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ORGANIZATIONAL FACTORS AFFECTING FRAUD TRENDS IN FINANCIAL SECTOR COMPANIES IN INDONESIA

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Abstract

The purpose of this study is to determine the organizational factors of banking companies that do fraud in Indonesia. The observational data in this study is 2010 to 2014. This research is empirical research, data is selected by using sampling technique. The observational data in this research is 45 and processed by using logistic regression analysis tool. The variable studied is fraud. While the organizational factors of the company are the disclosure of risk and independence of the function of internal auditors and the opinion of independent auditors. The test results prove that there is no organizational variables of the company and the opinion of independent auditors that significantly influence the indications of fraud in banking companies. ***Keywords**: Organizational factors, fraud, auditor opinion.*

BACKGROUND

Fraud according to International Standards on Auditing number 99 may be defined as a deliberate act by the management of a company, a party that plays a role in corporate governance, employees or third parties committing fraud or fraud to obtain unfair or illegal profits (Amiruddin and Sundari, 2012).

Various efforts that can be done by management to minimize the existence of fraud, such as improving corporate culture through the implementation of principles of good corporate governance (GCG). Because through the implementation of good corporate governance (GCG) will encourage the efficiency of corporate resource performance and produce long-term economic value of sustainable. It also establishes and streamlines internal audit function. As we know that the current role of internal auditors is very demanding, they are required to evaluate and contribute to improvements in risk management, internal control and governance processes using a systematic approach (Tugiman, 2015).

Financial Statement Fraud is a routine act that results in material misstatements in financial statements (AICPA 1987). APB (1998) acknowledges that fraud committed by management is difficult to detect during an audit of financial statements because management has its own way to hide fraud. Research on fraud has been done by Loebbecke et al (1989), that fraud is done because there are favorable conditions in entities and managers. Bell and Carcello (2000) indicate that the factors driving fraudulent financial reporting are weak control environments, rapid corporate growth, low profits, false profit management predictions, and corporate ownership status.

Fama and Jensen (1983) found evidence that internal control functions proxied with the role of external directors would improve corporate controls, thus reducing fraud by management. Young (2000) examines that the audit committee is the vanguard in anticipating fraud measures against financial statements. However, Beasley (1996) and Dechow et al (1996) found different evidence that the existence of the audit committee had no significant effect on fraud in financial reporting, due to the non-independent audit committee's position.

Enterprise risk management or also known as enterprise risk management is a risk management process that includes identification, evaluation and risk control that can threaten the business continuity of the company. The purpose of ERM design according to Beasley et al (2006) is to minimize the portfolio risk facing the company. The risks facing the company can be financial and non-financial risks.

Research in Indonesia that connects risk management to fraudulent financial reporting is relatively small. Most researchers examined the factors affecting risk management disclosure. Like Meizaroh and Lucyanda (2011), Suhardjanto and Dewi (2011), Simanjuntak and Lusi (2012). They examined the factors affecting risk management disclosure, did not examine the impact of risk management disclosure.

As it is known that fraud cases in financial reporting have been widely conducted, both at the international level and in Indonesia. Such as Enron, WorldCom, Kimia Farma, Bakrie and Brothers and Bank Century (www.Bapepam.go.id). The impact of this case is the decrease in users' financial statement confidence in the completeness and reliability of the accounting figures in the financial statements. Companies are expected to be more transparent in disclosing their company's financial information, thus helping decision-makers such as investors, creditors, and other information users in anticipating the ever-changing economic conditions (Almilia and Retriniari, 2007). This raises many requests to public companies to expand disclosure practices in annual reports, not only disclosing financial information but expanding risk disclosure.

Decision of the Chairman of Bapepam and Financial Institution Number: Kep-134 / BL / 2006 concerning Obligation of Submission of Annual Report to Issuers or Public Companies, that the company should present an explanation of the risks faced by the company and the efforts that have been done to manage risk. Another regulation concerning risk disclosure is a regulation issued by the Minister of State Owned Enterprises No. Kep-117 / M-MBU / 2002. It is mentioned that SOE companies should take the initiative to disclose not only the problems required by legislation but also important for decision-making by investors, shareholders / owners of capital, creditors, and stakeholders, one of which is anticipated material risk factors, including management's assessment of the business climate and risk factors.

Seeing the magnitude of the demands of the role of internal auditors in good governance and risk management, this research will examine the role of internal auditor function and risk management disclosure in anticipation of fraud fraudulent financial reporting. Based on the internal auditor's development survey data in 107 countries, it is known that the role of internal auditors in supporting the achievement of company goals is only 44% (Tugiman, 2015). If the role of internal auditors within the company is too low, it will encourage management to commit fraud in financial reporting.

In addition to testing the role of internal auditors, this study will also examine the risk management disclosure factor against the tendency of companies to engage in fraud. Corporate risk management disclosure is indispensable, as it contains a risk management process that includes identification, evaluation and risk control that may threaten the business continuity of the company. The purpose of risk management planning by Beasley et al (2006) is to minimize the portfolio risk facing the company. The higher the level of supervision performed by the company's supervisory functions, the risk disclosure is not very necessary (Oliviera et al., 2011), so this may reduce fraud in financial reporting.

