

Auditor Experience with Client and Fraud Detection: The Moderating Role of the Royal Family in the Gulf Cooperation Council (GCC) Context

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To date, companies pay more attention to detect fraud in financial reporting and how to generate high quality reports. Previous studies investigated the relationship between auditor experience with the client and fraud detection, unfortunately, royal family influence in explaining the relationship between them was ignored in previous studies. This study explores the current state of the research on the impact of auditor's experience with the client and fraud detection. A new conceptual model has been proposed based on the influence of Royal Family on fraud detection within Gulf Cooperation Council (GCC) country. This contributes to fraud literature and in obtaining new insight of auditing operations. In addition, this study contributes to the evaluation of the effect of the royal family on the relationship between auditor experiences with client and fraud detection in GCC companies as the presence of the royal family leads to better auditors to perform their work ethically and independently.

Key words: *Fraud detection, auditor experience, royal family, GCC.*

Introduction

Fraud detection has become a pertinent issue for managers or researchers in the Gulf Cooperation Council (GCC). The Association of Certified Fraud Examiners (ACFE) in 2016 reported that fraud is common to many organisations with an average of 5% revenue loss. According to PricewaterhouseCoopers (PwC), the highest number of unreported frauds in the GCC region are 17% and were discovered by accident in 2016. At the global level, only 3.9%

of fraud cases are discovered by accident for companies with whistleblower hotlines, while 7.8% for companies that do not have the hotlines (ACFE, 2016). Similarly, ACFE reports also state that the Middle-East and North African (MENA) region has the lowest occupational fraud rate that accounts for only 3.7% of the total cases. However, this region has the highest median loss from fraud of \$275,000 per case compared to the global median loss of \$150,000 per case. Based on these reports, we can conclude that the majority of fraud scandals in the region are revealed accidentally.

Most of the fraud scandals in the GCC region are related to the weakness of auditor's experience with their client, thus the auditors are likely unable to detect the existence of fraud. Although this issue is important in detecting fraud, however, previous studies ignored the attention of investigating it, rather most of the available studies focused more on audit tenure's impact on audit quality (Patterson & Smith 2017; Geiger & Raghunandan 2002; Lixin, Yuyan & Zhifeng 2016). As a result, this current study reviews the auditors experience with the client on fraud detection. Herda and Lavelle (2012) examined the impact of auditor commitment to the client on the perception and support provided by the client. The findings reveal that high commitment from the clients is positively related with high value-added services. In addition, auditors with positive client perceptions have stronger auditor-client relationships, which leads to extensive service delivery that exceed core audit services. Therefore, when auditor's experience with the client is high, it may also enhance fraud.

Besides that, the auditor experience with the client as a predictor for fraud detection, the royal family is also one of the important constructs to detect fraud scandal in the GCC region companies. According to Alzahrani and Che-Ahmad (2015), many companies in GCC associated with royal family members are managed more effectively since royal family members are stringent in overseeing management, which reduces the potential for mismanagement. Hence, the association with royal family can enhance the value of the firm for higher audit quality as well as auditors experience with the client (Al Ghamdi, 2012; Al-Hadi, Habib, Al-Yahyaee & Eulaiwi, 2017). Therefore, the effect of royal family on audit work to detect fraud need to be included in detecting fraud.

The royal family's role as a moderator in the relationship between auditor experience with client and fraud detection is important for GCC companies. This study conceptualises those roles based of the results of the past literature. For the fact that many prior studies examined fraud detection from different angles, this study uses them to critically analyse the important factors in determining fraud detection, especially the royal family and auditor experience with the client.

