

# Control Effectiveness And Fraud: Evidence In Indonesia Cooperative

Nanik Sri Utaminingsih, Anis Chariri, Indira Januarti

**Abstract:** This study investigated the factors that influence employee fraud in economic entities in the form of cooperatives. The uniqueness of the cooperative is oriented to the welfare of members and management is dominated by members, so it is possible to give different results from previous research. The research sample of 97 cooperative employees in the city area of Semarang, Indonesia. Partial least square (PLS) is used as an analysis tool. The results showed that the effectiveness of control, organizational commitment and compensation sufficient significantly influence employee fraud. While unethical behavior does not affect fraud. The indirect effect showed that control effectiveness can mediate on relationship between organization commitment to fraud.

**Index Terms:** Fraud, Control Effectiveness, Organization Commitment, Unethical behavior, Compensation sufficient.

## 1. INTRODUCTION

Referring to Statement on Auditing Standards (PSA) No. 70 (SA Section 316), Fraud is (1) Misstatements arising from fraud in financial reporting are misstatements or deliberate disappearance of amounts or disclosures in the financial statements to deceive the users of the financial statements. (2) Misstatements arising from improper treatment of assets (often referred to as misuse or embezzlement) relating to theft of assets of an entity resulting in financial statements are not presented in accordance with generally accepted accounting principles in Indonesia. Fraud in the company can be done by management or employees. Both have a negative impact on decision-making and are detrimental to the company and the public. Fraud can occur in all economic entities, including cooperatives. In Indonesia, the form of cooperative business is one of the backers of the country's economy. In accordance with the Law of the Republic of Indonesia No 25 of 1992 cooperatives have the function of building and developing the economic potential and capabilities of members and society. Cooperatives have the characteristics of management and supervisory cooperatives are members who make capital deposits to cooperatives. The management of cooperatives involving members has the aim of reducing fraud and financial management mistakes. However, cases of fraud in cooperatives still occur. In 2019 the fraudulent case in the Pandawa cooperative was responded to by the Financial Authority Service (OJK) and costing around 600 customers with billions ("www.republika.co.id," 2019). Fraud prevention has been carried out through regulations such as the application of the Sarbanes-Oxley Act in 2002. On the organizational side according to Free, Macintosh, & Stein (2007) an effective management control system is needed to deal with fraud. However, it has not been able to deal with fraud cases. According to Roden,

Cox, & Kim (2016) individual ethics and integrity cannot be overcome through regulation, but the prevention and detection of fraud must focus on how to deal with interpersonal dynamics and behavior that underlies the psychology of fraud perpetrators and the psychology of those responsible for governance, including auditors, and their interactions. Manurung, Rinta, & Saefudin (2015) argues that individual behavior factors influence employee fraud, he assumption developed is that an organization with a good control system cannot run without the support of organizational actors. Good individual behavior in the organization together with a good control system tends to reduce fraud. The Fraud Triangle developed by Cressey provides guidance that fraud is caused by pressure, opportunity and rationality. Pressure refers to motivation that arises from individual employees. Opportunity refers to the effectiveness or control of the organization. Whereas rationalization refers to the condition of ethical values possessed by individuals and their environment (Dorminey, Fleming, Kranacher, & Riley, 2012). Cooperatives as economic entities have the principle of cooperation and family relation among members. It has the threat of fraud. The potential for fraud in cooperatives can be greater than for public companies, because the closed nature of cooperatives is only oriented towards the welfare of cooperative members, so that external parties in the form of investors or other stakeholders difficult to enter the managerial area of cooperatives. Based on these thoughts, it is necessary to investigate the influence of pressures, opportunities and rationality on cooperative employee fraud. This research contributed to the reference in preventing fraud in Indonesian cooperatives. For methodology will be discussed in section 3, the results of the research and empirical findings will be discussed in section 4, and concludes with a conclusion..

