e. Bank of Ceylon, Commercial Bank of Ceylon, Hatton National Bank, People's Bank, Sampath Bank, and Seylan Bank are the six systemically important banks, holding 78 percent of the banking assets. Six subjects (systematically important Banks in Sri Lanka) were chosen from a sample of Sri Lankan Financial Institutions. Subjects who matched the sample requirements were determined by the researcher, as the designation above the executive level and now employed in Sri Lanka's systematically important banks.

Based on the literature review conducted, following Conceptual diagram was derived which shows the relationship among the concepts identified in the study.

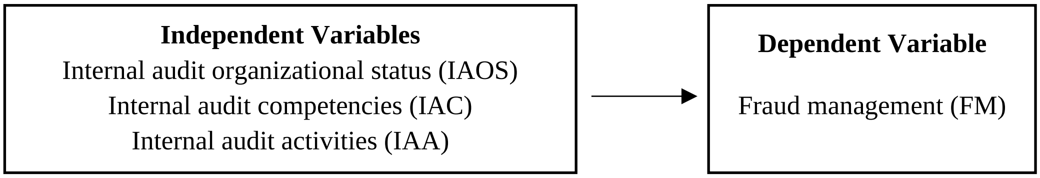

Figure 1: Conceptual diagram

A self-administered liker scale questionnaire was circulated to the samples who were chosen for this investigation. This questionnaire was the primary source of data collection that was considered in the process of fulfilling the goals of this study. As a consequence of this, the investigation will be carried out making use of primary sources of data in accordance to the goals of the study. E-mails and LinkedIn were used to disseminate the electronic versions of the surveys to the respondents so that they could fill them out and return them. This was done so that the response rate would be as high as possible. The administration of it takes less time and effort to complete. It provides the chance for anonymity because the subjects' names were not required to be included on the questionnaires that were to be filled out, and it reduces the likelihood of bias because the surveys were given in a consistent manner.

The process of developing the question had involved multiple steps, including the following: In light of the fact that an overall analysis of the situation surrounding the research was performed, it was essential that the study's objectives be met. The earlier work on the literature review served as a helpful starting point for the development of the questionnaire.

After that, the finished questionnaire was then given to the chosen internal audit members of a well-known bank in Sri Lanka who are already in the bank's internal audit division for the purpose of pre-testing and validity test from the experts. When it came time to polish the questionnaire and close any gaps in coverage, their thoughts and ideas were taken into consideration. The protocol for the pilot study was adhered to. The questionnaire was presented to ten (10) Branch Managers and ten (10) audit team members who were included in the study population. Each of these individuals was given the opportunity to complete it out. That every effort would be made to guarantee that as many completed questionnaires as possible were received in response. This completed questionnaire was subsequently made available in an online format, and responses were collected using Google forms.

Following the completion of the questionnaire survey, the data from the questionnaire were input into a data entry application that had been specifically developed for the purpose. The IBM SPSS software program, version 23, was utilized for the processing of the data. The researcher conducted quantitative content analysis on the responses to the open-ended questions with the intention of measuring developing features and notions. In terms of the analytical methodologies, first, descriptive statistics regarding the variables will be presented in order to acquire an overall concept of the sample of professional bankers working in practice.

Findings of the Study

In order to evaluate whether or not parametric tests are applicable, we first validated the normality of our data before proceeding with the testing of hypotheses. The statistics of skewness and kurtosis were utilized in order to accomplish this goal. The skewness scores for all of the variables were very close to 0, and the kurtosis results for all of the variables were within the range of -2 to +2; additionally, the standard errors for each of the variables were not very different from their respective Skewness and kurtosis scores, and as a result, the normality assumption was not violated (Garson, 2012; Field, 2009). Because it is the test that is most generally employed for each group, Levene's test (Levene, 1960) was used to determine whether or not there was homogeneity in the variance (Garson, 2012). The results of the tests indicate that none of the predictor variables are significant ($p > 0.05$), and as a consequence, the assumption of homogeneity of variance for the categorical variables in relation to the outcome variable has not been violated (Field, 2009).

Cronbach's alpha is a statistic that determines how internally consistent a set of things is, or how closely linked they are to one another as a whole. It is taken into consideration as a measurement of the reliability of the scale. The measure does not necessarily have to be unidimensional just because it has a "high" value for alpha. On reliability test the Cronbach's alpha value is should be above 0.7. According to the above table reliability is 0.880 and then the overall questionnaire is reliable and suggesting that the items have relatively high internal consistency.

