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The Failure of Internal Audit in Detecting Corporate Fraud Through Global Cases Study

Fitri Setiabudi
Internal Audit & Corporate Fraud Practitioner, Indonesia

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ABTRACT
This study investigates the reasons internal audit functions frequently fail to detect corporate fraud by examining fifteen global fraud cases through qualitative content analysis. It draws on a range of secondary materials, including academic literature, regulatory reports, investigative documents, and publications from the Association of Certified Fraud Examiners, to identify patterns that consistently emerge across cases. The results reveal enduring weaknesses such as limited independence, excessive reliance on management information, inadequate fraud risk assessment, insufficient professional skepticism, and the use of outdated audit techniques. These patterns are interpreted using the Fraud Triangle, Agency Theory, and the COSO Internal Control Framework to explain the systemic nature of internal audit failure. The findings suggest that internal audit ineffectiveness stems primarily from structural, cultural, and governance-related constraints rather than from procedural deficiencies alone. Overall, the study offers a cross-case synthesis that integrates multiple theoretical perspectives and provides practical insights for strengthening internal audit practices and enhancing fraud detection within corporate organizations.

Keywords: Internal Audit Failure, Corporate Fraud, Fraud Triangle, Governance and Oversight, Internal Control.

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Corresponding author :
Email: fitri.setiabudi@gmail.com

1. INTRODUCTION

Internal audit serves as a vital component in strengthening corporate governance, ensuring compliance, and detecting fraudulent activities (Ziorklui et al., 2024). It functions as the third line of defense, positioned to independently evaluate internal controls and assess fraud risk. Over the past two decades, the frequency and scale of corporate fraud have increased, despite the existence of internal audit units and regulatory frameworks aimed at prevention (Zaman Groff et al., 2016). Prominent cases such as Enron (USA), Wirecard (Germany), Toshiba (Japan), and Luckin Coffee (China) demonstrate how frauds involving billions of dollars went undetected for years. These incidents raise a critical question: why did internal audit fail to detect these frauds?

Numerous studies suggest that internal audit effectiveness is often hindered by organizational limitations, insufficient auditor independence, weak fraud risk planning, or a lack of professional skepticism (Melinda et al., 2022). While the theoretical role of internal audit is clear, providing assurance, risk evaluation, and oversight, its practical application often deviates due to structural or cultural barriers (Gao, 2017).

This study addresses this gap by systematically analyzing fifteen global fraud cases where internal audit failed to prevent or uncover fraudulent acts. The goal is to identify recurring patterns, root causes, and theoretical explanations behind these failures. By applying conceptual frameworks such as the Fraud Triangle Theory (Cressey), Agency Theory (Jensen & Meckling), and the COSO Internal Control Framework, this study will contextualize these audit failures within an academic and practical governance perspective.

The objective of this research is to:

a. Investigate the structural and functional weaknesses in internal audit practices related to fraud detection.
b. Classify the types of failure most observed in high-profile fraud cases.
c. Provide practical recommendations to improve internal audit's role in identifying fraud.

The contributions of this research are twofold: (1) it provides valuable insights for scholars examining fraud governance and internal control systems. (2) it offers practical direction for internal auditors, regulators, and audit committees seeking to strengthen the internal audit function in mitigating corporate fraud risks

This study contributes to literature in three ways. First, it provides one of the broadest cross case syntheses of internal audit failure by systematically analyzing fifteen global scandals across different industries and regions. Second, it integrates multiple theoretical lenses, namely the Fraud Triangle, Agency Theory, and the COSO framework, with underexplored constructs such as cultural suppression and organizational politics. Third, it develops a conceptual framework that explains why internal audit failure persists despite the formal adoption of control systems, thereby offering novel insights for both theory and practice. Thus, this study aims to examine why internal audit fails to detect fraud through an analysis of global corporate fraud cases.

2. LITERATURE REVIEW

Understanding why internal audits fail to detect fraud requires more than analyzing procedural errors; it demands a theoretical lens that reflects on organizational behavior, governance dynamics, and risk perception (Zou, 2019). This study draws upon three dominant frameworks in accounting and auditing literature: The Fraud Triangle Theory, Agency Theory, and the COSO Internal Control Framework serve as key conceptual bases for interpreting the organizational and behavioral factors that contribute to internal audit failures.

