The Influences of Internal Control and Good Corporate Governance on Frauds: Multiple Linear Regression Analysis

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Abstract

Purpose: This study aims to analyze the effect of internal control on fraud, the effect of good corporate governance on fraud, and the effect of internal control and good corporate governance on fraud. This research was conducted at the Rural Bank (BPR) in the municipality of Bandung

Theoretical framework: Fraud is often found in companies including goods, services, manufacturing, and banking companies. Fraud can negatively affect individuals and organizations. Fraud is an unlawful act that occurs due to pressure, opportunity, and rationalization to gain personal or collective benefits that can harm others (Christine & Apriwandi, 2022; Febriani & Suryandari, 2019)'.The'Association of Certified Fraud Examiners (ACFE) Indonesia showed fraud is mostly found through media reports and was mostly conducted by company employees (Association of Certified Fraud Examiners Indonesia, 2019)

Design/methodology/approach: This study uses data collection techniques by distributing questionnaires to rural banks in the city of Bandung with a collection of 30 respondents. The obtained questionnaires were tested using validity and reliability to test the feasibility of the obtained questionnaire data. The test equipment used in this study is to use the test requirements analysis including the normality test, multicollinearity test, and heteroscedasticity test. The method used in data analysis is Multiple Linear Regression Analysis, Simultaneous Significance Test, Partial Significance Test, and Coefficient of Determination Test

Findings: The results of this study indicate that internal control has a negative and insignificant effect on fraud. Good corporate governance has a positive and significant effect on fraud. As well as internal control and good corporate governance simultaneously affect fraud.

Research, Practical & Social implication: Internal Control and Good Corporate Governance (GCG) simultaneously affect the occurrence of fraud, Internal control has a negative and insignificant influence on fraud, meaning that the presence of internal control does not have any impact on fraud

Originality/value: Implying that'internal'control'and'Good Corporate'Governance'simultaneously'affect the frauds.

Keywords: *Internal Control, Good Corporate Governance, and Fraud.*

1. INTRODUCTION

Fraud is often found in companies including goods, services, manufacturing, and banking companies. Fraud can negatively affect individuals and organizations. Fraud is an unlawful act that occurs due to pressure, opportunity, and rationalization to gain personal or collective benefits that can harm others (Christine & Apriwandi, 2022; Febriani & Suryandari, 2019)'.The'Association of Certified Fraud Examiners (ACFE) Indonesia showed fraud is mostly found through media reports and was mostly conducted by company employees (Association of Certified Fraud Examiners Indonesia, 2019) About fraud, companies often have loopholes that allow fraud to occur, such as weak security system. Even in the banking sector, Bank Indonesia (BI) admitted that many fraud cases occurred in the banking sector due to weak internal controls, even in the rural banking sector (BPR). Financial Services Authority (OJK) mentioned that BPRs are the financial institutions with the highest vulnerability to crime or fraud. In the last 15 years, 115 BPR units have been liquidated due to fraud. The supervisory determines the sustainability of financial institution performance, including the People's Credit Agency (BPR). Inadequate supervision will cause BPR business activities difficult to control (detikFinance, 2021). Conducting strong supervision to prevent this in the banking sector should be the focus of the industry. The Financial Services Authority (OJK) as a regulator and supervisor of financial institutions, including banks, needs to evaluate and make stricter banking regulations to minimize the chance for fraud to occur. Following the provisions regarding risk management, banks must set specific risk management policies and procedures, including an adequate internal control system of bank business activities and operations at all levels of the Bank's organization (Ezer, 2021)

In November 2017,' the Financial Services Authority (OJK) revealed a banking crime case of the Rural Bank (BPR)'KS Bali Agung Sedana, Bali. The fraud was carried out by the "NS" the President Director of the bank, who granted loans to 54 debtors with a value of IDR 24.225 billion through non-standard credit procedure. Before the revocation of the business license, the bank had been Under Special Supervision since April 12, 2017. With this status, BPR KS Bali Agung was given a 180-day opportunity until October 9, 2017, to carry out improvements (Sitanggang Laurensius Marshall Sautlan, 2017). This case relates to the employment of Indonesian Migrant Workers (IMW) in Japan by PT. Indonesia Human Support Corporate (IHSC). IHSC required every IMW to deposit a certain amount of funds to IHSC for employment training costs, which amount differed in every worker between 30 million to 60 million IDR. The amount depended on the area of origin of the prospective IMW which included Bali, Banyuwangi, and Lombok, with a total of 54 IMWs. IMW who applied to Japan expected to gain monthly salaries between 18 million to 20 million IDR per month. IHSC also required every worker to submit a certificate of property rights/SHM for collateral.

The certificates were the collateral of the loan approved by Jalaludin as the President Director of IHSC to PT.'Rural Bank'KS'Bali Agung Sedaya (BPR KS BAS).'Nyoman Supariyani'as the Managing Director of BPR KS BAS then ordered the employees of BPR KS BAS to process the loan for 54 debtors with a total value of IDE 24.225 billion. The amount of the credit varied from IDR 200 million to IDR 600 million per debtor granted between March 2014 to December 2014. In applying for the credit, IMWs were unaware of this credit application and they never received the loan. Their salaries were even marked up from IDR 13 million per month to IDR 30 million for fifteen years. In addition, the disbursement of the credit was settled before all administrative procedures had been fulfilled. The fund was allegedly used to purchase some properties (Dan et al., 2011).