Table I: Reliability Statistics

Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items
.880	.882	35

Descriptive statistics

Demographic Information

Table II: Demographic Information

Demographic	**Categories**	**N**	**%**
Gender	Female	129	54.89
	Male	106	45.11
		235	**100**

The purpose of the survey was to learn more about the responder, hence a question about gender was included. A majority of ladies (55%) and males (45%) participated in the study, indicating that the results were not skewed by any preconceived notions about either gender.

Age Distribution

Table III: Age Distribution

Demographic	**Categories**	**N**	**%**
Age	Below25	10	4
	25-34	107	46
	34-44	72	31
	45-50	24	10
	Above 51	22	9
		235	**100**

The study requested the respondent to indicate their age category, from the findings, 46% of the respondents were aged between 25 to 34 years, 31 % of the of the respondent indicated they were aged between 35 to 44 years, 10% of the respondents indicated were aged between 45 to 50 years, whereas 9% of the respondents indicated that they were aged above 51 years also 4% respondent that indicate they were below 25. This is an indication that respondents were well distributed in terms of their age.

Level of Education

Table IV: Level of Education

Demographic	Categories	N	%
Level of Education	Secondary Certificates	10	4
	Diploma Level	31	13
	Bachelor's Degree Level	123	52
	Masters Level	59	25
	PHD	10	5
	Other- Only Professional Causes	2	1
		235	**100**

The study requested the respondent to indicate their highest level of education. from the findings It was established that 52% of the respondent indicated their highest level as degree, 25% of the respondent indicated their highest level as as masters,13% of the respondents indicated their highest level of education as diploma, whereas 5% of the respondents indicated their highest level as PHD ,4% of the respondents indicated their highest level as secondary certificates and, 1% of the respondents indicated their highest level as Only Professional Causes. This is an indication that most of the respondents focused on this study had university degrees as their highest level of education.

Period of Service

Table V: Period of Service

Demographic	Categories	N	%
Period of Service	Less than 2 years	21	9
	2-5 Years	70	30
	6-10 Years	47	20
	More than 10 Years	97	41
		235	**100**

The study requested respondent to indicate the number of years they had served for the bank. From the findings the study established that 41% of the respondents had worked for a period of raging More than 10 Years 30% of the respondent indicated that they had worked for a period raging between 2 to 5 years 20% of the respondents had served for 6-10 Years, and finally 9% of the respondents indicated to had worked for a period of less than 2 years, this implies that majority of the respondents had served for a considerable period which indicates that most of the respondents had vast knowledge which could be relied upon by this study. The observed data (Field, 2009) also indicate that predictor variables are rated high toward fraud management in the financial services firms. This implies that appropriate organizational status of internal audit, its competence and activities are key toward managing fraud in the organization.

Correlation Analysis

Karl Pearson's correlation coefficient is used to test the relationship between employee performance and its selected determinants using SPSS. Correlation matrix is given in below.

Table VI: Correlation Analysis

		FM	IAOS	IAC	IAA
FM	Pearson Correlation	1			
	Sig. (2-tailed)				
	N	235			
IAOS	Pearson Correlation	.573**	1		
	Sig. (2-tailed)	.000			
	N	235	235		
IAC	Pearson Correlation	.576**	.401**	1	
	Sig. (2-tailed)	.000	.000		
	N	235	235	235	
IAA	Pearson Correlation	.505**	.367**	.419**	1
	Sig. (2-tailed)	.000	.000	.000	
	N	235	235	235	235
**. Correlation is significant at the 0.01 level (2-tailed).					

According to the correlations analysis indicate a strong positive relationship between internal audit organizational status and fraud management (r=0.573** and $p < 0.01$). Meaning that when internal audit organizational status increases, fraud management is enhanced. Thus, H1 is supported. Similarly, there is a significant positive relationship between internal audit competence and fraud management (r=0.576** and $p < 0.01$), implying that any positive change in internal audit competence is related to a positive change in fraud management. Thus, H2 is accepted. There is also a significant positive relationship between internal audit activities and fraud management (r=0.505** and $p < 0.01$). This means that an increase in internal audit activities leads to improved fraud management. Therefore, H3 is also supported.

