Islamic Corporate Governance and Internal Control Influence on Fraud in Sharia Commercial Banks

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Article Info:

Abstract:

This study aims to examine impact of Islamic Corporate Governance and Internal Control on Fraud on Sharia Commercial Bank in Indonesia. The unit analysis of this research is Sharia Commercial Banks in Indonesia which have been registered in the Financial Services Authority (OJK) period 2012 to 2017. This research was done to 11 Islamic commercial banks by using quantitative-descriptive approach. The results of this research showed that Sharia Supervisory Board and Internal Control have negative effect and insignificant on Fraud. However, Audit Committee has a positive effect and significant on fraud.

Introduction

The development of the banking sector in Indonesia is an interesting phenomenon to be observed. Conventional banks and sharia banks are the choices of today. Sharia banks carry out their duties based on sharia principles. Related to this, it does not guarantee Sharia banks are free from fraud. Modern companies present a corporate governance mechanism that is able to guarantee the implementation of commitments agreed upon by all parties that conduct business relations to anticipate the development of an increasingly complex business world and various cases of fraud. Related to this, Sharia banks in carrying out their operations must be based on Islamic principles with good corporate governance. Corporate governance from an Islamic perspective is termed Islamic Corporate Governance.

Internal control is another important factor that must be owned and implemented by companies to reduce fraud in addition to good corporate governance. Weak internal control can be an incentive for individuals or groups to commit fraud (Anugerah, 2014). Weaknesses in the internal control system as measured by audit findings from the Audit Board consist of weaknesses in the accounting and reporting control systems, and weaknesses in the implementation of the budget control system and weaknesses in the internal control structure (Setiyawati, 2016). Good internal control can enable management to be ready for rapid economic changes, competition, shifting customer demand and priorities and restructuring for future progress (Rujito, Cholifah, & Iskandar, 2016).

Internal control or integrated framework is a standard used by companies in designing, analyzing, and evaluating internal control (Warren, M. Reeves, & Philip E. Fess, 2015). The management of an entity has the responsibility to uphold and maintain internal control (Yuwannita & Ariani, 2016). The tendency of fraud is related to the existing internal control system in an organization, where good internal control causes an organization to avoid fraud. Internal control influences not only the prevention of fraud but also has implications for financial performance (Mappanyukki, Setyawati, & Muti’ah, 2012).

The above description motivates researchers to examine Islamic corporate governance, internal control and fraud. First, the weak governance and internal control of companies provide opportunities for fraud in Sharia banks. Second, to find out whether Islamic corporate governance and internal control of Sharia Banking in Indonesia have an influence on the fraud that occurs at the institution.
Literature Review and Hypothesis Development

According to Jensen & Meckeling, (1976), Agency theory is the basic thing used to understand the relationship between principals and agents. In this case the agency relationship is a contract between one or more people who employ others to provide a service and then delegate decision making authority to the agent. Based on this theory, there is a separation between the owner (principal) and the manager of the company (agent), causing agency problems. Furthermore, the separation of owner and manager also creates information asymmetry, which is a condition where agents have access to information that is not owned by the principle. Imbalance of information owned by the owner and manager of the company imposes the emergence of information asymmetry. Based on the assumption of human nature, every human being has a tendency to act by prioritizing his personal interests.

In the Black's Law Dictionary, fraud covers all kinds of things that humans can think of, and that one strives to benefit from others with false suggestions or coercion, and covers all unexpected, tricky, cunning, hidden ways and every way that is not honest that causes others to be deceived. Tuanaokotta (2007) explains that fraud occurs because of 3 (three) conditions called the fraud triangle. First, there is an incentive / pressure, second, there is an opportunity, and thirdly, there is a rationalization / attitude or the tendency of the actor to justify his actions. Someone or a group of people will commit fraud if within themselves there is pressure or encouragement that can arise from a variety of situations, such as urgent financial needs, there is pressure from other parties, dissatisfaction with the workplace organization, the existence of greed and others. The motive then causes a person or group of people to look for opportunities to commit fraud and the opportunity becomes open if the internal control in the organization is weak.