## 2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

### 2.1 Unethical Behavior and Fraud

Unethical behavior is behavior that is contrary to ethics. Unethical behavior as a proxy for rationalization from the Fraud Triangle. When employees behave unethically, it will hamper the achievement of company goals. This form of unethical behavior can be an abuse of position and power or abuse of organizational resources. The impact of unethical behavior normatively will reduce the effectiveness of internal

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control and increase the tendency for fraud. Moore, et al. (2012) states that unethical behavior as a component of morality, contributes to the emergence of employee fraud tendencies the hypothesis is compiled:

H1a: Unethical behavior has a positive effect on fraud

H1b: Unethical behavior negatively influences the effectiveness of internal control

### 1.1 Commitment Organization and Fraud

Employee loyalty to the organization has a large impact on the achievement of organizational goals. Cooperatives have employees who normatively have a high loyalty to the organization, due to the status factor as the owner of capital. If the organizational commitment increase, so the desire of employees to improve organizational performance will be increase and affect the tendency to commit fraud is decrease. In another view, organizational commitment is related to the effectiveness of internal control. When the commitment of employees to the organization increase, the more employees will obey the control system so that effective control is created. Wilopo (2006), Virmayani, Gede, & Atmadja (2017) reinforce that organizational commitment influences fraud. So the hypothesis is arranged:

H2a: Organizational commitment has a negative effect on fraud.

H2b: Organizational commitment has a positive effect on the effectiveness of internal control

### 1.2 Compensation sufficient and Fraud

Compensation sufficient is a proxy for pressure from the fraud triangle. Compensation for employees in cooperatives consists of 2, namely compensation as employees and compensation as members who have contributed capital to the cooperative. First compensation is salary and second compensation is profit sharing as a member of the cooperative. The suitability of compensation received by cooperative employees is designed so that employees do not have the motivation to commit fraud. The higher the appropriateness of compensation set with the desires of employees, it will reduce the tendency for fraud. Tang & Chiu (2003) explains that love for money makes an employee take into account the appropriateness of the compensation he receives, and when the compensation is deemed inappropriate, then he can be violated. So the hypothesis is arranged:

H3 : Compensation sufficient has a negative effect on fraud.

### 2.4 Effectiveness Control and Fraud

Control is an effort and management activity to ensure the company's goals can be achieved. Control effectiveness is an opportunity proxy for the fraud triangle. How a control can run according to established procedures and regulations depends on the actors of the organization, especially managerial. The higher the employee's perception of the importance of internal control, the easier it will be to improve the effectiveness of control. The effectiveness of internal control refers to the implementation of 5 components of internal control, namely the control environment, risk assessment, information and communication, control and monitoring activities. The higher the effectiveness of internal control, the less chance of committing fraud, and vice versa. So the hypothesis is arranged:

H4 : Effectiveness control has a negative effect on fraud.

H5: Organization Commitment has negative effect on fraud by control effectiveness

H6: Unethic Behavior has positive effect on fraud by control effectiveness

## 2.5 Research Framework

Based on the triangle fraud theory, we develop research framework :

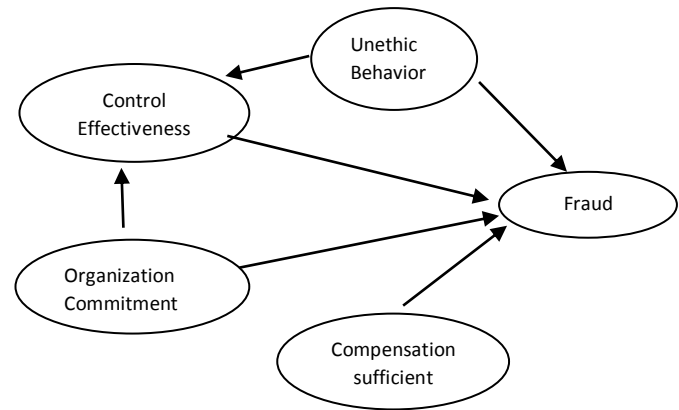


FIGURE 1. RESEARCH FRAMEWORK

## 3 RESEARCH METHODS

This research is a quantitative research. The data used is the perception of cooperative employees in the city of Semarang, Central Java, Indonesia. Data was collected through a questionnaire distributed over a certain period of time. Partial least squares (PLS) are used to analyze data and answer hypotheses.