Discussion and Recommendation

Discussion

The results reported in this paper suggest that internal audit organizational status, competence and internal audit activities are significant predictors of fraud management. For example, the results indicate that when internal audit administratively reports to executive management and functionally to the audit committee of the board, this is likely to enhance fraud management. This is consistent with the suggestion that the hybrid reporting lines of the internal audit improves the quality of governance that is important in fraud firms (Farber, 2005) such as financial services' companies – making agency theory a relevant framework for understanding variances in fraud management. Because internal auditors' scope of activities includes detection and prevention of fraud within an organization (Perry and Bryan, 1997), this role makes it considered part of management and thus it could be argued that this is not enough in curbing management's presumed pursuit of its egotism. However, the independence of internal auditors will be enhanced if contemporaneously they report to the audit committee of the board. That way the internal auditor's role in managing fraud is improved by the enhanced independence. The results also suggest that management should always consult internal audit on matters of fraud management improvement. In this respect, internal audit function is seen as a partner to management in the quest for fraud management improvement which seems to concur with Norman et al.'s (2010) observation that internal auditors may increase their assessment of risk of fraud when reporting to executive management rather than to audit committee. But it is still expected that the reporting line to the audit committee offers the necessary moral courage of internal auditors in reporting fraud cases (Khelil et al., 2016). So, while the internal audit should always report functionally to the audit committee, in fraud management, this study suggests that internal auditors must receive adequate support from management.

The results reported in this paper suggest that it is one of the requisite competences of internal auditors that they say no to instances that lead to fraud in organizations and should be rewarded by management basing on performance. This paper suggests that this performance should include the extent to which the internal auditor has been instrumental in fraud management. Value addition of the auditor, in this perspective, is seen through such performance as being consistent with the suggestion by Chambers (2014). Internal auditor's competence thus plays a key role in stirring entity-wide fraud awareness, fraud investigations and reporting. Therefore, internal audit competence will increase compliance with audit plans and making of clear audit reports to management and the audit committee to ensure proper communication of fraud investigations outcomes and taking appropriate action in case of detected fraud. The empirical results presented herein confirm the prior literature in this regard, thus contributing to the internal audit and fraud management literature, particularly that focusing on the financial services sector.

Future suggestions

The results further suggest that individual contribution of internal audit activities to fraud management are subdued when internal audit competence and appropriate organization status (for example, the dual reporting lines of internal audit) are present. Therefore, if internal auditors have appropriate status in the organization and are competent, they will help management implement effective controls, manage risks and evaluate the sufficiency of various governance procedures to prevent, detect and respond to fraud. This corroborates with Ubaid (2011) on the effectiveness of internal audit among the Egyptian listed firms. Other corroborative studies have indicated that internal auditors are sensitive to factors that may lead to fraudulent financial reporting and that when they encounter such factors, internal auditors may be more likely to design tests to search for fraud, which in turn can increase the likelihood of detection (Church et al., 2001; Rae and Subramaniam, 2008; Chambers and Odar 2015).

Summary and conclusion

The purpose of this paper is to examine the contribution made by the internal audit organizational status, internal audit competence and internal audit activities on fraud management in the financial services firms. We surveyed 6 financial services firms and find that internal audit competence are significant predictors of fraud management. Once internal auditors are competent and have, they are likely to perform activities which enhance fraud management. The results reported in this paper suggest that internal audit organizational status, competence and internal audit activities are significant predictors of fraud management. For example, the results indicate that when internal audit administratively reports to executive management and functionally to the audit committee of the board, this is likely to enhance fraud management. Also highlighted is that each financial service sector's concern about internal audit and forensic accounting is a value-added function of an organization and gives more attention to that area in the modern era.

This study offers several implications. As forensic accounting is more concern concept in modern financial institutions when fraud is suspected, a forensic accountant can ascertain the nature of the crime, the motivating factors, and the value of the stolen property. A certified forensic accountant has the education and experience to advice clients in both the civil and criminal justice systems. We explore the role played by the internal audit organizational status in can moderate level enhancing fraud management, meaning that internal auditors who are unbiased and report functionally to the audit committee and administratively to executive management are likely to enhance fraud prevention, detection and reporting. This study has also established that internal auditor with adequate knowledge, skills and experience are in a better position to help management in establishing effective anti-fraud measures. Internal audit activities significantly predict fraud management in the Sri Lankan setting once the internal auditors have appropriate status in the organization and are competent. For policymakers like the Bank of Sri Lanka, the findings of this study will help them in prescribing the qualifications for internal auditors. Besides, internal auditors should be given the appropriate status in the entity and perform their new and expanded activities as per the institute of internal auditors (Intitute of Internal Auditors, 2013a, 2013b). The results are important for internal audit policy development, for example, in terms of prescribing the competences and reporting lines for the internal auditors to enhance fraud management in the financial services sector in Sri Lanka.

Despite the contributions and implications, this study focused on financial services firms in Sri Lanka to determine the contribution of internal audit organizational status, internal audit competence and internal audit activities on fraud management. It is possible that these results are only applicable to financial services sector unlike other sectors. The study also used more of quantitative data which sometimes misses certain information and limits the respondent's opinions on the study variables. While care was taken to control for response bias, it is unlikely it could be ruled out completely. However, this study clearly brought out the overall contribution of internal auditors in fraud prevention, detection and reporting as necessary.

