Factors That Affect the Tendency of Accounting Fraud

Riri Pratiwi1 and Hari Setiyawati2

1 Faculty of Economy and Business, Universitas Mercu Buana, Jakarta, Indonesia
2 Faculty of Economy and Business, Universitas Mercu Buana, Jakarta, Indonesia

DOI: https://doi.org/10.56293/IJMSSSR.2022.4697

Abstract: The objective of this study is to examine the factors that influence a person who commits accounting fraud. The factors include the effectiveness of the internal control system and information asymmetry. The population of this study was all Regional Working Units (SKPD) in South Tangerang City and Regional Working Units in Tangerang City. The sample in this study used a purposive sampling technique and used primary data in the form of a questionnaire to collect the data. The responses obtained were 40 out of 41 from the distributed questionnaires. In analyzing the data, this research used PLS (Partial Least Square) analysis. The results of this study indicate that the effectiveness of the internal control system significantly influences the tendency of accounting fraud. Moreover, information asymmetry does not affect the tendency of accounting fraud.

Keywords: Effectiveness of the Internal Control System, Information Asymmetry, Accounting Fraud Tendency

1. Introduction

A government system adheres to a decentralized system in which local governments are given full authority to explore, manage, and utilize its potential of the region that can be justified. Local governments strive to provide services to the community by practicing public service standards such as transparency, accountability, participation, equal rights, and obligations. To fulfill the rights and obligations as well as carry out the tasks given by the residents, the regional government must possess a comprehensive plan to obtain maximum results. Local governments prepare these plans and create various policies in the form of budgets. In the process of budgeting preparation, financial statements and declaring new policies can lead to another problem such as accounting fraud or commonly known as a fraud.

Fraud as an intentional misstatement of financial reports (Arens et al., 2017) Some fraud cases in Indonesia include allegations of misappropriation of the state budget in the procurement process of goods and services in the Tangerang City Government, which were reported by the Tangerang Anti-Corruption Study Center (PUKAT) and alleged illegal levies (extortion) at SDN Pucung 2, Pondok Aren - South Tangerang. Accounting fraud can occur due to several factors such as pressure, opportunity, and rationalization. Many cases of fraud are caused by opportunities or possibilities. One of the reasons for opening opportunities to commit fraud is because of the absence or the ineffectiveness of internal control in an organization. Internal control is an organizational plan and method used to maintain or protect assets, present accurate and reliable information, improve efficiency, and to encourage compliance management policies (Krismiaji, 2015). In addition to internal control, information asymmetry also provides opportunities for fraud. Information asymmetry is the imbalance of information between agents as parties who have information with the principals as information users.

Research that examines the determinants that influence accounting fraud has been widely conducted. However, previous studies had revealed different results. The results of the study conducted by (Ahriati, D., Basuki, P., & Widiastuty, 2015) showed that the internal control system did not affect the tendency of accounting fraud. Meanwhile, in (Sarwono, 2016) the effectiveness of internal control affected accounting fraud. Research conducted by (Aranta, 2013) proved that there was a positive relationship between information asymmetry towards accounting fraud, and the research's result by (Ahriati, D., Basuki, P., & Widiastuty, 2015) mentioned that there was no effect of information asymmetry on the tendency of accounting fraud.
2. Theoretical Background

2.1 Fraud.

Tuanakota (Tuanakotta, 2014) mentioned that fraud is a deliberate act by one or several people in management, TCWG (Those Charged with Governance), employees, or third parties. Institute of Internal Auditor in (Priantara, 2013) defined fraud as any act that is characterized by deception or breach of trust to guarantee personal or business benefits or profits. The Association of Certified Fraud Examiners (ACFE) classifies fraud into three types of actions committed, namely: fraudulent statements, asset misappropriation, and corruption. In 2002 SAS no 99 in (Kassem & Higson, 2012) stated that these three conditions are generally present when fraud occurs. First, the management or other employees have incentives or are under pressure, which provides reasons for fraud. Second, the actual situation - for instance, the absence of control, ineffective control, or the ability of management to override controls that provide opportunities for fraud. Third, those involved can rationalize the motive for committing fraud. Some individuals have an attitude, character, or set of ethical values that allow them to consciously and intentionally commit dishonest actions. However, some honest people can also commit fraud in an environment that puts them in pressure.

2.2 Internal Control System

According to (Romney et al., 2020), internal controls are the processes and procedures implemented to provide reasonable assurance that control objectives are met. While (Mulyadi, 2016) said that internal control includes organizational structure, methods, and measures that are coordinated to maintain organizational wealth, examine the accuracy and reliability of the accounting data, promote efficiency, and encourage compliance with management policies. In 1992, the COSO (Committee of Sponsoring Organization of the Treadway Commission) introduced a control framework that was broader than the traditional accounting control model and included risk management. The internal control consists of 5 interrelated components, namely: 1. Control Environment, 2. Control Activities, 3. Risk Assessment, 4. Information and Communication and 5. Monitoring.