Literature Review

a. Fraud Detection

Fraud is a wide-ranging and multifaceted term taking on different meanings depending on the context. Given the large interest in understanding fraud, different groups and researchers have offered various definitions of the concept. For example, fraud is an illegitimate or criminal deceit destined to result in financial or personal benefit based on The Oxford English Dictionary (2018). More specifically, fraud is described as the deliberate manipulation of financial documents, reports, and statements with the purpose to deceive investors and shareholders on the financial health of a company (Zabihollah, 2002). At the same time, the ACFE uses the term occupational fraud and abuse to refer to fraud as the use of a person's occupation to enrich oneself by deliberately misusing or misapplying organisational resources or assets. The term covers the fraud done by employees, managers, executives, or owners of the organisation that is the victim of the fraud (ACFE, 2016). It can be perpetrated through asset misappropriation where the employees engage in checking forgery, checking kiting, procurement fraud, expense reimbursement fraud and commission fraud (Nawawi & Salin, 2018). Another common way of occupational fraud is vendor fraud committed through billing schemes, bribery and kickbacks, overbilling and price fixing (Vona, 2017). Furthermore, Orimoloye, Austin, and Keys (2015) defined fraud as a scheme where an employee defrauds the employer with the goal of personal enrichment through misappropriation of the employer's assets. The definitions have three things in common. First, occupational fraud is done by people working for an organisation. Second, it is perpetrated for the financial benefit of the person who commits it. Third, the fraud costs the employer (organisation) resources or assets. Hence, perpetrators of occupational fraud breach their fiduciary duty to their employer, who bears the direct cost of the fraud.

From the auditing profession's perspective, fraud is defined in the International Auditing Standards (ISA) No. 240 published by International Federation of Accountants (IFAC) as "an intentional act by one or more individuals among management charged with the governance of the company, employees or third party involving the use of deception to obtain unjust or illegal advantage" (IFAC, 2009). Fraud can be perpetrated by an employee, management or organisation as identified in the fraud triangle, which shows the motivation for fraud within an organisation. The fraud triangle models the factors that prompt fraudulent behaviours, consisting of incentive, opportunity, and rationalisation. Incentive is the personal pressure that induces the need to commit fraud such as financial problems; Opportunity encompasses the prevailing circumstances that facilitate an individual to commit fraud such as lack of controls, while Rationalisation is the attitude and values that allow an individual to justify the commitment of fraud, such as dishonesty among senior management (Alvin, 2016). Fraud is generally a manipulation of financial document report for clients, thus misleading and mismanaging organisational resources.

Fraud detection in this study is described as the capability of the auditor to investigate the manipulation of financial document reports. Conventionally, auditor procedures also have ineffectiveness in determining the financial statement fraud due to a lack of knowledge and experience accounting fraud among auditors. The infrequent nature of fraudulent manipulation also makes it difficult for external auditors to detect falsified accounting information, especially when perpetrated by senior management (Fanning & Cogger, 1998). Therefore, this study focuses on exploring fraud detection concepts from auditor experience with the client.

b. Auditor Experience with the Client

Auditor experience with the client discovers the quality of the audit report. Logically, for an auditor to effectively exercise their professional judgment when conducting an audit, they require adequate knowledge of the client as explained by Flint, Fraser, and Hatherly (2008). This implies that auditors with longer tenures have a more comprehensive framework for auditing a firm based on their experience with the client. Similarly, Okolie (2014) described auditor tenure as the duration within which the auditor and client maintain a professional relationship. The increased academic discourse surrounding mandatory rotation has brought into focus the effect of auditor tenure on auditor independence. As shown by Johnson, Khurana, and Reynolds (2002), short auditor tenures possess a negative effect on the audit quality compared to long tenures. In addition, Myers, Myers, and Omer (2003) examined the relationship between the auditor tenure and the abnormal accruals as a proxy for earnings quality. The findings indicate that auditor tenure is directly linked to earnings quality. Longer auditor tenure tends to result in higher earnings quality. According to the researchers, this finding could be explained by the fact that with longer auditor tenure, extreme management decisions regarding reporting financial performance are constrained. Moreover, Mansi, Maxwell, and Miller (2004) examined the proportionality between the audit firm tenure and the required return on bonds. The bond returns implies that the bond market perceives longer tenure to be correlated with higher earnings quality. Evidently, existing literature provides extensive indication that auditor tenure is highly correlated with audit quality and earnings quality, with no significant evidence indicating the negative effect of auditor tenure on auditor independence.

