Factors Affecting Banking Fraud Prevention and Their Impact On The Quality of Financial Statements

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A B S T R A K

Penelitian ini diawali dengan fenomena dimana beberapa perusahaan sektor perbankan mengalami peningkatan kasus korupsi dalam pengelolaan keuangan. Rendahnya sistem pengendalian intern dan belum terlaksananya tata kelola perusahaan yang baik dijadikan sebagai peluang untuk melakukan kecurangan dengan memanfaatkan posisi dan jabatan. Jika kedua hal ini dilakukan dengan baik, perusahaan tentunya dapat meminimalisir terjadinya fraud yang akan mempengaruhi kualitas laporan keuangannya. Penelitian ini bertujuan menganalisis peran bank dalam mempraktikkan sistem pengendalian intern dan tata kelola yang baik. Penelitian ini menggunakan pendekatan kuantitatif dengan jenis penelitian kausal. Penelitian ini menggunakan pendekatan kuantitatif dengan jenis penelitian kausal. Populasi dalam penelitian ini adalah bank umum swasta nasional yang terdaftar di Bursa Efek Indonesia. Sampel ditentukan berdasarkan metode accidental, dengan jumlah sampel sebanyak 34 perusahaan bank konvensional. Proses pengumpulan data primer menggunakan kuesioner. Data dianalisis dan diolah menggunakan Smart PLS. Hasil penelitian menunjukkan bahwa sistem pengendalian internal berpengaruh positif dan signifikan terhadap pencegahan fraud, tetapi tidak berpengaruh terhadap kualitas laporan keuangan. Sedangkan prinsip good corporate governance berpengaruh positif dan signifikan terhadap pencegahan fraud dan juga kualitas laporan keuangan. Pencegahan Fraud berpengaruh positif dan signifikan terhadap kualitas laporan keuangan.

A B S T R A C T

This research begins with a phenomenon where several banking sector companies experience increased corruption cases in financial management. The low internal control system and the lack of good corporate governance are opportunities to commit fraud by taking advantage of positions and positions. If these two things are done well, the company can undoubtedly minimize fraud, which will affect the quality of its financial statements. This study aims to analyze the role of banks in practicing reasonable internal control and governance systems. This research uses a quantitative approach with a causal type of research. This research uses a quantitative approach with a causal type of research. The population in this study is a national private commercial bank listed on the Indonesia Stock Exchange. The sample was determined based on the accidental method, with a total sample of 34 established bank companies. The process of collecting primary data using a questionnaire. Data were analyzed and processed using Smart PLS. The results showed that the internal control system had a positive and significant effect on fraud prevention but no effect on financial reports' quality. At the same time, the principles of good corporate governance have a positive and significant effect on fraud prevention and the quality of financial reports. Fraud prevention has a positive and significant effect on the quality of financial reports.

1. INTRODUCTION

Banks are public trustees who are trusted to manage and regulate public finances, therefore banks must protect customer money against the risk of financial fraud as stated in Law no 10 of 1998 concerning the Banking Law, among others ranging from criminal acts related to banking industry licensing, bank secrecy, bank supervision and development, bank business and unauthorized transfer of accounts (Meliana & Hartono, 2019). An example of fraud in the banking world is the case of embezzlement of Bank Maybank Indonesia customer funds, where there was a case of embezzlement of bank customer funds on behalf of Winda Lunardi amounting to Rp. 20 billion made by the former head of

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the Maybank Cipulir branch from 2015-2020. This is due to the weak internal supervision of the bank. Implementing an effective internal control system assists the business in safeguarding its assets, ensuring the availability of accurate information and reports, enhancing compliance with applicable laws and regulations, and minimizing the risk of losses, deviations, and violations of the precautionary principle. Additionally, implementing good corporate governance helps reassure the public that the company is protected from fraudulent practices. The high intensity of fraud that occurs in an institution requires the implementation of good and comprehensive business management. Good corporate governance management is designed to reduce the possibility of fraud. The implementation of good corporate governance is in line with fraud prevention (P. P. Dewi et al., 2021). If the company has implemented the steps described in the implementation of good corporate governance such as openness, non-discrimination, clear responsibilities, and community control, the company will be able to prevent fraud (Prena & Kusmawan, 2020).