Seen from this case, fraud seemed to occur due to the internal control which lacks systematic supervision from other parties to evaluate all activities. Internal control affects the relevance of the information which affects the decision-making ability of managers based on the results or consequences of an action or event (Apriwandi & Supriyono, 2021; Muna & Haris, 2018). Weak internal control due to the lack of a security system relates to the internal control component.'Furthermore, such cases can be prevented through a fraud prevention system implemented within good corporate governance.'A company with good corporate governance can prevent fraud from occurring. Frauds are commonly conducted by the company management itself, therefore, a company where many frauds occur shows that the company does not have good corporate governance. With the tight market competition, companies/institutions are not only required to be able to run their business efficiently and effectively. They also have to maintain the company's sustainability. For this reason, the regulator that requires banking institutions (in the above case means BPR) did not apply corporate governance which is the embodiment of responsibility. According to (Christine & Apriwandi, 2022; Fahmullah et al., 2022)' internal control'and good'corporate governance share positive and significant effects on fraud prevention. Frauds in banking industries, especially rural banks, are not merely committed for personal financial purposes only, but also to improve bank performance. Frauds are dominated by fictitious loans and embezzlement of credit installments (Andrie Djatmiko, 2017). The effectiveness of fraud prevention can be improved by implementing a more effective internal control system. Effective internal control helps protect assets, ensures the availability of reliable financial and managerial reporting, improves conformity with applicable rules and regulations and reduces the risk of losses, irregularities, and violations (Fahmullah et al., 2022). On the other hand, several researchers did not find any significant influence of internal control on fraud prevention (Herawaty & Hernando, 2021)Even further, internal control was found to have a significantly negative influence on good corporate governance (Fahmullah et al., 2022). this can have an impact on the economy of society in general and affect the psychology of society and cause stress and self-esteem (Suhron., 2016; 2017;2018). The results of the research contradict the ones stating that internal control did not influence good corporate governance (Saputra, 2017). The inconsistent results of those research intrigued the researcher to conduct this research to re-examine how internal control validity' and good corporate governance affect fraud prevention. In this research, the effects of internal control and good corporate governance on fraud occurrence were examined.

2. LITERATURE REVIEW AND RESEARCH FRAMEWORK

The Influence of Internal'Control'on Frauds

In general, the part of the system that is used as operational procedures and guidelines for a particular company or organization is referred to as internal control. Internal control systems prevent system abuse (Ryan & Ridwan, 2017).

Internal control was defined by (Harry, 2014) as a set of policies and procedures to safeguard the assets of the company, ensure the accuracy of the accounting data available to the company, and ensure compliance with management policies and all applicable laws. COSO identified five components of internal control: Control Environment, Risk Assessment, Control Procedures, Monitoring, and Information and Communication. Fraud is an intentional act by one or more individuals in management or those charged with governance, employees, and third parties that involve the use of fraud to obtain an unfair advantage which is an act of who violated the law. (Institut Akuntan Publik Indonesia, 2013)

Statement On Auditing Standard (SAS) 99 (AU 316) (Saputra, 2017) mentioned the fraud triangle as follows. (1) Intensive pressure: when management or other employees are under pressure to commit fraud. Most fraud experts believe that pressure can be grouped into 1. Financial pressure 2. Pressure to commit wrongdoings 3. Work-related pressure 4. Other pressures. (2) Opportunities refer to the situations that allow management to commit fraud. (3) Attitude / Rationalization refers to the attitude or a set of ethical values that allow management or employees to make mistakes. Rationalization occurs as someone is looking for justification for his fraudulent activity. With good internal control, the company will run all of its activities and achieve the predetermined goals (Chintyana et al., 2017; Febriani et al, 2019) Employees will have more opportunities to commit fraud if there is an insufficient internal control (Dewi & Ratnadi, 2017). Internal control has a significant role in preventing fraudulent behavior. Poor internal control design can lead to weak control thereby creating opportunities for fraudulent behavior (Fernandhytia Fernanda & amp; Muslichah., 2020) In good internal control, the auditor must convince management through evidence of fraud (Taufik & Dianita, 2020; Fitrawansyah, 2014)

Muhamad 2017 (Fahmullah et al., 2022) explained that the effectiveness of internal control has a negative influence on fraud at BPR Banda Aceh City, this means that the hypothesis that internal control has a negative influence on fraud at BPR Banda Aceh City can be accepted. Thus more intensive internal control leads to less fraud at BPR Banda Aceh. An insignificant influence can also occur in the weak implementation of an internal control system which can result in non-compliance with the laws and regulations that apply (Herawaty & Hernando, 2021). Contrary to (Sunaryo et al., 2019) found that internal control had a positive and significant influence on the tendency of accounting fraud. The results of this study indicate that better internal control doesn't reduce accounting fraud.' This research, therefore, proposed the following hypothesis.