### 3.1. SAMPLE AND MEASUREMENT

The sample of this research is cooperative employees who have services in finance. The number of cooperatives in the city of Semarang is 51 cooperatives. The questionnaires were distributed as many as 130. The returning questionnaires were as many as 105. The questionnaires that fulfilled the requirements were 98 questionnaires. Fraud was measured by 9 question items derived from the Occupational fraud classification system, the Association of Certified Fraud Examiners. Unethical behavior is measured by 4 questions reduced from the instrument developed by Tan. Organizational commitment is measured by 6 questions developed by Mc Neese-Smith (1996) in Wilopo (2006). The suitability of compensation using 6 questions comes from Tang & Chiu, (2003) modified by Wilopo (2006). The effectiveness of internal control uses 5 questions developed by Wilopo (2006)

## RESULT AND DISCUSSION

The first test conducted was a measurement model to determine convergent validity, composite reliability and discriminant validity. In this test there are several indicator variables that must be dropped because they do not meet the requirements.



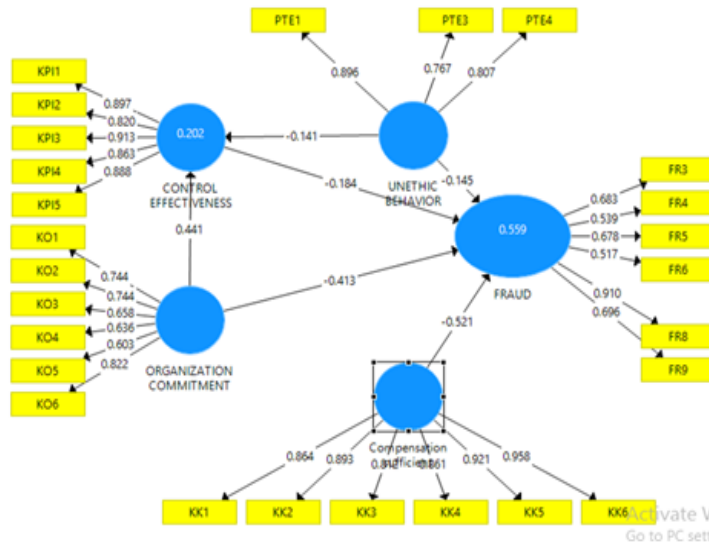
Figure 2. Model 1

Based on the factor loading value for fraud indicators, there are 3 indicators that have a factor loading value below 0.50, are FR1, FR2, FR7. These three indicators will be dropped for the next test. For the unethical behavior indicator in the second test, the PTE2 indicator shows a value below 0.50 so it is dropped. While the indicators of control effectiveness, indicators of organizational commitment and indicators of compensation suitability indicate a loading factor value above 0.50 so that all indicators can be used for subsequent testing.

Table 1 Reliability and validity

Construct	Crombach's Alpha	Composite Reliability	R-Square
Fraud	0,767	0,835	0,559
Unethic Behavior	0,791	0,864	-
Control Effectiveness	0,925	0,943	0,202
Organization Commitment	0,801	0,854	-
Compensation Sufficient	0,945	0,956	-

The measurement of discriminant validity by cross loading shows that all indicators have a higher correlation value to the construct than the correlation of the indicator with other constructs, so that latent constructs can predict according to the construct block. Table 1 shows the Crombach's Alpha for each construct > 0.70. Composite reliability value for constructs of fraud, control effectiveness, compensation sufficient, organizational commitment, unethical behavior has a composite reliability value > 0.8 so that it shows that all constructs are fit measurement tools. R-square value for Fraud is 0.559 and control effectiveness is 0.202. The greater the value of R-square, the greater the independent variable is able to explain the dependent variable. Inner model testing is done using model 2, after the indicator dropping is done. Model 2 as in figure 3.