Disclosure on risk management in Indonesia is still limited to voluntary disclosure, except for the banking industry. So there is still a lot of disclosure. Research in Indonesia that connects risk management factors to fraud in financial reporting is relatively small. Most researchers examined the factors affecting risk management disclosure.

THEORETICAL FRAMEWORK

Agency theory explains that there is a conflict of interest between the agent (Management) and the principal (owner). This theory assumes that managers as agents are responsible for maximizing the benefits of the principal, but on the other hand managers also have an interest in maximizing their welfare so that it is likely that agents do not always act in the best interests of the principal (Jensen and Meckling, 1976).

Enterprise risk management or also known as Enterprise Risk Management (ERM) is a risk management process that includes identification, evaluation and risk control that can threaten the business continuity of the company. The purpose

of ERM design according to Beasley et al (2006) is to minimize the portfolio risk facing the company. The risks facing the company can be financial and non-financial risks.

There is research on the relationship between the Board of Independent Commissioners on the Level of Risk Disclosure, the result of which firms with a high proportion of independent board of commissioners will usually be required to provide more information in order to balance the risk level of their personal reputation (Lopes and Rodrigues 2007 in Oliviera et al., 2011). So as to reduce agency costs, firms with a higher proportion of independent board of commissioners will tend to disclose more information.

James's research (2003) shows that users of financial statements assume the internal audit function reporting to senior management is less able to provide protection against fraud in financial reporting. This is due to the assumption that the function of internal auditors is not independent, and possible internal auditor activity is limited in scope. It is necessary to have internal audit function objectivity through a stronger reporting structure, that is, with the responsibility of overseeing the internal audit function directly by the audit committee. Uzun et al., 2004 in Mattousi and Gharbi (2011) found that the higher the proportion of independent directors from outside the company, the less the tendency of fraud occurs within the company.

Organizational Factors related to Financial Statement Fraud

Fraudulent financial reporting is likely to be found when the auditor suspects an accounting error or lack of clarity regarding the management of the transaction and the account balance. However, this fraud is often found due to financial difficulties of the company, which in turn will make the company bankrupt. Research on fraud has been done by Loebbecke et al (1989), that fraud is done because there are favorable conditions in entities and managers. Bell and Carcello (2000) indicate that the factors driving fraudulent financial reporting are weak control environments, rapid corporate growth, low profits, false profit management predictions, and corporate ownership status.

Fama and Jensen (1983) found evidence that internal control functions proxied with the role of external directors would improve corporate controls, thus reducing fraud by management. Young (2000) examines that the audit committee is the vanguard in anticipating fraud measures against financial statements. However, Beasley (1996) and Dechow et al (1996) found different evidence that the existence of the audit committee had no significant effect on fraud in financial reporting. Beasley (2000) examines corporate governance between samples of companies that commit fraud and those who do not fraud; they find evidence that fraud firms have few audit committees. It is possible that the audit committee is not independent and does not work maximally. While the sample companies that do not do fraud, put more extern directors.

Various efforts that can be done by management to minimize the existence of fraud, such as improving corporate culture through the implementation of principles of good corporate governance (GCG). Because through the implementation of good corporate governance (GCG) will encourage the efficiency of corporate resource performance and produce long-term economic value of sustainable. It also establishes and streamlines internal audit function. As we know that the role of internal auditors is very heavy, they are required to evaluate and contribute to improvements in risk management, control of internal control and governance processes using a systematic approach (Tugiman, 2015).

Internal auditors should not conduct audits related to management and governance risks if the organization's internal control is inadequate. Internal control of the organization is adequately expressed in the opinion of the external auditor with an unqualified opinion (Tugiman, 2015). Based on the internal auditor's development survey data in 107 countries, it is known that the role of internal auditors in supporting the achievement of company goals is only 44% (Tugiman, 2015).

Based on the above theories, as well as some research that has been done before, the hypothesis proposed in this study are as follows:

H1: The role of the function of internal auditors affect the tendency to do fraud.
H2: Disclosure of risk management influences the tendency to do fraud.

RESEARCH METHOD

This research is empirical research using secondary data. The population in this study are all financial sector companies listed on the Indonesia Stock Exchange 2010-2014. Sampling technique used in this research is purposive sampling, with criterion: company convey annual report openly and data available complete.

The data in this research is secondary data. The data required in this study is data of financial companies listed on the Indonesia Stock Exchange obtained from www.idx.co.id, and annual report data (company annual report) listed on the Indonesia Stock Exchange obtained from www.idx. co.id.

Variable in this research consist of 3 variables, namely dependent variable, independent variable and control variable. Dependent variable in this research is fraud. This variable is measured using the dummy variable. Number 1 indicates that the company is indicated to manipulate the financial statements, and the number 0 if the company is not indicated to manipulate the financial statements. The company is indicated to manipulate the financial statements proxied by using Beneish M-Score model.