2.3 Information Asymmetry

Information asymmetry is where management as a party have more information compared to investors or creditors (Suwardjono, 2017). Hanafi (Hanafi & Halim, 2018) stated that "The concept of signaling and information asymmetry is closely related, the asymmetric theory says that the parties associated with the company do not have the same information about the prospects and risks of the company, certain parties have better information than the outsiders". There are two types of information asymmetry stated by (Scott, 2015), namely: 1. The adverse selection that occurs because some people such as company managers and other insiders are more aware of the present conditions and prospects of a company than investors, 2. Moral Hazard can occur because of the separation of ownership with control. The concern for information asymmetry is essential when one party does not have information about the quality of the other parties or when one party is more concerned with the tendency of the other parties' behavior (Stiglitz, 2000) in (Courtney et al., 2017). High information asymmetry between managers and shareholders is evidence that shareholders have a lack of resources, incentives, or access to relevant information to monitor managers' actions (Schipper, 1989; Warfield, Wild and Wild 1995) in (Richardson, 2000).

3. Conceptual Framework and Hypothesis

Internal control is an organizational system or procedure used to maintain assets, create efficiency, and comply with management policies. To anticipate any accounting fraud that might occur within the organization, an effective internal control system is required. In a study conducted by (Sarwono, 2016) stated that the effectiveness of the internal control system influences fraud.

Information asymmetry is a concept that illustrates a situation where an agent, for instance, one has more information, thus it is considered better than another agent. If an information imbalance occurs in an organization, it can open up opportunities for the fund manager to commit fraud. Research conducted by (Aranta, 2013) showed that information asymmetry had a significant and positive effect on the tendency of accounting fraud.
Figure 1. Conceptual Framework

Based on the conceptual framework above, the hypotheses of this study are as follows:
H1: The effectiveness of the internal control system has a significant effect on the tendency of accounting fraud
H2: Information asymmetry significantly affects accounting fraud

4. Research Method

This type of research is causal quantitative research that aims to examine the hypotheses about the effectiveness of the internal control system (X1), information asymmetry (X2) as an independent variable, and the tendency of accounting fraud (Y) as the dependent variable.

This population of the study was 79 Regional Working Units in South Tangerang and Tangerang city and 41 Regional Working Units chosen as the research samples. The research samples were determined by using a purposive sampling method and the data source used in this study is primary data that was obtained directly from the respondents. While collecting the data, this research used a questionnaire method and use the Partial Least Square (PLS) approach to analyze the data. The effectiveness of the internal control system variable consists of 5 dimensions, namely 1) Control environment, 2) Control activities, 3) Risk assessment, 4) Communication and information, and 5) Monitoring. The asymmetric variable of information consists of 2 dimensions, 1) Adverse selection and 2) Moral hazard. Meanwhile, the variable of accounting fraud tends to consist of 3 dimensions, namely, 1) Deviation of assets, 2) Financial statement fraud, and 3) Corruption.

5. Results And Discussion

5.1 Research Variables Description

The results of the descriptive analysis of each variable are described follows:

Table 1 Variable Descriptions

<table>
<thead>
<tr>
<th>No.</th>
<th>Variable</th>
<th>Average Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Accounting Fraud Tendency</td>
<td>2.73</td>
</tr>
<tr>
<td>2.</td>
<td>The Effectiveness of the Internal Control System</td>
<td>4.13</td>
</tr>
<tr>
<td>3.</td>
<td>Information Asymmetry</td>
<td>3.25</td>
</tr>
</tbody>
</table>
The statistical description results of the variables show that the effectiveness of the internal control system variable has an average value of 4.13. This number indicates that Regional Working Units in South Tangerang and Tangerang City have effectively implemented the internal control systems. However, the information asymmetry variable gained 3.25 of its average value. This means that the Regional Working Units in South Tangerang and Tangerang City provide a small amount of information asymmetry. In addition, variable accounting fraud tendency obtained an average value of 2.73 which indicates that the accounting fraud tendency in Regional Working Units at South Tangerang and Tangerang City is low.

5.2 Validity Test

The following picture presents the results of the output loading factor of the Effectiveness of the Internal Control System construct, the Information Asymmetry, and the Accounting Fraud Tendency on the Smart PLS application:

![Figure 2. Conceptual Framework](image)

Based on the output in the presented path diagram, the loading factor for each construct achieves the convergent validity to have an indicator value > 0.5. All loading factors are significant at the 5% level.

5.3 Reliability Test

A variable in research can be reliable if the variable has a construct reliability value greater than 0.6. The results of the reliability output above show that for all dimensions in organizational culture variables, the effectiveness of the internal control system, information asymmetry, and accounting fraud tendency have composite reliability above 0.7 and alpha cronbachs above 0.6. Except for control activities, Fraudulent Statement and adverse selection are below 0.6 but still considered sub-marginal by examining the value of composite reliability above 0.7. Thus, it can be concluded that the indicators used in each dimension have excellent reliability or capable to measure the construct.