Figur 3. Full Model 2

Hypothesis testing uses model 2 by analyzing the statistical T and P value with alpha of 5%. The test results are presented in table 3.

Table 2 Hypoteses Testing

Inner Weights	STDEV	t-Statistics	P-Value	Conclusion
Unethic Behavior --> Fraud	0,096	1,512	0,131	H1a Rejected
Unethic Behavior --> Control Effectiveness	0,103	1,372	0,171	H1b Rejected
Organization Commitment--> Fraud	0,067	6,203	0,000	H2a Accepted
Organization Commitment--> Control Effectiveness	0,056	7,936	0,000	H2b Accepted
Compensation Sufficient --> Fraud	0,078	6,662	0,000	H3 Accepted
Control Effectiveness --> Fraud	0,064	2,872	0,004	H4 Accepted

Table 3 and figure 3 show that the effect of unethical behavior on fraud is -0.145 with a probability value of 0.131 so H1a is rejected. Likewise for affect unethical behavior on control effectiveness shows a coefficient of -0.141 with a probability value of 0.171 is not significant at alpha 5% so H1b rejected. This result is different from the research of Moore et al., (2012). The difference in results can be caused by differences in salient characteristics between public organizations and organizations in the form of cooperatives. The direct relationship in the commitment organization construct to fraud shows a coefficient of -0.413 with a probability value of 0.000 so that H2a is accepted. The meaning is the higher the organizational commitment of cooperative employees, the fraud will go down. The relationship of organizational commitment to control effectiveness shows a coefficient of 0.411 with a probability value of 0.000 then H2b can be accepted. This result

supports Supiyanto's (2015) research, but it differs from the research of Manurung et al. (2015) especially in the direction of the coefficient. This result is in accordance with the characteristics of membership in cooperatives. Management which is also part of the capital holders certainly has a big interest in the going concern of cooperatives, so reducing fraud as one of the causes of bankruptcy in cooperatives must be avoided. In this research, the relationship of compensation sufficient to fraud has a coefficient of -0.521 and a probability value of 0.000 so that H3 is accepted. This result gives the meaning that the higher the compensation sufficient, the lower the fraud will be. So compensation sufficiently has a negative effect on fraud. Individuals who receive compensation according to their workload tend not to want to commit fraud, compared to individuals who do not get the appropriate compensation. They will act fraud to adjust between the benefits and workload received. These results support the research of Tang & Chiu (2003). The relationship between control effectiveness against fraud has a coefficient of -0.184 and a probability value of 0.004 so that H4 is accepted. The higher control effectiveness will have an impact on reducing fraud. When the employees' perceptions of cooperatives on the organization's internal control can be effective, fraud can be detected by the control, so the tendency to commit fraud is reduced. These results support research conducted by Rae & Subramaniam (2005) Testing the indirect relationship between organizational commitment to fraud through the effectiveness of controls proved that the effectiveness of control is able to mediate. This is based because the relationship of organizational commitment to fraud shows significant. So is the relationship between the effectiveness of controls against fraud and the relationship between organizational commitment to the effectiveness of control so it concluded that visible nature of mediation is mediation is not perfect. Based on this test, H5 cannot be rejected. Testing the indirect relationship between unethical behavior to fraud through control effectiveness shows the results there is no mediating effect. The relationship between unethical behavior towards showed no significant fraud, as well as in relation to the behavior unethical effectiveness control. So it was concluded that H6 cannot be accepted.

## CONCLUSION

This research concludes that control effectiveness, organization commitment and sufficient compensation have a significant effect on employee fraud in cooperative organizations. The result of indirect relationship testing is that control effectiveness is able to mediate the relationship between organizational commitment to fraud. The weakness of this study is the low participation of cooperative employees, which only amounted to 97 out of a population of cooperatives employees in the city of Semarang, Indonesia. The results of this study also provide direction for future research, that the addition of variables as a proxy of triangle fraud can be done.

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