The influence of the internal control system on fraud prevention has been studied by several previous studies which claims that internal control systems help prevent fraud (Hamdani & Albar, 2016; Puspasari & Suwardi, 2016; Utami et al., 2020). The study's findings indicate that the more effective the internal control system of the company, the more effective the prevention of fraud (the lower the proclivity to cheat) in managing finances. Meanwhile, researchers have examined the effect of internal control systems on the quality of financial reporting (Hidayah, 2019; Setiyawati, 2013), it states that internal control systems improve the quality of financial reports. Internal control system efficacy can help avoid accounting fraud and hence improve the quality of financial statement information. If the internal control system is competent, the financial reports will be of high quality. However the internal control system has no effect on the quality of financial reports (Nurlis & Yudiati, 2017). The effect of applying the principles of good corporate governance on fraud prevention has been studied that good corporate governance helps avoid fraud (Kurniawan & Izzaty, 2019; Martins & Júnior, 2020). Professionalism, transparency, accountability, and responsibility in financial management all contribute to reducing the likelihood of fraud. However, good corporate governance has no effect on fraud prevention (in fact, it has a negative effect) (Hartanto et al., 2019). Meanwhile, the effect of good corporate governance principles on the quality of financial reporting has been studied by previous studies that states that good corporate governance has a beneficial effect on the financial reporting quality (Fuadah & Setiyawati, 2020; Herdiyopie et al., 2020; Mulyanti & Rahma, 2020). Whereas the objective of good corporate governance is to retain objectivity in operating a transparent organization in order to present timely and accurate financial reports based on material, relevant, and non-confidential information.

The purpose of the internal control system is to prevent errors, detect fraud, and identify weaknesses and vulnerabilities, which must be implemented and understood seriously by all leaders and employees, and must be applied at all levels of the organization, both functionally attached and supervised by independent parties, where implementation is capable of detecting weaknesses and deviations that occur in a timely manner. The internal control system has a positive effect on fraud prevention (Hamdani & Albar, 2016; Puspasari & Suwardi, 2016; Utami et al., 2020). The use of good corporate governance principles within a company can reassure the public that the company is protected from fraudulent practices. Professionalism, transparency, accountability, and responsibility in financial management all contribute to reducing the likelihood of fraud. It is intended that by the use of good corporate governance principles, a good and trustworthy image can be developed. Good corporate governance has a positive effect on fraud prevention (Kurniawan & Izzaty, 2019; Martins & Júnior, 2020). Whereas good corporate governance has no effect on fraud prevention (in fact, has a detrimental effect) (Hartanto et al., 2019).

Internal control system effectiveness can help avoid accounting fraud and hence improve the quality of financial statement information. If the internal control system is good, the financial reports will be of high quality. The internal control system has a positive effect on the quality of financial reports (Hidayah, 2019; Setiyawati, 2013). Whereas, internal control system has no effect on the financial reporting quality (Nurlis & Yudiati, 2017). The objective of implementing good corporate governance principles is to retain objectivity while operating a transparent organization in order to present timely and accurate financial reports based on material, relevant, and non-confidential information states that good corporate governance has a positive effect on the quality of financial reports (Fuadah & Setiyawati, 2020; Herdiyopie et al., 2020; Mulyanti & Rahma, 2020). Financial reports are considered to be of high quality if they meet numerous standards/characteristics, including being understandable, relevant, reliable, and comparable. These four characteristics are required for financial statements to achieve the acceptable level of quality. Fraud prevention has a positive effect on the quality of financial reports (Manik, 2020; Manik & Kusasi, 2019). The difference between this study and earlier ones is that previous studies sampled a broader range of issuers, including BUMN, BUMD, Regional Government, BPR, and

several private companies. Meanwhile, the purpose of this study is to show whether banking fraud can be minimized by implementing an internal control system and practicing good corporate governance by applicable laws and regulations to gain investor trust and maintain a positive image and whether this has an effect on the quality of the company's financial statements.