Fraud Triangle Theory

Donald Cressey (1953)'s Fraud Triangle Theory posits that fraud occurs when three elements converge: pressure, opportunity, and rationalization (Febriani et al., 2023).

a. Pressure or Motivation refers to financial or personal demands that drive an individual toward misconduct, such as monetary distress or pressure to meet performance expectations.
b. Opportunity represents the perceived ability to engage in fraudulent behaviour when internal controls are weak or supervisory mechanisms fail to function effectively.
c. Rationalization describes the mental process through which offenders justify unethical actions in a way that aligns with their personal beliefs or self-concept.

Motivation arises when individuals encounter pressures or incentives that influence their behaviour, while opportunity emerges when weaknesses or gaps in internal control systems create conditions that can be exploited or inadequate oversight, and rationalization allows perpetrators to reconcile their actions with personal codes of ethics (Gabriela, 2023; Dorminey et al., 2012).

The Fraud Triangle remains a foundational theory in fraud detection and forensic auditing. However, in cases such as Enron, Wirecard, and FTX, internal auditors failed to recognize opportunities created by weak controls and ignored rationalizations provided by executives (Hermawan & Novita, 2021). Opportunity was often enabled by weak or bypassed controls, while rationalization was overlooked due to the absence of behavioral fraud assessment. In Toshiba and Olympus, cultural conformity reinforced rationalization, as auditors preferred silence over confrontation due to hierarchical pressures (Ziorklui et al., 2024). These cultural and organizational factors fall outside the Fraud Triangle but exacerbate its core mechanisms.

Agency Theory

Jensen & Meckling (1976)'s Agency Theory describes the relationship between principals (shareholders) and agents (management), where management is expected to act in the best interests of the shareholders (Mugao & Ndeto, 2021). However, conflicts arise when the interests of agents diverge from those of principals, leading to opportunistic behaviors such as fraud. Agency theory views the corporation as a nexus of contracts between various parties, primarily shareholders (principals) and managers (agents) (Al Mamun et al., 2013).

Agency theory positions the internal audit function as a mechanism designed to reduce the principal-agent conflict. Within this relationship, shareholders as principals depend on managers, or agents, to act in alignment with their interests (Pande, 2011). However, when managerial incentives are misaligned, they may act opportunistically, requiring oversight mechanisms like internal audit to reduce information asymmetry.

In the Satyam and WorldCom cases, internal audit failed to fulfill this monitoring role, largely because it lacked the independence or access necessary to challenge executive decisions (Groff et al., 2016). These failures exemplify the consequences of weak agency controls. Internal auditors, even when employed within the firm, must maintain objective distance from management to serve their monitoring function effectively.

Agency theory also highlights the importance of audit committee oversight, which was either absent or ineffective in many fraud cases (Adams, 1994). Without strong governance from independent boards or audit committees, internal audit cannot act autonomously, thereby reducing its effectiveness in monitoring and mitigating fraud risk.

COSO Internal Control Framework

The Committee of Sponsoring Organizations of the Treadway Commission (2013) presents the Internal Control-Integrated Framework, which provides a comprehensive approach for the design, implementation, and evaluation of internal control systems (Committee of Sponsoring Organizations of the Treadway Commission and Internal, 2013).

The COSO Frame work helps in provides a comprehensive structure for designing and evaluating internal control systems and provides a structure encompassing five interrelated components (Moeller, 2013):

a. Control Environment
b. Risk Assessment
c. Control Activities
d. Information and Communication
e. Monitoring Activities

This study finds that breakdowns in risk assessment and monitoring were consistent across most cases. In Luckin Coffee, for example, sales were fabricated and accepted into the system without effective cross-verification or real-time data auditing. In Olympus, losses from failed investments were concealed over years due to poor monitoring and lack of follow-up on internal concerns.

Additionally, the control environment, the foundation of all other COSO elements were compromised in cases like Wells Fargo and FTX, where pressure to meet performance targets or rapid growth goals overtook control procedures. The absence of ethical tone at the top severely undermined internal audit's authority and impact (Shapiro, 2014).

Critical Reflection on Theoretical Alignment

While these three frameworks offer a strong basis for analysis, this study finds that their implementation within organizations is often superficial. Many companies adopt COSO or fraud risk assessment policies on paper but fail to operationalize them in practice. Internal audit functions frequently exist without sufficient authority, resources, or access, making them symbolically independent but practically powerless (Christopher, 2018).