Despite the evidence against auditor rotation by scholars such as Carcello and Nagy (2004), it has been discussed that long-time audit-client relationships can result in a loss of independence and objectivity. Conflict of interest and complacency are some of the unethical practices that arise from having long-standing audit tenures (Patterson, Smith & Tiras, 2017). These reasons then suggest the viability of auditor rotation. The argument against audit rotations indicates that new auditors tend to impair quality. However, scholars opine that there are reasons as to why that happens. First, the auditors are yet to grasp the operational

and business systems of the company. Another reason could be that the new auditors have no experience with the company's error patterns. Additionally, following the scandals in multinational companies such as Enron, audit rotation is slowly gaining attraction. First, it is proposed that audit rotation is useful when trying to regain the trust and confidence of investors. Audit rotation also enhances the accountability, objectivity, and independence that may have been lost in the previous tenure through developing a peer-review system upon the previous auditors' turnover. This system would limit aggressive accounting practices that may have been adopted in the previous tenure (Cassell, Myers, Myers & Seidel, 2016). Therefore, auditor experience with the client is needed to generate the quality of audit report.

c. Royal Family

The royal family alludes to the immediate members of the ruler and sometimes to the extended family. Like in many monarchies across the world, the rule in the GCC is traditionally hereditary, which makes the ruling families royals. These families have the imperative of not only leading, but also uniting the nation and advocating for the best interests for the people and businesses (Kabasakal, Dastmalchian, Karacay & Bayraktar 2012). Members of the ruling family from the immediate to the extended family exert a sense of leadership which triggers loyalty within the nations. Subsequently, when the royal family members are involved in business, they have an impeccable impact on how other people engage in business and ownership (Ghamdi, 2012). Thus, the royal family comprises of the extended family of the different rulers in the GCC.

The royal families have been tasked with the responsibility of undertaking constitutional changes and providing the relevant leadership to stimulate investments in their specific regions. The monarchies enjoy some degree of privileges with regards to the management of existing regional resources. The GCC countries all have different forms of monarchies structured to help them realise their regional growth and potential. GCC countries have monarchies in different states including the Saudi Royal Family, Omani Royal Family, Kuwaiti Royal Family, United Arab Emirates Royal Families and the Bahraini Royal Family. The families are distinguished by the member states of the Gulf region. They play active roles in representing their countries in political forums, investment platforms, and offer relevant guidance on international relations. Nonetheless, the families have also been structured in such a way that would ensure the involvement of other stakeholders in the running of the kingdoms. The strategies have been effective in ensuring that gridlocks associated with monarchies do not have adverse impacts on the economies of the states (Thiollet & Vignal, 2016; Woertz, 2016) including fraud detection.

In the context of the royal family, fraud detection has become an interesting issue related to political ties and corporate transparency. Based on some studies, it indicates that the risk of

fraud reduces the likelihood of companies to hire quality auditors. For example, Leuz and Oberholzer-Gee (2006) determined that political connections reduce a company's transparency because if a firm engages high-quality auditors, some of the political favours of the dubious legality it receives may be exposed. Similarly, Polsiri and Jiraporn (2012) revealed that companies that were funded by the Thailand government up to the 1997 Asian financial crisis faced a higher risk of collapse than other firms. However, in the GCC context, it showed that the royal family enhanced the audit quality as explained by Ariningrum and Diyanty (2017).

D. The Relationship between the Auditor Experience with the Client and Fraud Detection

In general, professional judgment is elemental in identifying material misstatements in financial statements. The extent that auditors can go about uncovering the likelihood of financial misstatement has been investigated on the basis of strategic-systems method and transaction-focused method by Bierstaker, O'Donnell and Schultz, (2010). A sample of 93 participants from two groups' (strategic-systems training and experience with transaction-focused training and experience group) auditors were used in the study. The findings indicated that auditors can examine new information based on their previous knowledge relating to the client (Bierstaker et al., 2010). In other words, extensive auditor tenure provides the auditor with sufficient experience to determine the financial status of the client as well as the business operations. Fairchild (2007) conducted an experimental study involving a two party observation between manager and auditor. This method has been described as a game-based observational study. The findings revealed that an increase in the auditor tenure increases the capability in determining fraud as well as the assurance of a qualified opinion. In addition, Geiger and Raghunandan (2002) revealed that the audit reporting failures tend to occur in the early years of the auditor-client relationship which implies that longer tenures are correlated with lower audit reporting failures. These outcomes proposed that longer tenure allow auditors to fully acclimatize themselves with the financial performance of a firm and are therefore in a better position to identify financial anomalies such as fraud.