According Koesmana, Kristiawan, & Rizki (2007) Fraud that occurs in organizations / companies can be done by various levels starting from the lower level, the management to the owner. The procurement process in a company is one example of fraud, where the perpetrator is a person or group of people in the company (employees) who receive compensation from partners involved in the procurement process.

Sharia banks in carrying out their activities must be guided by Islamic principles. To guarantee the application of sharia principles, it is necessary to have sharia supervision played by the Sharia Supervisory Board (El Junusi, 2012). The audit committee as an extension of the board of commissioners is an element of corporate governance that can prevent fraud by carrying out the oversight function of the company's internal control system (Anugerah, 2014).

Internal control is a process carried out by the board of commissioners, management and other personnel in an organization. Internal control, also called an integrated framework, is a standard used by companies in designing, analyzing, and evaluating activities within a company (Warren et al., 2015). If the internal control of a business is weak, the possibility of fraud in the company is very large (Soekrisno, 2012).

Based on a review of the theory and previous studies, the hypotheses proposed in this study are as follows:

H1 = The Implementation of Duties and Responsibilities of the Sharia Supervisory Board has a negative effect against Fraud
H2 = Number of Audit Committees has a negative effect on fraud
H3 = Internal Control has a negative effect on fraud

Study Method

The study was conducted at a Sharia Commercial Bank that was registered at the Financial Services Authority (OJK) during 2012-2017 through the Financial Services Authority website, www.ojk.go.id and from the websites of each bank that was the object of research. The time of the study begins in November 2018. The researcher uses the method of multiple linear regression analysis because this study examines the relationship of two or more independent variables where previously the classical assumptions were made in the first stage. The population is the whole of the research subjects. In this study the population taken is the Sharia Commercial Bank GCG Report that have been registered with the Financial Services Authority (OJK). Sampling was conducted in this study using 58 samples.

Fraud in this study is measured by looking at the amount of internal fraud that occurs in sharia commercial banks disclosed in the GCG implementation report of each sharia commercial bank (Najib & Rini, 2016). Duties and Responsibilities of the Sharia Supervisory Board refer to Tania (2015) and Asrori (2014) which uses the value of sharia bank GCG self assessment in assessing Islamic Corporate Governance variables. The implementation of the duties and responsibilities of the Audit Committee in this study was measured by looking at the number of Audit committees for one year contained in the GCG implementation report of Sharia banks. Internal control in this study was measured by looking at the composite value of the results of the self assessment of the application of the internal audit function contained in the GCG implementation report conducted by sharia commercial banks.
Results And Discussion

Descriptive Statistics Test Results

Descriptive statistics analysis provide description of data viewed from minimum value, maximum value, mean, and deviation standard of data.

| Table 1: Descriptive Statistics |
|--------------------------------|
|                             | N | Minimum | Maximum | Mean  | Std. Deviation |
| Frequency of sharia supervisory board meeting | 58 | 6.00 | 36.00 | 14.5690 | 5.63234 |
| Number of Audit Committees | 58 | 2.00 | 7.00 | 3.7586 | 1.15941 |
| Internal Control | 58 | 1.00 | 3.00 | 1.9428 | .61937 |
| Fraud | 58 | 1.00 | 25.00 | 4.6379 | 5.05652 |
| Valid N (listwise) | 58 |

Source: The result of the study data processing (2019)

Descriptive Statistics output shows the number of respondents (n) of 58. DPS meetings were held a minimum of 6 times and a maximum of 36 times, where the average DPS meeting was 14.56 times. The audit committee has a minimum of 2 members and a maximum of 7 members, with an average of 3.76. The minimum composite value is 1 and the maximum is 3, where the average is 1.94. Fraud that occurs minimum 1 and maximum 25, where the average fraud is 4.64. Normality test result shows that the value of Asymp. Sig. (2-tailed) is higher than the significance level of 0.05 (0.170 > 0.05). Thus, conclusion can be taken that residual data on this regression model is distributed normally.

Classical Assumption Test Results

Multicollinearity test result displaying correlation among independent variables does not relate to value above 0.9. This means that the independent variables are excluded from multicollinearity assumption. Durbin Watson autocorrelation test result shows Durbin Watson (DW) number of 2.105. This value will be compared with table value using significance value of 5% with sampel 58 samples and 6 variables.