Moreover, interpersonal dynamics, political pressure, and cultural conformity are rarely addressed in traditional audit theory but play a decisive role in audit failure. Theories must be applied within the context of organizational realities, where fear of retaliation, lack of support, and internal politics often neutralize control mechanisms (Zou, 2019).

In conclusion, bridging the gap between theoretical intent and practical audit behavior remains essential. A stronger integration of fraud psychology, governance ethics, and real-time risk intelligence may offer a more holistic theoretical base for future audit design.

3. METHODS

This study employs a qualitative multiple case study approach to investigate the recurring causes of internal audit failure in detecting corporate fraud. The chosen methodology allows for in-depth analysis of real-world fraud incidents by examining contextual factors, organizational structures, and audit mechanisms across different companies and countries.

Research Design

A multi-case content analysis was conducted, focusing on fifteen corporate fraud cases that occurred between 2000 and 2022. This design is appropriate to identify patterns and themes that emerge from different settings, industries, and governance structures. The study does not aim to generalize statistically, but to understand complex, real-life audit failures through a comparative interpretive lens.

Research Targets and Selection Criteria

The research targets are corporate organizations (public and private) that were involved in major fraud scandals with documented audit failures. The inclusion criteria for case selection were:

a. Publicly available reports from regulatory bodies, media, or courts
b. Evidence of internal audit function (present or absent)
c. Demonstrated failure in preventing or detecting fraud
d. Coverage in academic or professional publications.

The fifteen selected cases span various countries (e.g., USA, Germany, Japan, China, India), industries (finance, tech, retail, energy), and organizational sizes.

The final set of fifteen cases was selected through a multi stage process. First, more than thirty well known corporate fraud cases were identified from academic publications, regulatory reports, and the ACFE Report to the Nations. Second, inclusion criteria were applied, focusing on cases with documented internal audit functions and publicly available investigation reports. Third, cases were screened to ensure variation in country, industry, and fraud type, producing a final sample of fifteen cases between 2000 and 2022.

Data Collection Techniques

Data was collected through secondary document analysis, drawing from the following sources:

a. Academic journal articles and books discussing the selected cases
b. Case studies published in audit and fraud research literature
c. ACFE's Report to the Nations (2010–2022)
d. Regulatory reports (e.g., SEC, European Parliament, PCAOB)
e. Investigative journalism (e.g., Financial Times, The Wall Street Journal).

All data were organized into case summaries with key elements extracted for comparison and coding.

Researcher's Role and Positioning

As this is a desk-based qualitative study, the researcher acted as an independent analyst interpreting secondary data. No direct interaction with the subjects of the cases was conducted. The researcher's presence was limited to designing the analytical framework, coding the case data, and synthesizing patterns thematically.

Data Analysis Procedure

Each fraud case was analyzed systematically by focusing on the following dimensions:

a. Type of fraud committed (e.g., revenue manipulation, asset misappropriation)
b. Role and structure of internal audit, including reporting lines and scope
c. Specific reasons for audit failure, categorized into thematic codes:
    a. Lack of independence
    b. Weak risk assessment
    c. Overreliance on management
    d. Lack of professional skepticism
    e. Cultural or ethical constraints

Cross-case comparison was then used to identify dominant themes and link them to theoretical frameworks, such as the Fraud Triangle, Agency Theory, and COSO.

The analysis followed three steps. First, all cases were summarized into structured case profiles, capturing the fraud type, audit function characteristics, and causes of failure. Second, a coding schema was developed using five thematic categories: lack of independence, weak risk assessment, overreliance on management, lack of professional skepticism, and cultural or ethical constraints. Third, cross case comparison was conducted to identify recurring patterns. Coding was performed manually using spreadsheets, and data triangulation was applied by consulting multiple independent sources (academic articles, regulatory documents, and investigative journalism) for each case to ensure consistency and validity.

Validity and Reliability Measures

To ensure credibility and validity, data triangulation was applied:

a. Multiple sources were used for each case to confirm accuracy.
b. Thematic saturation was checked across the fifteen cases to validate the recurrence of specific failure patterns.
c. Framework mapping (i.e., aligning findings with theory) was used as a consistency check.