The findings contradict the need for compulsory auditor rotation due to the negative correlation between the auditor tenure and inaccurate audit reporting. Patterson and Smith (2017) further determined the impacts of auditor tenure and auditor rotation on fraud detection and the management's tendency to commit fraud. The findings of the study reveal that higher auditor tenure increases the fraud detection through the accumulation of audit evidence, which in turn limits expected undetected fraud by reducing the management's incentive to commit fraud. Higher auditor tenure also enables the auditor to develop an effective testing strategy, which reduces the total audit effort resulting in higher auditor efficiency. These findings suggest that auditor rotation has the unintended consequence of

reducing fraud detection since each new auditor will need to collect audit evidence over time in order to develop a testing strategy, thereby, enhancing the management's propensity to commit fraud.

Auditor rotation improves the audit quality, but numerous studies indicate that there has been mixed or inconclusive evidence of the impacts of audit firm rotation on the quality of audits (Firth, Rui & Wu 2012). According to Firth et al. (2012), very little effort by the researchers is made on considering various forms of rotation by partner and firm, as well as voluntary and mandatory, when making a comparative analysis. Crucial to this lies with the "arguments for and against mandatory auditor rotation". Baatwah (2016) utilised an empirical study to investigate the impact of auditor rotation on audit quality in the GCC. Currently, GCC countries rotate audit firms in public companies after four to five consecutive years. Baatwah (2016) proxies audit quality through discretionary accruals as well as modified audit opinions which reveals that there exists no significant correlation between the audit firm tenure and the discretionary accruals but possesses a positive and significant link with the changed audit opinions. There has been extensive discourses on audit firms in GCC according to a study by Said and Khasharmeh (2014), which revealed that auditor rotation increases audit costs, while having minimal impact on auditor expertise and experience. The study emphasised the importance of extending the tenure of audit firms over a long duration and adding more expertise and experienced auditors. However, despite the controversy of the impact of rotation and appointment of auditors in public companies, their audit reports are expected to conform to the International Financial Reporting Standards (IFRS) (Al jifri, 2013). This ensures the reduction of financial reporting and disclosure variation besides the enhancement of recognition and measurement practices across the globe.

The interesting issue in the GCC nations that is being characterised by weak restrictive structures and mechanisms of enforcement causes the effectiveness of the audit not being realised (Aljifri, 2013). Furthermore, their financial reporting and system of disclosure fall behind the economies and business sector growth and development. Chi, Myers, Omer & Xie (2017) investigated the relationship between the audit partner pre-client experience and the client-specific experience to explain variation in the audit quality. The authors utilised discretionary accruals to determine the audit quality while relying on the interest rate spreads to measure the perception of audit quality. The results of this study indicate that both the pre-client experience as well as the client-specific experience possess a significant positive effect on the audit quality. In addition, the experiences also have a significant positive effect on the perception of audit quality. The results also revealed that the pre-client experience possess a significant positive link with the audit quality in the early stages of an engagement, but the positive relationship diminishes when the auditor engages the client for over four years. The findings suggest that an increase in tenure is correlated with the decrease in the audit quality despite the growth in client-specific knowledge. Therefore, this study proposed that:

Proposition 1: There exists a positive relationship between the auditor experience with the client and fraud detection in the context of GCC countries.

e. The Relationship between the Royal Family and Fraud Detection

The royal families are directly involved in active investments in the GCC regions. The families have direct control over the investments, which implies that they show key interests in ascertaining the impacts of their resources to their economies and strategic companies that control a significant part of the country's performance. The dominance of the royal family in the given board positions is also evidence of their concerns to ensure that management takes place effectively. The study by Alzahrani & Che-ahmad (2015) identified that the presence of royal families in key board positions has an overall positive impact on the performance of the firms. Apart from that, the ownership structures in countries such as Thailand are different given that it is diversified, and thus more individuals are charged with the responsibility of overseeing organisational functions.