Based on DW table with T=58 and K4 will result in dl = 1.4325 and du 1.7259, thus 2.105 > 1.7259 and (4-d) or 1.895 > 1.7259, no positive and negative autocorrelation exists or in other words, there is no autocorrelation shown. Heteroscedasticity test result by showing scatter plot diagram shows random scattered plots above and below 0 on Y axis. This shows no heteroscedasticity in the regression model.

Model Feasibility Test Reports 1

| Table 2: Determination Coefficient Test Results |
|-----------------------------------------------|
| Model Summary<sup>b</sup> | Model | R | R Square | Adjusted R Square | Std. Error of the Estimate | Durbin-Watson |
|-------------------------------|------|----|----------|----------------|------------------------|---------------|
| T                            | .556<sup>a</sup> | .309 | .270 | .80099 | 2.105 |

Source: The result of the study data processing (2019)

The Adjusted R Square is 0. 0.270 that means 27% of Fraud variables in sharia bank can be explained by the variation of the three independent variables (The Implementation of Duties and Responsibilities of the Sharia Supervisory Board, Number of Audit Committee, and Internal Control). While the remaining 0.73 is explained by other variables. The calculated F test result is 8.034 and significance value is 0.000. Since the probability is far less than 0.05, the regression model can be employed to predict that The Implementation of Duties and Responsibilities of the Sharia Supervisory Board, Number of Audit Committee, and Internal Control collectively influence the Fraud.

Hypothesis Test

T statistics test result in table 3 shows that of the thee independent variables included in the regression model Sharia Supervisory Board variable comes with 0.552, and Internal Control 0.249 and Audit Committee Size 0.568, and the three variables are far above 0.05. While Number of Audit Committees is significant at 0.05.

Table 3 showst the result of hypothesis test. In the first hypothesis, Sharia Supervisory Board shows the calculated t of -1.894 and significant value is 0.064 > 0.05 and it can be concluded that Sharia Supervisory Board has negative and insignificance influence to fraud, thus the first hypothesis is acceptable. The second hypothesis comes with t calculated value of 4.225 and significance value of 0.000 < 0.05 and it can be concluded that the number of committee audit brings positive and significant influence to the fraud or the second hypothesis
rejected. In the third hypothesis, come with the calculated t is -1.166 and the significance value is 0.249 > 0.05 and it can be concluded that internal control has negative and insignificance influence to fraud, thus the third hypothesis is accepted.

Table 3: t-Test

| Model                              | Unstandardized Coefficients | Standardized Coefficients |
|------------------------------------|-----------------------------|---------------------------|
|                                    | B   | Std. Error | Beta | t   | Sig. |
| I (Constant)                       | .837| .1398      | .598 | .552|
| Frequency of sharia supervisory board meeting | -.308| .163 | -.20 | -1.894 | .064 |
| Number of Audit Committees         | 1.611| .381 | .483 | 4.226 | .000|
| Internal Control                   | -.601| .516 | -.142| -1.166| .249|

Source: The result of the study data processing (2019)

Conclusion

Based on regression analysis that has been carried out, the following conclusion can be taken:

1. The Implementation of Duties and Responsibilities of the Sharia Supervisory Board as measured by the number of meetings shows the calculated t of -1.894 and significant value is 0.064. It shows The Implementation of Duties and Responsibilities of the Sharia Supervisory Board that has a negative and insignificant effect on the occurrence of fraud at Sharia Commercial Banks thus the first hypothesis is acceptable. This shows that The Implementation of Duties and Responsibilities of the Sharia Supervisory Board insignificant influence of fraud that occurs.

2. The Audit Committee as measured by the number of members of the audit committee comes with t calculated value of 4.225. It shows that the significance value of 0.000 The Audit Committee has a positive and significant effect on the amount of fraud that occurs in Sharia Commercial Banks in Indonesia or the second hypothesis rejected. This shows the more the number of members of the audit committee the higher the number of frauds that occur.

3. Internal Control come with the calculated t is -1.166 and the significance value is 0.249. It shows internal control has a negative and insignificant effect on fraud in Sharia Commercial Banks in Indonesia thus the third hypothesis is accepted. These results indicate that internal control at Sharia banks insignificant influence of fraud that occurs.

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