2. METHODS

The approach taken in this study is quantitative with a causal type. The population is represented by national private commercial banks that are publicly listed on the Indonesia Stock Exchange. The sample was determined using the accidental sampling approach, with a total of 34 conventional national private commercial banks firms included in the sample. The data used is primary data by submitting a questionnaire via google form to several respondents representing each bank, namely managers and related staff, with a return rate of 100% for a questionnaire of 34 companies. The data were analyzed using descriptive analysis techniques and processed using the Smart PLS 3.0 application, by carrying out data quality tests, namely validity and reliability tests (outer model), as well as evaluation of the goodness of fit structural model (inner model) which includes coefficient of determination, predictive relevance, and also hypothesis testing. Definitions of operationalization of variables and measurements used are presented in Table 1.

Table 1. Variable Operationalization and Variable Measurement

Variable	Dimension	Indicator	Reference
Internal Control System	Control environment	Commitment to ethical ideals, integrity, management independence, the Board of Directors' supervisory function, organizational structure, management reporting lines, management authority and responsibility, employee recruitment, development, retention, employee roles, and employee responsibilities.	(Romney & Steinbart, 2015)
	Risk Assesment	Identification objectives of the organization, risk assessment objectives of the organization, risk identification, risk analysis, risk assessment, identification of control changes, and also assessment of control changes.	
	Control activities	Select control activities, establish control activities, implement controls, and also exercise control.	
	Information and communication	Obtain relevant and quality information, communicate internally, and also communicate to external parties.	
	Monitoring	Select continuous evaluation, develop continuous evaluation, conduct continuous evaluation, evaluate internal control deficiencies, and also communicate internal control deficiencies.	
Good Corporate Governance	Transparency	Providing material and relevant information, presenting financial statements in a transparent manner, and also making management decisions openly.	(Effendi, 2016)
	Accountability	The company's detailed and explicit definition of employee duties and responsibilities, Board decisions affecting shareholders, and also an effective interest calculation system each year.	
	Responsibility	The company pays attention to the community and the surrounding environment, and employees are also responsible for contributing according to the company's vision and mission.	
	Independency	Corporate policy making, as well as corporate decision making.	
	Fairness	Expressing opinions for the benefit of the company, making fair financial statements, as well as legal standing in the company.	

Variable	Dimension	Indicator	Reference
Fraud Prevention	Prevention	Determination of anti-fraud rules, implementation of anti-fraud rules, imposition of sanctions, internal control system, separation of functions according to responsibilities, availability of media to accommodate information, forming a special team, follow-up on findings, periodic evaluation, supervisory management, periodic employee rotation, and also leave rules.	(Najib & Rini, 2016)
	Detection	Detecting fraud with existing indicators, a system for detecting, monitoring corruption, supervising the misuse of assets, supervising fraud in financial reporting, providing early detection tools, adequate procedures, information for investigations, collecting information, and also forming an investigation team.	
	Investigation, reporting, and sanctions	Form an investigative team, collect evidence, conduct interviews, analyze objectively, be careful of the evidence obtained, seek expert opinion, and also report the results of the investigation.	
	Monitoring, evaluation, and follow up	Monitoring and evaluating fraud, as well as follow-up mechanisms.	
Quality of Financial Reports	Understandable	The information presented can be understood by the user.	(Bachtiar & Nurfadila, 2019)
	Relevant	Has the benefit of feedback, has the benefit of being productive, complete, and also on time.	
	Reliable	Honest, verifiable and neutral presentation.	
	Comparable	The information presented can be compared with previous financial statements.	

3. RESULTS AND DISCUSSIONS

Results
Variable Description

In the variable of implementing the internal control system, the average value of the variable is very high, namely 4.27, as shown in Table 2.