References

ACCA. (2021). *ACCA GLOBAL.* Retrieved from https://www.accaglobal.com/pk/en/student/exam-support-resources/professional-exams-study-resources/strategic-business-leader/technical-articles/internal-audit.html

Accountants, C. I. (January 2009). *Fraud risk management-A guide to good practice.* United Kingdom: Chartered Institute of Management Accountants.

Adams, M. B. (Volume 9 - Dec 1, 1994). Agency Theory and the Internal Audit. *Managerial Auditing Journal* .

Aiken, L. S. (1991). Multiple regression: Testing and interpreting interactions. *Newbury Park, CA: Sage*.

Aksoy, T. a. (Vol. 3 -2013). "Measuring the internal audit performance: tips for successful mplementation in Turkey. *International Journal of Business and Social Science*, 72-76.

Al-Baidhani, A. M. (2020). The Role of Audit Committee in Corporate Governance: Descriptive Study.

Al-Najjar. (2011). The Determinants of Audit Committee Independence and Activity:Evidence from the UK. *International Journal of Auditing*, 191-203.

Andrew D. Chambers, M. O. (2015). A new vision for internal audit. *Managerial Auditing Journal, Emerald Group Publishing*, 34-55.

Asare, S. D. (2008). Internal Auditors' Evaluation of Fraud Factors in Planning an Audit: The Importance of Audit Committee Quality and Management Incentives. . *International Journal of Auditing*, 181–203.

Bank of Ceylon. (2020). *Bank Of Ceylon annual Report 2020.* Colombo,Sri Lanka: Bank of Ceylon.

Bryan K. Church, J. J. (March 2001). Factors Affecting Internal Auditors' Consideration of Fraudulent Financial Reporting during Analytical Procedures. *Auditing A Journal of Practice & Theory*, 65-80.

C. T. Gamage, P. K. (December 2014). *A PROPOSED REASERCH FRAMEWORK:EFFECTIVENESS OF INTERNAL CONTROL SYSTEM IN STATE COMMERCIAL BANKS IN SRI LANKA.* Sri Lanka: International Journal of Scientific Research and Innovative Technology.

Carcello, J. a. (2003). Audit Committee Characteristics and Auditor Dismissals Following "New" Going-Concern Reports. *The Accounting Review*, 95-117.

CGAP. (2015, July 04). *Fraud in Uganda: how millions were lost to internal collusion*. Retrieved from www.cgap.org/blog/fraud

Chambers, A. (July 1, 1993). *Effective Internal Audits: How to Plan and Implement.* Financial Times Management.

Chambers, A. D. (2014). New guidance on internal audit – an analysis and appraisal of recent developments. *Managerial Auditing Journal, Emerald Group Publishing,* , 196-218.

Chan, K. a. (2008). Audit Committee and Firm Value: Evidence on Outside Top Executives as Expert-Independent Directors. *Corporate Governance Journal*.

Commission, C. o. (May 2013). *Internal Control — Integrated Framework 'Ëxecutive Summary".* Committee of Sponsoring Organizations of the Treadway Commission.

D.T. Jayasinghe, R. A. (2019). *The Level of Usage and Importance of Fraud Detection and Prevention Techniques Used in Sri Lankan Banking and Finance Institutions: Perceptions of Internal and External Auditors.* Colombo: The Journal of Applied Research The Institute of Chartered Accountants of Sri Lanka.

Daniela Petraşcua, A. T. (May 2014). *The Role of Internal Audit in Fraud Prevention and Detection.* 21st International Economic Conference 2014 -Procedia Economics and Finance .

Deloitte. (2014). *Financial Crime Strategy Roadshow.* Deloitte Southeast Asia Ltd.

Department, E. R. (2021, April 30). Releases Annual Report for the Year 2020. *The Central Bank of Sri Lanka Releases its Annual Report for the Year 2020*.

(n.d.). *Discretionary-accruals models and audit qualifications.*

Dwamena, r. O. (2021). The Roles and Status of Internal Auditors in Public Sector Organizations. *Dama Academic Scholarly & Scientific Research jOURNAL*, 01-22.

Ekow Nyarko Dadzie-Dennis, D. L. (September 2018). Employee Fraud in the Banking Sector of Ghana. *SBS Journal of Applied Business Research*.

Examiners, A. o. (2020). *Report To the Nation 2020 Global Study on Occupational fraud and abuse.* Association of Certified Fraud Examiners.