H1: Internal control affects fraud

The`Influence`of`Good`Corporate`Governanc e`on`Frauds

As stated good corporate governance is a set of rules that establish the rights and responsibilities of shareholders,' management,' creditors, employees, government, and other internal and external stakeholders.'To put it another way, it is a system that controls and directs a company (Surjadi & Rudolf, 2016). In its implementation, a company will refer to the general principles of GCG which are Tariffs, namely Transparency, Accountability, Responsibility, Independence, and Fairness. (IAI, 2015) ensured that proper implementation of the corporate governance principle would decrease the information asymmetry. In addition, their direction and supervision will also improve, while the possibility of various adverse conflicts of interest will decrease. Good corporate governance is expected to help a company run well and it can prevent fraud from occurring. Fraudulent acts can be minimized by implementing good corporate governance (Sanusi et al., 2019). Kurniawan & Izzaty (2019) also stated that good corporate governance can prevent fraud and vice versa. Furthermore, companies that fraud will be greater in companies that do not apply effective and professional management. The theory that states good corporate governance will reduce the risk of abuse or fraud prevention supports the findings of this research. Because every principle of good corporate governance is always related to the principles of openness, nondiscrimination, clear responsibility, and control, it is understandable that the implementation of good corporate governance can prevent fraud (Mulyani, 2020). So the researchers put forward the following hypothesis:

H2: Good Corporate Governance affects Fraud.

The Effects of Internal Control and Good Corporate Government on Frauds

According to KPMG (Anggraeni, 2020), weak internal control is the most common cause of fraud. One of the risks of the failure to implement ineffective internal controls is lower performance. In addition, (Fitrawansyah, 2014) stated that several parties are involved in fraud prevention, including good corporate governance and transaction-level control processes. Good corporate governance is carried out by management to eliminate or at least reduce the possibility of fraud. (Olivia, 2015; Muna et al, 2018) mentioned that’Good’Corporate’Governance, Internal Control together had a significant negative simultaneous’ influence on fraud. Therefore, the following hypothesis was proposed as follows.

H3: Internal control and Good Corporate Governance affect fraud.

3. METHOD

This quantitative research examined influence of internal control and good fraud of governance corporate’(study of the Regional Public Company (Perumda) in Rural Banks in Bandung). Primary data were gained from 30 respondents to whom questionnaires were distributed. The questionnaire consisted of statements that indicate each of the independent variable and dependent variables. Each statement was measured using a five-point Likert scale (1-5). Data were processed using descriptive statistical testing and linear regression analysis on IBM SPSS Statistics. The quality of the data was first examined in validity and reliability tests. The questionnaire consisted of written questions on the influence of GCG and internal control on fraud. Furthermore, the classical assumption test consisting of a normality test, multicollinearity test, and heteroscedasticity test was also performed. After that, Multiple Linear Regression Analysis, Simultaneous Significance Test, Partial Significance Test, and Coefficient of Determination Test were carried out.

4. RESULTS AND DISCUSSIONS

The following part presents the results of the hypothesis testing.

The`Influence’of`Internal’Control on Frauds

The first hypothesis states that internal control (X1) is a `significant influence on fraud (Y). The regression coefficient value of the internal control variable was -0.177. This value is not significant at the 0.05 level of significance with a p-value of 0.128. In addition, the t count was 1.572 < from the t table value of 2.052. Hence, internal control has a negative and insignificant influence on fraud. The influence of the X1 variable is partial by -7.3%.

The Influence of Good Corporate Governance on Frauds

The second hypothesis states that Good Corporate Governance (X2) has a significant influence on fraud (Y). The results of statistical tests showed a regression coefficient of 0.206 which is significant at sig 0.05 and p-value of 0.000. The t count was 4.313 > from the t table of 2.052. It implies that Good Corporate Governance has a positive and significant influence on fraud. The influence of variable X2, namely Good Corporate Governance on variable Y, namely Fraud is partial by 51.6%.

The`Influence`of'Internal'Control'and Good Corporate Governance on Frauds

The third hypothesis states that internal control and good corporate governance affect fraud. Simultaneous F test resulted in an F count of 10.734 with a sig value of 0.000 smaller than 0.05. The F count is greater than the F table of 3.354, implying that'internal'control'and'Good Corporate'Governance'simultaneously'affect the frauds.

5. CONCLUSIONS

Regarding the results of this research, several conclusions were drawn as follows.

1. Internal'control'has'a'negative and insignificant influence'on'fraud, meaning that the presence of internal control does not have any impact on fraud at Perumda BPR Bandung.

2. Good Corporate Governance (GCG) has a positive and significant influence on fraud at Perumda BPR Bandung. GCG is a good system applied by banks for more optimal achievement of the company's visions and missions.

3. Internal Control and Good Corporate Governance (GCG) simultaneously affect the occurrence of fraud at Perumda BPR Bandung.

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