Table 2. Description of the Implementation of Internal Control System Variables

No	Dimension	Mean	Standar Deviation	Category
1	Control environment	4.41	0.60	Very high
2	Risk assesment	4.25	0.56	Very high
3	Control activities	4.27	0.64	Very high
4	Information and communication	4.16	0.58	High
5	Monitoring	4.26	0.57	Very high
	Total	**21.35**	**2.95**	
	Average	**4.27**	**0.59**	**Very high**

This indicates that national private commercial banks in Indonesia have an excellent internal control system in place, which can effectively assist companies in maintaining assets, ensuring the availability of accurate information and reports, increasing compliance with applicable laws and regulations, and mitigating risk of loss, deviation, and violation of the precautionary principle. This is supported by qualified human resources and information technology systems that were developed to assist the corporation in achieving its objectives and whose implementation is capable of detecting weaknesses, errors, and fraud within the company. In the variable of applying the principles of good corporate governance, the average value of the variable is high at 4.08, as shown in Table 3.

Table 3. Description of the Application of the Principles of Good Corporate Governance

No	Dimension	Mean	Standar Deviation	Category
1	Transparency	4,18	0,75	High
2	Accountability	4,08	0,76	High
3	Responsibility	4,13	0,62	High
4	Independency	3,72	0,98	High
5	Fairness	4,28	0,70	High
	Total	**20,39**	**3,81**	
	Average	**4,08**	**0,76**	**High**

This signifies that the concepts of good corporate governance are being applied effectively at Indonesia's national private commercial banks in order to foster a good and trustworthy business image with the goal of improving company performance and profitability. In the fraud prevention variable, the average value of the variable is very high at 4.21, as shown in Table 4.

Table 4. Description of Fraud Prevention Variables

No	Dimension	Mean	Standar Deviation	Category
1	Prevention	4,32	0,68	Very high
2	Detection	4,14	0,71	High
3	Reporting, investigation and sanctions	4,20	0,58	High
4	Monitoring, evaluation and follow up	4,18	0,57	High
	Total	**16,83**	**2,54**	
	Average	**4,21**	**0,64**	**Very high**

This indicates that the implementation of an anti-fraud strategy at Indonesia's national private commercial banks has been excellent, with a focus on prioritizing the implementation of an internal control system capable of mitigating the risk of fraud, identifying and detecting fraud in the bank's business activities, digging up information/investigating each report of fraud, imposing sanctions on the fraud, as well as monitoring and evaluating fraud and follow-up mechanisms. In the financial report quality variable, the average value of the variable is very high at 4.25, as shown in Table 5.

Table 5. Description of Financial Report Quality Variables

No	Dimension	Mean	Standar Deviation	Category
1	Understandable	4,21	0,63	Very high
2	Relevant	4,19	0,70	High
3	Reliable	4,30	0,69	Very high
4	Comparable	4,29	0,57	Very high
	Total	**17,00**	**2,59**	
	Average	**4,25**	**0,65**	**Very high**

This means that the financial reports produced by national private commercial banks in Indonesia are of high quality because they meet several criteria, including being understandable, relevant, reliable, and comparable, allowing them to be used to describe company performance and as a basis for decision-making.

Validity Test

A validity test is conducted to ensure that the instrument is capable of accurately measuring the variables being assessed. In this study, it is known that the loading factor for the second-order meets convergent validity, which is indicated by an indicator value greater than 0.5. At the 5% level, all loading factors in the second and first order are significant. The validation test findings indicate that numerous indicators are invalid and must be eliminated due to a low convergent validity value (loading factor <0.5). The majority of invalid indicators come from variables in the internal control system, namely

commitment to ethics, commitment to integrity, management independence, the board of directors' supervisory function, employee roles, and risk assessment. This is almost certainly the result of incompetent human resources. Although the description of the internal control system variables is very high, in the sense that the internal control system has been implemented very well at national private commercial banks in Indonesia, without qualified human resources, the company's goal is to be able to detect weaknesses, errors, and fraud that occur, in the company will not be accomplished.

Reliability Test

The reliability test is related to the accuracy and consistency of the measurement results. Table 6 is a table of reliability test results on each dimension.