Nonetheless, Alzahrani and Che-ahmad (2015) refutes this by mentioning that having close family associates in key board positions helps to foster accountability and reliability in financial reporting. Habtoor and Ahmad (2017) also affirmed that the occurrence of the royal family members in the organisational board helps to foster accountability and ensures that disclosures take place effectively. They protect the resources of their kingdom by ascertaining that the companies realise their objectives. Besides, like other nations, the presence of royal family members is just an enhancement and not necessarily the only composition of boards. Habtoor and Ahmad (2017) affirmed that their presence, when combined with other officials, improves efficiency and ensures that the company can link its critical resources with both the internal and external environments.

Since the presence of royal family members in boards only enhances operation, it is, therefore, safe to conclude that there is a lack of agreement in the available literature on the effect of auditor characteristics, such as the impacts of auditor experience with the client on audit quality and fraud detection. Knechel and Vanstraelen (2007), in the research of stressed private companies in Belgium, established that auditor tenure does not have a significant effect on the audit quality. In contrast, Ghosh and Moon (2005) established a positive relationship between earnings quality and auditor tenure in deference to market perception. The authors further contend that extended tenure possess a significant effect on the stock rankings and the accuracy of earnings forecast resulting in the conclusion that auditor experience with client enhances the audit quality. The evident inconsistency in the effects of auditor experience with the client on audit quality, which leads to better fraud detection in prior research, requires further investigation in order to establish the veracity of the hypotheses relative to the GCC. Moreover, extant literature is unclear of the impact of

political connections on the ability of audit quality or auditor's experience with the client to detect the fraud. Some studies indicate that political ties increase audit quality (Ariningrum & Diyanty 2017) while others suggest that they reduce audit quality (Khan, Khan, Mihret, Mihret, Muttakin & Muttakin, 2016). Therefore, this study proposed that:

Proposition 2: There exists a positive relationship between the royal family and fraud detection in the context of GCC countries.

f. The Moderating Role of the Royal Family in Auditor Experience with Client and Fraud Detection

The moderating role of the royal family in the relationship between auditor experience with client and fraud detection can be explained in many perspectives and prior relevant studies. In extant literature, there is inconsistency in establishing the link between political relations and audit quality, with some studies indicating a positive relationship (Ariningrum & Diyanty 2017) while some studies reveal a negative relationship (Khan et al, 2016). It indicates that the relationship of auditor experience with client and fraud detection still need to be explored using a different method.

For this study, the researcher adds the royal family as a moderator with a considered characteristic of GCC. Exclusively, the inclusion of royal family members reduces the agency problem by enhancing the level of managerial supervision at minimal agency costs. Alzahrani and Che-Ahmad (2015) aver that the mere presence of royal families in the board and the perception of their power is enough to reduce the possibility of wrongdoing. These board positions of the members of the royal families have given them the mandate to oversee management and, thus, they have a direct line to influence matters such as fraud detection and poor management. It is also opined that the effects of royal family members are augmented by their ability to authoritatively reduce conflict.

The royal family members further limit the agency costs by impartially moderating the interests of management and shareholders, which involves extensive monitoring to ensure audit quality and the expedient detection of fraud. It should be mentioned that the royal family existence is particularly essential in terms of fraud detection as it adds another layer of verification. Moreover, information retained by the royal family is helpful for increasing auditor experience since it contributes to firm-specific knowledge of the auditor and enhances fraud detection. In this regard, it is possible to claim that the royal family facilitates fraud detection amplifying effects of auditor experience with the client. Hence, it is expected that the royal family's existence possesses a respective impact on the relationship between auditor's experience with client and fraud detection.



Proposition 3: The royal family moderates the relationship between auditor experience with client and fraud detection in the context of GCC countries.