4. RESULTS AND DISCUSSION

Results

This section outlines the results derived from examining fifteen global fraud cases, with particular attention to how internal audit functioned or failed in identifying fraudulent activities. The cases selected vary in country, industry, and organizational context, yet display similar patterns in audit breakdown. The presentation begins with structured data (Table 1), followed by synthesis of common root causes (Table 2), and concludes with a thematic discussion of the findings.

Table 2 reveals consistent patterns of internal audit failures across fifteen major global fraud cases. The most prominent issue identified is the lack of professional skepticism, occurring in 12 out of 15 cases. This indicates that internal auditors frequently accepted management representations without critical verification, allowing fabricated transactions, inflated revenues, or incomplete disclosures to remain undetected for years. Cases such as Wirecard, Parmalat, GE, and Toshiba illustrate how insufficient questioning of unusual financial patterns enabled executives to manipulate financial statements.

The second most common pattern is weak fraud risk assessment, recorded in 11 of the 15 cases. Many internal audit functions failed to identify high-risk areas such as aggressive revenue recognition, complex related-party transactions, and off-balance-sheet structures. Companies including Enron, Carillion, Valeant, and Petrobras demonstrate how inadequate risk identification limited the ability of auditors to design effective audit procedures. This weakness suggests that internal audit departments often focused

Table 1**. Summary of Fraud Cases and Audit Failures**

No	Company	Country	Year	Type of Fraud	Audit Failure
1	Enron	USA	2001	Off-balance sheet financing	Lack of independence
2	WorldCom	USA	2002	Overstated assets	Weak scrutiny of accounting
3	Satyam	India	2009	Fake revenues & balances	Overreliance on management
4	Toshiba	Japan	2015	Profit inflation	Pressure on audit unit
5	Tesco	UK	2014	Premature revenue recognition	Failure to verify transactions
6	Wells Fargo	USA	2016	Fake accounts	Ignored toxic incentives
7	Carillion	UK	2018	Aggressive accounting	Ignored assumptions
8	Luckin Coffee	China	2020	Fake sales	Lacked verification procedures
9	Wirecard	Germany	2020	Fabricated funds	Failed bank confirmation
10	Olympus	Japan	2011	Hidden investment losses	Missed multi-year red flags
11	Valeant	Canada	2015	Fictitious partnerships	Ignored suspicious structures
12	Petrobras	Brazil	2014	Corruption & markups	Weak internal review
13	GE	USA	2019	Revenue manipulation	Lack of fraud indicators
14	Parmalat	Italy	2003	Fake bank accounts	Skipped confirmation steps
15	FTX	Bahamas	2022	Misused client funds	No internal audit function

Source: Data Processed

on routine compliance activities rather than dynamic fraud risk evaluation.

Overreliance on management appears in 10 cases and represents another systemic failure. In organizations like Satyam, Olympus, and Valeant, auditors relied heavily on information provided by senior executives, even when that information contained inconsistencies or lacked independent corroboration. This dependence weakened the internal audit function's ability to act as an objective assurance provider and allowed fraudulent activities to be concealed through controlled access to data.

A lack of independence was observed in 9 cases, including Enron, Wells Fargo, Tesco, and Wirecard. These cases show how internal audit units that are structurally or culturally influenced by senior management are less able to challenge questionable practices. In several examples, internal auditors reported directly to executives implicated in fraud, which compromised objectivity and reduced the likelihood of escalation when red flags were identified.

Lastly, the absence of an internal audit function was identified only in the case of FTX. This absence highlights the extreme end of internal audit failure, where no formal assurance or oversight mechanism existed to review financial integrity. The FTX collapse demonstrates how the complete lack of internal audit contributes to unchecked decision-making and elevated fraud risk.

Overall, the patterns in Table 2 suggest that internal audit failures are not isolated incidents but reflect structural and behavioral weaknesses that recur across industries and jurisdictions. Strengthening auditor independence, improving fraud risk assessment frameworks, and fostering critical skepticism are essential to preventing similar failures in the future.

These results provide the empirical basis for further interpretation regarding structural, cultural, and procedural weaknesses, which are analyzed in the subsequent Discussion section.