Table 6. Reliability Test

Variable & Dimension	Composite Reliability	Cronbach Alpha
Internal Control System (X1)	0.950	0.945
Control environment	0.876	0.833
Risk assesment	0.883	0.840
Control activities	0.884	0.842
Information and communication	0.838	0.714
Monitoring	0.857	0.787
Good Corporate Governance (X2)	0.911	0.892
Transparency	0.839	0.713
Accountability	0.827	0.691
Responsibility	0.845	0.634
Independency	1.000	1.000
Fairness	0.846	0.728
Fraud Prevention (Y)	0.965	0.961
Prevention	0.934	0.922
Detection	0.933	0.920
Investigation, reporting, and sanctions	0.928	0.909
Monitoring, evaluation, and follow up	0.901	0.784
Quality of Financial Reports (Z)	0.910	0.886
Understandable	1.000	1.000
Relevant	0.888	0.827
Reliable	0.771	0.564
Comparable	1.000	1.000

Based on Table 6, it can be concluded that for all dimensions on variables of the internal control system, good corporate governance, fraud prevention, and quality of financial reports have composite reliability > 0.7 and cronbach alpha values > 0.6 except for the reliable dimension which has cronbach's alpha value is 0.564 (< 0.6), but it can still be said that the indicators used have good reliability and are able to measure the construct. Based on the results of the analysis of the validity and reliability tests above, the second order has an effect on the first order dimension.

Evaluation Of The Goodness Of Fit Structural Model (Inner Model)

Evaluation of the structural model is a step that includes the coefficient of determination (R^2) and predictive relevance (Q^2) and hypothesis testing. Based on data analysis, the R^2 value for the fraud prevention variable is 0.430, which means that this variable can be explained by the internal control system and good corporate governance variables by 43%, while the remaining 57% is influenced by other variables outside the research model. The R^2 value for the financial report quality variable is 0.545, which means that the variable can be explained by the internal control system and good corporate governance variables by 55%, while the remaining 45% is influenced by other variables outside the research model. In explaining the fraud prevention and the quality of financial reports variables, the evaluation of the inner model is quite good. While the predictive-relevance (Q^2) value is 0.741 or 74%, which means that the model is able to explain the phenomenon of financial report quality associated with the variables of fraud prevention, internal control systems, and good corporate governance. This means that the model has a good predictive value and hypothesis testing can be carried out.

Hypothesis Test

To test the hypothesis, the value of Tstatistics is partially used in each path of direct influence. In this study, it is known that all dimensions of each variable have a t-statistic value > 1.660, indicating that they can be used to measure each construct. Table 7 and Table 8 summarizes the results of associations between constructs/variables and dimensions.

Table 7. Dimension Test

Variable	Parameter Coefficient	T Statistic	P Value	Note
Internal Control System				
Control environment	0.881	23.289	0.000	Significant
Risk assesment	0.805	10.659	0.000	Significant
Control activities	0.894	25.729	0.000	Significant
Information and communication	0.866	22.733	0.000	Significant
Monitoring	0.925	36.719	0.000	Significant
Good Corporate Governance				
Transparency	0.932	33.272	0.000	Significant
Accountability	0.760	6.620	0.000	Significant
Responsibility	0.887	18.877	0.000	Significant
Independency	0.551	2.213	0.014	Significant
Fairnes	0.867	20.105	0.000	Significant
Fraud Prevention				
Prevention	0.902	26.444	0.000	Significant
Detection	0.923	44.369	0.000	Significant
Investigation, reporting, and sanctions	0.884	24.127	0.000	Significant
Monitoring, evaluation, and follow up	0.726	9.002	0.000	Significant
Quality of Financial Reports				
Understandable	0.849	10.624	0.000	Significant
Relevant	0.958	38.516	0.000	Significant
Reliable	0.880	21.913	0.000	Significant
Comparable	0.647	7.154	0.000	Significant

Table 8. Hypothesis Testing Results

Effect Between Variables	Parameter Coefficient	T Statistik	P Value	Note
Internal control system → Fraud prevention	0.314	1.721	0.043	Significant
Good corporate governance → Fraud prevention	0.378	2.145	0.016	Significant
Internal control system → Quality of financial reports	-0.125	0.455	0.325	Not Significant
Good corporate governance → Quality of financial reports	0.741	2.212	0.014	Significant
Fraud prevention → Quality of financial reports	0.473	2.153	0.016	Significant