5.4 Evaluation of Goodness-of-Fit Structural Model (Inner Model)

Research evaluation of the goodness-of-fit model is measured by using the value of R-Square (R2). The R-Square (R2) value in PLS output is 0.374 and the Adjusted R-Square (Adj-R2) value is 0.340. These results indicate that the accounting fraud model is described by the effectiveness of the internal control system. Meanwhile, the information asymmetry obtains 37.4% and other points are described by other variables outside the research model.
5.5 Hypothesis Testing

Hypothesis testing in this study is based on the output of Partial Least Square and applies a 5% significance level. The value of the parameter coefficient and T statistic significant value can be examined in the following table:

<table>
<thead>
<tr>
<th>The influence between Variables</th>
<th>Parameter Coefficient</th>
<th>T statistic</th>
<th>P Value</th>
<th>Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>The effectiveness of the internal control system → Accounting Fraud Tendency</td>
<td>-0.581</td>
<td>5.035</td>
<td>0.000</td>
<td>Significant</td>
</tr>
<tr>
<td>Information Asymmetry → Accounting Fraud Tendency</td>
<td>0.137</td>
<td>0.137</td>
<td>0.319</td>
<td>Insignificant</td>
</tr>
</tbody>
</table>

The result of the first hypothesis testing concerning the effect of the effectiveness of the internal control system on accounting fraud tendency shows a parameter coefficient of -0.581 with a statistical value of 5.035 > T table 1.96. Besides, the P value 0.000 is less than the significant level of 0.05 which indicates that the effectiveness of the internal control system significantly influences the tendency of accounting fraud. Thus, the first hypothesis in the research is accepted.

In testing the second hypothesis, which concerns the effect of information asymmetry on the accounting fraud tendency, the result reveals that the parameter coefficient of 0.137 with a statistical value of 0.137 < T table 1.96. In addition, P value 0.319 is greater than the significant level (0.05) which indicates that information asymmetry does not have a significant effect on accounting fraud. Therefore, the second hypothesis in the study is rejected.

5.6 Discussion

According to the results of statistical tests and the significance, the effectiveness of the internal control system has a significant effect on the accounting fraud tendency. The tendency of accounting fraud occurs because of the opportunities, with the absence of an internal control system which leads to weak supervision that provides opportunities for fraud. In a study, (Mulya et al., 2020) stated that internal control weaknesses and defects in its implementation are the factors that provide possibilities of fraud in large numbers and last for a long time. Internal control is an organizational system or procedure used to maintain assets, create efficiency, and comply with management policies. In conclusion, the internal control systems at the institutions have been effectively implemented. This can be observed from the responses of respondents who stated that institutions are excellent at capturing and distributing the required information to implement, manage, control the operational activities. The institutions have carried out a continuous assessment of internal control implementation to evaluate whether the control has been performed properly and create adjustments if is required. Accounting fraud will not occur and can be detected with an effective internal control system. The results of this study are in line with the research by (Eliza, 2015) and (Sarwono, 2016) that the effectiveness of internal control affected fraud. Different results were obtained from the research of (Surjandari, D. A., & Martaningtyas, 2015) which revealed that the internal control system did not influence fraud.

The results of statistical tests and the significance reveal that information asymmetry does not significantly influence the tendency of accounting fraud. This result can be caused because of the low information gap between agents and principals which can be identified from the respondents’ responses. The majority of the respondents’ responses stated that all activities performed by agents are acknowledged by the principal or in accordance with the contract. The Regional Working Units or Local Government will be as the agents and the principal is the Regional House of Representatives that represent the community. The local governments organize Regional Government Financial Reports as responsibility for the use of the public funds. Concerning information asymmetry where the executive (Regional Working Units) has more information about actual performances, motivation, and goals, which potentially can generate moral hazard and adverse selection, information asymmetry occurs because the legislative (Regional House of Representatives) does not possess adequate information about the executive performances. The legislative is uncertain about how the executive contributes to the actual results.
of government institutions. In Regional Working Units, the asymmetric information can be accomplished by monitoring or supervision conducted by the Regional Inspectorate and audits conducted by the National Audit Board. In addition, information asymmetry can also be succeeded through the use of disclosures in financial statements. The results of this research are in line with research conducted by (Ahriati, D., Basuki, P., & Widiastuty, 2015) which stated that there is no influence of information asymmetry on the tendency of accounting fraud. However, the results of this study contradict a study by (Aranta, 2013) which revealed that the information asymmetry positively influences the tendency of accounting fraud.

6. Conclusion And Suggestion

According to the presented results of the study and discussion, it can be concluded that the effectiveness of the internal control system significantly influences accounting fraud tendency, while the information asymmetry does not affect the tendency of accounting fraud.

From the results of the study and conclusions, it can be suggested as follows: the results of this study provide practical implications in the Regional Working Units (SKPD) environment on how to reduce the tendency of accounting fraud in each institution. However, it is expected that the SKPD can enhance the effectiveness of the internal control system to reduce the tendency of accounting fraud. Furthermore, to decrease or minimize information asymmetry, the institutions are expected to be more transparent about institution operations and effective internal control.

References

 ga, Yogyakarta: BPFE.