Table 2. **Patterns of Internal Audit Failure**

Root Cause	Frequency	Example Cases
Lack of independence	9 of 15	Enron (USA), WorldCom (USA), Toshiba (Japan), Tesco (UK), Wells Fargo (USA), Carillion (UK), Luckin Coffee (China), Wirecard (Germany), Olympus (Japan)
Overreliance on management	10 of 15	Satyam (India), Enron (USA), WorldCom (USA), Toshiba (Japan), Valeant (Canada), Olympus (Japan), GE (USA), Parmalat (Italy), Petrobras (Brazil), Luckin Coffee (China)
Weak fraud risk assessment	11 of 15	Carillion (UK), Luckin Coffee (China), Petrobras (Brazil), Valeant (Canada), GE (USA), Tesco (UK), WorldCom (USA), Toshiba (Japan), Olympus (Japan), Parmalat (Italy), Enron (USA)
Lack of professional skepticism	12 of 15	GE (USA), Parmalat (Italy), Wirecard (Germany), Luckin Coffee (China), WorldCom (USA), Enron (USA), Toshiba (Japan), Olympus (Japan), Valeant (Canada), Petrobras (Brazil), Tesco (UK), Carillion (UK)
No internal audit function	1 of 15	FTX (Bahamas)

Source: Data Processed

DISCUSSION

From the cross-case comparison, four dominant themes emerged that directly explain the failure of internal audit in these cases:

a. Structural Weaknesses in Internal Audit Function
   Many organizations lacked an independent reporting structure for internal audit. In Enron and Toshiba, internal audit was heavily influenced by senior management, compromising its ability to operate objectively. This theme confirms the Agency Theory perspective, where auditors become ineffective monitors when they are controlled by the very agents they are meant to oversee (Adams, 1994).
b. Oversight Gaps in Risk Assessment
   In cases such as Carillion and Petrobras, internal audit failed to prioritize fraud risk or assess high-risk transactions. COSO's component of "Risk Assessment" was either weak or misaligned. This reveals that audit planning was compliance-driven, not risk-driven (Hamdani & Albar, 2016).
c. Lack of Technical Capacity and Tools
   Especially in tech-oriented frauds like Luckin Coffee and Wirecard, internal audit did not utilize digital forensics or data analytics. Modern fraud often involves large volumes of transactional data; yet, traditional audit methods were used, which lacked depth. This aligns with findings from the ACFE that show only a small percentage of frauds are uncovered by audits compared to tips and data monitoring (Rodríguez-Quintero et al., 2021).
   This aligns with findings from the ACFE Report to the Nations (2022), which shows that only 12% of occupational fraud was detected by internal audit, while 42% was detected through tips (ACFE, 2022). This suggests that internal audit, as traditionally implemented, often lacks the tools and strategies necessary for proactive fraud detection in complex environments.
d. Organizational Culture and Suppression
   In several cases such as Olympus and Wells Fargo, internal auditors either ignored or suppressed red flags due to fear of retaliation or loyalty to leadership. This reflects a cultural barrier that inhibits internal audit effectiveness. It also expands on the Fraud Triangle, particularly in how rationalization and pressure can affect auditors as well as perpetrators (Zou, 2019).

Interpretation and Relation to Existing Theories

These findings support and extend three major theoretical frameworks:

a. Fraud Triangle (Cressey, 1953), Most organizations in the sample failed to recognize rationalization and opportunity indicators, especially when top executives were involved.
b. Agency Theory (Jensen & Meckling, 1976), Internal audit could not function as a monitoring mechanism when organizational structure blurred lines of accountability.
c. COSO Framework (2013), Key weaknesses were consistently found in risk assessment, monitoring, and control environment, the foundation of COSO's internal control system.

The study also suggests that beyond these frameworks, ethical climate, organizational justice, and whistleblower protection play a decisive role in fraud detection and audit responsiveness areas underrepresented in mainstream audit theory.

Theoretical Gaps

While the Fraud Triangle, Agency Theory, and the COSO Internal Control Framework provide a useful foundation for analyzing internal audit failures, this study finds several gaps in their explanatory power. First, the Fraud Triangle primarily focuses on the perpetrator's motivation, opportunity, and rationalization, but it neglects organizational dynamics such as cultural suppression, fear of retaliation, and political pressures that discourage auditors from acting on red flags. Second, Agency Theory emphasizes the monitoring role of internal audit in mitigating the principal agent conflict, yet it underestimates the extent to which auditors themselves are constrained by management influence, limited resources, or weak audit committees. Third, the COSO framework is often adopted as a formal compliance tool, but in practice it may remain superficial. Many companies claim adherence to COSO, yet internal audit functions still lack authority, independence, or risk-based planning.