While independent variable in this research is risk management and effectiveness of company internal audit function. The risk management variable is measured using the company's risk disclosure amount. While the variable effectiveness of the function of internal auditors measured from the level of independence of the internal auditor function within the company. The control variable used in this study is the auditor's opinion. This opinion is measured using dummy variables. Figures 1 show the auditor's opinion other than fair, and the number 0 indicates a reasonable auditor's opinion. As Tugiman (2015) argues, that adequate internal organizational control will be demonstrated in the opinion of the external auditor with an unqualified opinion.

The data in this study will be analyzed by using logistic regression analysis, which is processed by using SPSS software. The logistic regression model in this research is as follows:

$$Fr = \beta 0 + \beta 1\ MR + \beta 2\ AI + \beta 3\ O + \varepsilon$$

In this case: (FR): Fraud, measured using dummy variables. Value 1 if company is manipulator and 0 if non manipulator; (MR): Risk Management, measured by the amount of risk disclosure; (AI): Effectiveness of internal control functions, measured from the level of independence of the internal auditor function within the company; (O): Opinion of the external auditor; (e) : *error term*

After the data processing, it will be tested against the hypothesis. The research hypothesis will be supported if the significance value t of the regression processing results shows a significance value of less than 5%.

To determine the company's manipulator or non-manipulator, identified by using Beneish M-Score analysis. If the value of M-Score is below -2.22 then the possibility of the company is prudent, but if M-Score is greater than -2.22 then the possibility of the company doing manipulation in its financial statements.

RESULT AND DISCUSSION

The observation year used in this study is 2010 to 2014. The number of samples in this study is as many as 45 samples. The description of this research data is shown in table 1 below:

Table 1. Frequency Distribution

	Kriteria	Jumlah	Prosentase
Posisi AI	1	28	0.62
	2	17	0.38
		45	
Risiko	3	6	0.13
	4	4	0.09
	5	4	0.09
	7	1	0.02
	8	30	0.67
		45	
Opini	1	37	0.82
	0	8	0.18
		45	
Fraud	1	42	0.93
	0	3	0.07
		45	

The highest risk disclosure number is 8 risk type, that is 67%. The increasing number of disclosures shows the transparency of corporate information. So, this will suppress the existence of fraud within the company.

The auditor's opinion mostly (83%) is unqualified. This indicates that the financial statements prepared by the banking party is reasonable and free from material misstatement and fraud.

While the indication of the existence of fraud is relatively small, ie only 7%. This is because to judge a company actually doing fraud only through measurement. In addition, high banking regulation will greatly reduce the possibility of banking companies doing fraud.

Based on logistic regression analysis, Table 2 shows the result of regression analysis.

Based on the results of logistic regression though it is known that there is no independent variable that can predict banking companies to do fraud. This is due to several factors. If seen from the frequency distribution of data available in table 1 above, then most banking companies have complied with banking regulations well. Internal auditors already have a high level of independence in performing their duties. So that it can suppress the indications of fraud in financial reporting and able to evaluate the effectiveness of corporate control, which this manahal has an important role against fraud. The large number of risk disclosures signifies the disclosure of corporate information. The more information disclosed, the less risk of fraud committed by the company. Companies that conduct fraud will usually limit the amount of information disclosure, this is done to cover inaccurate information.

Most auditor opinions are unqualified. Means the company in preparing the financial statements have met the criteria set out in the applicable accounting standards and does not contain material misstatement and fraud. The auditor guarantees the truth of the opinion, because if the auditor acts rashly in giving opinion, it can be sanctioned either profession or by his client. Besides, high banking regulation will require the company to obey the regulation, so it will be long thought to do fraud.

Table 2. Logistic Regression Analysis
Variables in the Equation

		B	S.E.	Wald	df	Sig.	Exp(B)
Step 1[a]	AI	18.608	8680.825	.000	1	.998	1.206E8
	RISK	-14.188	3299.878	.000	1	.997	.000
	OPINI	.916	1.378	.442	1	.506	2.500
	Constant	95.998	27789.662	.000	1	.997	4.913E41

a. Variable(s) entered on step 1: AI, RISK, OPINI.

CONCLUSION

The purpose of this study is to examine the organizational factors of banking companies that influence the tendency of banking companies to do fraud. Based on the data and discussion above, it is concluded that there is no organizational factor that can indicate the banking company doing fraud.

Based on the frequency distribution, most banking companies have run or complied with banking regulation with share. Positions and attitudes of highly independent internal auditors, high levels of disclosure of information, and compliance in the preparation of high financial statements this can be seen from the opinion of the auditor given.

This study has limitations, among others, is the measurement of companies doing fraud using predictions. So as not to be able to give a true picture of fraud. So for the next research can use a more accurate prediction. In addition, organizational measurement uses only the number of risk disclosures and the position of the internal auditor. The next research can use different sizes and add research variables.

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