Discussion

Internal control system implementation has a positive and significant effect on fraud prevention. The more effectively the internal control system is implemented, the more effective fraud prevention efforts will be, as a good internal control system over the banking system reduces the possibility for fraud by detecting it early, which has a positive effect on improving customer trust. The findings of this investigation are consistent with previous research which states that the internal control system has a

positive effect on fraud prevention (Hamdani & Albar, 2016; Puspasari & Suwardi, 2016; Utami et al., 2020). The use of good corporate governance principles has a major positive impact on fraud prevention. The more effectively good corporate governance principles are applied, the lower the probability of fraud, where the presence of good corporate governance principles in banking financial management reduces the likelihood of fraud and illustrates to the public that the bank is protected from fraudulent practices. This research is consistent with previous research which states that good corporate governance has a positive effect on fraud prevention (Kurniawan & Izzaty, 2019; Martins & Júnior, 2020).

Internal control has a significant role to prevent fraudulent behavior. Poor internal control design can lead to weak controls that can create opportunities for fraudulent behavior to occur. Good internal control coupled with the implementation of the Whistleblowing system has a significant influence in improving the proven fraud control system. An internal control environment that requires assistance from various relevant stakeholders, this support can strengthen the effectiveness of existing internal controls (Marciano et al., 2021). Contextually some of the principles of the findings in internal control to prevent fraud, it is known that the higher the internal control, the higher the fraud prevention effort. This is also in line with the Fraud triangle theory that fraud can occur if there is slack in the internal control of an institution. This shows that internal control is very important, among others, to provide protection for entities against human weaknesses and to reduce the possibility of errors and actions that are not in accordance with the rules (U. N. Dewi et al., 2021). There is no relationship between the internal control system's implementation and the quality of financial reports. Internal control system effectiveness in banking does not improve the quality of financial reports, which is due to inadequate human resource support, which results in the internal control system not being implemented optimally. This contradicts research which states that the internal control system has a positive effect on the quality of financial reports (Hidayah, 2019; Setiyawati, 2013).

The use of good corporate governance principles has a considerable positive effect on the quality of financial reporting. The more effectively corporate governance principles are applied, the higher the quality of financial reports, whereby banking companies can produce timely and accurate financial reports using material, relevant, and non-confidential information, with the goal of maintaining objectivity in conducting business transparently and presenting financial reports that are understandable, relevant, reliable, and comparable. The results of this study are in line with previous studies which states that good corporate governance has a positive effect on the quality of financial reports (Fuadah & Setiyawati, 2020; Herdiyopie et al., 2020; Mulyanti & Rahma, 2020). Fraud prevention has a considerable positive impact on the quality of financial statements. The more effective fraud prevention efforts are, the higher the quality of the financial statements. Any attempt to prevent fraud in the banking system will affect the quality of its financial reports, all of which are supported by a good internal control system and good corporate governance. If fraud can be controlled, the quality of the financial statements will be better, which has an impact on the better accountability of the entity. The results of this study are in line with research which states that fraud prevention has a positive effect on the quality of financial reports (Manik, 2020; Manik & Kusasi, 2019).

4. CONCLUSION

Based on the results of the problem formulation, hypothesis testing, and discussion, it can be concluded that: (1) The implementation of the internal control system has a positive and significant effect on fraud prevention, where the implementation of a good internal control system over the banking system will reduce the opportunity to commit fraud because can be detected early, which will impact increasing customer trust; (2) The application of the principles of good corporate governance has a positive and significant effect on fraud prevention, where the implementation of good corporate governance can provide an indication to the public that the bank is protected from fraudulent practices; (3) The implementation of the internal control system does not affect the quality of financial reports, where the implementation of the internal control system in banking companies does not affect the quality of financial report information to be good, because the internal control system that has been implemented has not been implemented optimally, causing the quality of financial reporting produced to be poor unsatisfying; (4) The application of the principles of good corporate governance has a positive and significant impact on the quality of financial reports, where the application of the principles of good corporate governance can produce timely and accurate financial reports from material, relevant and no hidden information; (5) Fraud prevention has a positive and significant impact on the quality of financial reports, where any fraud prevention efforts in the banking system will affect the quality of financial reports.

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