These gaps indicate that existing frameworks need to be expanded by incorporating behavioral, cultural, and ethical dimensions to fully explain why internal audit frequently fails to detect corporate fraud.

Comparative Insights

While similar root causes of audit failure were observed across the fifteen cases, the way these weaknesses manifested varied by context. For example, in the United States (Enron, WorldCom, Wells Fargo), internal audit was often undermined by structural conflicts of interest and aggressive financial reporting pressures. In contrast, in Asian cases such as Toshiba and Olympus, cultural suppression and hierarchical conformity were more influential, discouraging auditors from challenging management despite clear red flags. European cases such as Wirecard and Parmalat highlighted technical gaps, where traditional audit methods failed to keep pace with complex financial structures.

These comparative insights suggest that audit failure cannot be attributed solely to independence or risk assessment gaps. Instead, failures are shaped by a combination of cultural, organizational, and regulatory environments. Existing theories such as the Fraud Triangle and COSO provide partial explanations but do not capture the contextual nuances of why these patterns repeat. This indicates the need for expanding internal audit theory to incorporate cultural and institutional dimensions that influence auditor behavior.

Answer to Research Questions

a. The findings confirm that audit failure is a multi-dimensional problem rooted in:
b. Structural design (independence and access),
c. Procedural limitations (risk-based audit planning),
d. Technical gaps (fraud analytics),
e. Cultural suppression (fear and silence).

Implications for Theory and Practice

Practically, organizations must treat internal audit not as a compliance requirement but as a strategic function. Theoretically, there is a need to expand audit theory to include behavioral and cultural dimensions, especially in high-power environments where management override is prevalent.

5. CONCLUSION

This study concludes that internal audit failures in detecting fraud are driven not only by procedural shortcomings but also by deeper systemic weaknesses, including weak governance structures, lack of independence, insufficient risk orientation, and cultural resistance to transparency. This study answers the research question by demonstrating that internal audit failures arise from the interaction of structural, risk-related, technical, and cultural constraints. Collectively, these factors show that audit failure is rarely the result of a single deficiency; instead, it emerges from the combined effect of organizational, procedural, and behavioral weaknesses that limit the internal audit function’s ability to detect fraud effectively. Strengthening internal audit therefore requires not only improving technical procedures but also addressing governance dynamics, ethical climate, and the organizational culture in which auditors operate.

Limitations and Suggestions

This study relies entirely on secondary data from publicly documented fraud cases, which may limit the depth of insight into internal audit practices that were not disclosed in official investigations. Access to internal audit working papers or interviews with auditors would provide richer and more nuanced evidence. Additionally, this research focuses on large, well-known global cases; therefore, its findings may not fully represent audit challenges in small or medium-sized organizations.

Future research could examine internal audit failures using first-hand data, such as interviews with internal auditors, audit committee members, or fraud investigators. Studies may also explore fraud detection challenges in different sectors (e.g., government entities, financial institutions, digital platforms), or evaluate how emerging technologies, such as continuous auditing, AI-driven analytics, and behavioral monitoring can enhance fraud detection capabilities.

To address the systemic weaknesses identified, stakeholder-specific recommendations are proposed:

a. Regulators should strengthen requirements related to internal audit independence, fraud risk assessment, and continuous monitoring. Mandatory disclosures on internal audit structure and authority could improve transparency and accountability.
b. Boards and Audit Committees should ensure that internal audit reports directly to the audit committee rather than to management, allocate adequate resources for forensic and analytic capabilities, and foster a governance culture that protects auditors from retaliation when raising concerns.
c. Professional Bodies are encouraged to expand certification frameworks to include behavioral fraud analysis, forensic auditing, and data-driven fraud detection techniques. Continuous professional education should emphasize ethics, governance dynamics, and advanced fraud analytics.
d. Internal Audit Functions should adopt continuous auditing tools, integrate fraud risk assessment into annual audit planning, strengthen the use of data analytics, and reinforce professional skepticism through training and cultural support. Internal auditors must be empowered with independence, authority, and unrestricted access to information to perform their roles effectively.

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