Methodology

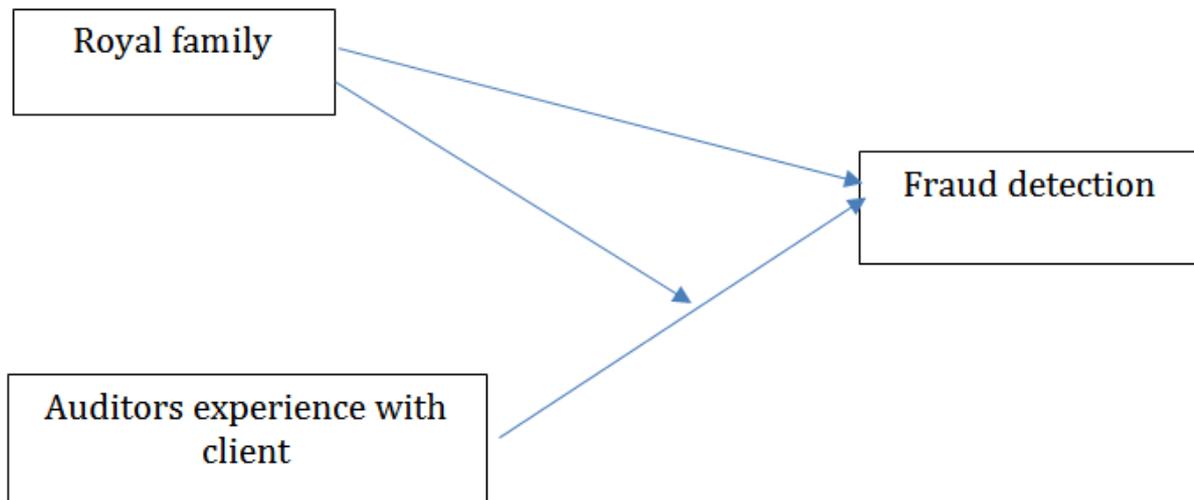
This study dwells on literary resources to examine the structure of knowledge on an auditor's experience with fraud detection. These resources are published papers, books, technical reports and dissertations. The aim was to review the pertinent literature about fraud detection depending on the auditor's experience with the client and the influence of the royal family of GCC countries. The resources are acquired through an online database.

Search techniques used for this study relied on important keywords. The use of combined keywords were also used. For example: "fraud" AND "detection", "royal" AND "family", "auditor" AND "experience" and finally auditor's experience with the client. After collecting all data, sorting and coding were performed in order to prepare the materials for analysis. Relevant articles regarding the topic were sorted out. Important claims and findings were coded out. Finally, ideas left out by those previous studies were examined, thereafter, a new conceptual model was proposed. This is strictly based on the literature review analysis of the royal family as an interesting variable in the determination of fraud detection which was the motivation for this entire work.

Discussion and Conclusion

Following from the literature review, a conceptual model on the royal family moderating the relationship between auditor's experience with client and fraud detection was proposed (see Figure 1). It can be also summarised that there are two important proposed variables deemed to determine fraud detection namely: Auditor experience with the client and the Royal family.

Figure 1. Conceptual model



Chi et al., (2017) performed similar work on conceptualising auditors experience, however, the approach was based on the relationship between the audit partner pre-client experience and the client-specific experience to explain the variation in the audit quality. Following this logic, auditor experience with the client became an interesting variable to predict fraud detection. Specifically in GCC countries, the royal family are part of a vital aspect of financial investment, where the royal family are mostly the majority shareholders or owners of the big companies in the region. Therefore, fraud detection is important for the royal family to protect their investment. Strictly speaking, the inclusion of royal family members might reduce the agency's problem by enhancing the level of managerial supervision at minimal agency costs. Royal family select auditors with experience, specifically auditors with the experience with clients in order to conduct an audit in their firm. This ensures a high-quality auditing financial report. Based on the literature review analysis, this paper formulated the concept that included the royal family as a moderating variable in the relationship between auditor experience with client and fraud detection. This is justified by the work of Alzahrani and Che-Ahmad (2015), which entails that the royal families have the power to reduce the possibility of wrongdoing. The royal families are often considered to have a great influence on GCC companies including their respective crucial natures. Those GCC companies that have gotten involved with some royal family often get to be managed better and appropriately. Therefore, this study contributes to the evaluation of the effect of the royal family on the relationship between auditor experience with client and fraud detection in GCC companies as the presence of the royal family leads to better auditors to perform their work ethically and independently.

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