Farinha, J. (2003). Corporate Governance: A Survey of the Literature. *Journal of BusinessFinance & Accounting*, 1173–1209.

Goodwin, J. (2003). The Relationship between the Audit Committee and the Internal Audit Function: Evidence from Australia and New Zealand. *International Journal of Auditing*, 263–278.

India, K. (2012). *India Fraud Survey 2012* . KPMG.

International, K. (2012). *Fraud, Bribery and Corruption Survey 2012- A report on the key findings.* KPMG International.

J.S.Kumari, R. A. (2019). *Investors' Perception and Audit Expectation-Performance Gap (AEG) in the Context of Listed Firms in Sri Lanka.* Colombo: The Journal of Applied Research The Institute of Chartered Accountants of Sri Lanka.

James L. Bierstaker, R. G. (1 June 2006). Accountants' perceptions regarding fraud detection and prevention methods. *Managerial Auditing Journal,* 520-530.

K.Wadhwa, A. S. (2020). Financial Fraud Prediction Models: A Review Of Research Evidence. *International Journal of Scientific & Technology Research*.

Khan, H. (2011). A Literature Review of Corporate Governance . *2011 International Conference on E-business, Management and Economics* .

KPMG. (2020). *COVID-19:KPMG Fraud Survey.* KPMG International.

Lanka, F. I. (2014). *National Money Laundering and Terorist Financing Risk Assessment* . Central bank of Sri Lanka.

Lanka, K. i. (Issue 6 ,5th November 2020). *SriLanka Banking Report.* Sri Lanka: KPMG .

Lanka, K. S. (Issue 7,June 2021). *Sri Lanka Bankin Report* . KPMG Sri Lanka.

Martinov-Bennie, N. (2011). The internal audit function: Perceptions of internal audit roles, effectiveness and evaluation. *Managerial Auditing Journal*.

Mazlina Mat Zain, N. S. (31 August 2006). Internal Auditors' Assessment of their Contribution to Financial Statement Audits: The Relation with Audit Committee and Internal Audit Function Characteristics. *International Journal of Auditing*, 1-18.

McNally, J. S. (June 2013). *The 2013 COSO Framework & SOX Compliance- ONE APPROACH TO AN EFFECTIVE TRANSITION.* The Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Mr Brett Williams, P. A. (Vol. 8, Issue 3, 2010). Exploratory factor analysis: A five-step guide for novices. *Journal of Emergency Primary Health Care*.

Muhammad Shaheer Nuhu, F. U. (December 2017). Relationship between Forensic Accounting, Internal Audit Quality and Corporate Fraud Prevention: A Study of Listed Banks in Nigeria . *The International Journal of Business and Management Research*.

Olaoye Clement Olatunji, D. R. (November 2017). The Roles of Auditors in Fraud Detection and Prevention in Nigeria Deposit Money Banks: Evidence from Southwest. *European Scientific Journal* .

Oleh W. Steve Albrecht, C. O. (2014). *Fraud Examination.* Western, Mason, OH.United State of America.

Olukowade Eliezer, B. E. (2015). Relevance of Forensic Accounting in the Detection and Prevention of Fraud in Nigeria. *Historical Research Letter*.

PWC. (11 August 2020). *Fraud Risk and Control in the New Normal Age.* PWC.

PWC. (March 2020). *PwC's Global Economic Crime and Fraud Survey* . PWC.

S.D, G. (2017). An Empirical Study Of The Relevant Skills, Knowledge And Education In Forensic Accounting, And The Current Status Of Related Services In The Sri Lankan Context. *University of Sri Jayewardenepura* .

Scott L. Summers, J. T. (Vol. 73, No. 1 -Jan., 1998). Fraudulently Misstated Financial Statements and Insider Trading: An Empirical Analysis. *The Accounting Review-American Accounting Association*, 131-146.

Stephen Kwaku Asare, R. A. (31 October 2008). Internal Auditors' Evaluation of Fraud Factors in Planning an Audit: The Importance of Audit Committee Quality and Management Incentives. *International Journal of Auditing*, 181-203.

The Institute of Internal Auditors. (2021). *The Institute of Internal Auditors Global*. Retrieved from Internal Audit Competency Framework: Who It Is For: https://global.theiia.org/standards-guidance/Pages/IAC-Framework-Who-It-Is-For.aspx

Umaru Hussaini, A. A.-B. (2018.12.12). The effect of fraud risk management, risk culture and performance of banking sector: A conceptual framework. *International Journal of Multidisciplinary Research and Development*, 71-80.

Wolfe, H. (2004,2011). The Fraud Management Lifecycle Theory:A Holistic Approach to Fraud Management. *Journal of Economic Crime Management*, 1-38.