THE EFFECT OF INTERNAL CONTROL AND INDIVIDUAL MORALITY ON THE TENDENCY OF ACCOUNTING FRAUD

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ABSTRACT
Accounting fraud is a problem commonly faced by both companies and users of financial statements. Accounting fraud often occurs due to weak internal controls. In addition, accounting fraud is also influenced by one's ethics, especially the morality of individuals to cheat. The purpose of this study is to determine the effect of internal control and individual morality on the tendency to commit accounting fraud. This research is done by using experimental method. The sample used in this research is 85 accounting students of Maranatha Christian University. The testing tool used in this study is a two-way Anova. The results show that internal control has no effect on accounting fraud, but individual morality has an effect on accounting fraud. Individual with low morality will tend to commit accounting frauds rather than those with high morality.

INTRODUCTION

These days, fraud has been gaining much public attention. It is not only because of the growing corruption cases in Indonesia, but also because of the need to recognize fraud in order to sustain the business (Wind, 2014: 1). Fraud is an unlawful action that harms the entity / organization and benefits the perpetrators (Karyono, 2013: 1).

In 2002 the United States issued a new rule known as Sarbanes-Oxley Act (SOA) applied to companies listed on the New York Stock Exchange (NYSE). The emergence of this rule was due to several cases of fraud occurring in companies listed on NYSE, such as *Enron* and *WorldCom* for the case of fraudulent financial reporting (Fitrawansyah, 2014: 7).

According to the Association of Certified Fraud Examiner (ACFE), there are two types of fraud: internal fraud and systems control fraud. Internal fraud occurs naturally inherent in any form of activity whereby each person has a tendency to commit fraud. Systems control fraud occurs due to weak internal systems control and the perpetrator usually has knowledge of how the internal systems control works (Karyono, 2013: 5).

Most frauds occur when there is a weak or even no internal control. Physical storage of property, access to accounting records, and the knowledge or authority to refuse control are the main content of fraud in the general ledger and financial statements (Tunggal, 2008: 10-11). According to a research conducted by ACFE, fraud in financial statements usually has a higher impact on corporate asset losses. In addition, it will also have a negative impact on shareholders and investment in general (Wind, 2013: 8). Without internal deterrence or control, fraud will be very easy to happen (Wind, 2013: 23).

Financial and accounting frauds are generally caused by need (dependence) and greed (mind) (Tunggal, 2008: 11). The fraudsters can be from both inside and outside of the organization. Fraud can be committed by management and employees (Karyono, 2013: 1). Fraud is a distortion of moral perceptions called truth, justice of law, justice, and equality (Tunggal, 2008: 8). Morality is considered one of the underlying reasons for a person to act ethically (Fahmi, 2015: 22).

The latest phenomenon related to accounting fraud occurred on Toshiba Corporation which was hit by accounting scandal worth US $ 1.2 billion causing the company leader, Hisao Tanaka, and two other executives to resign. According to a third-party investigation report, the "skilled" accounting irregularities were hidden from outside parties. The report also mentioned that corporate leaders were trying to delay bookkeeping losses and employees could not afford to fight against management orders (Basari, 2015).

Eliza (2015: 86), in her research entitled *"Pengaruh Moralitas Individu dan Pengendalian Internal terhadap Kecenderungan Kecurangan Akuntansi"* shows that internal control and individual morality have a negative and significant influence on the tendency of accounting fraud. Puspasari and Suwardi (2012) in their research entitled *"Pengaruh Moralitas Individu dan Pengendalian Internal terhadap Kecenderungan Kecurangan Akuntansi: Studi Eksperimen pada Konteks Pemerintah Daerah"* shows that individuals with low morality have a tendency to commit accounting fraud under no internal control conditions. Dewi (2016) in his research entitled *"Pengaruh Moralitas Individu dan Pengendalian Internal pada Kecurangan Akuntansi (Studi Eksperimen pada Pemerintah Daerah Provinsi Bali)"* shows that individuals with low morality tend to commit accounting fraud under no conditions of internal control elements.

This research is a replication of the research conducted by Dewi (2016). The difference of this research from the previous research lies in the sample used. This research uses sample of final semester students of Maranatha Christian University. This research uses experimental design with a two-way ANOVA statistic test.

LITERATURE REVIEW

Internal Control

COSO (Moeller, 2014:13) defines internal control as follows:

"*Internal control is a process, affected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations*".

According to International Standards on Auditing (*ISA)* in Hayes *et al.*, (2014:236),

"Internal control is the process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations."

Moeller (2014:36) mentions 5 key components of internal control: *(1) control environment, (2) risk assessment, (3) control activities, (4) information and communication, (5) monitoring activities*. *The control environment should be considered the foundation for all other components of internal control, and it has an influence on each of the three objectives and over all unit and entity activities* (Moeller, 2014:42).

Individual Morality

According to Velasques (2002:11), ethics is the discipline that examines one's moral standards or the moral standards of a society. Furthermore, Velasques (2002:27) states that ethics is the study of morality and that a person begins to do ethics when he or she turns to look at the moral standards that have been absorbed from family, church, friends, and society, and begins asking whether these standards are reasonable or unreasonable and what these standards imply for situations and issues.

The morality of a person or a group of people is related to not only what a person or a group of people does, but also what they think and view about what is good and what is not good, about what is right and what is not right to do (A. Gunawan Setiardja, 1980: 9 in Turisno, 2007: 15).

Morality refers to a concept that defines an action with respect to the nature of value, so morality is related to the quality of human deeds. Although morality is related to the attitudes and behaviors of individuals, the individuals can only behave in the context of societies that have certain cultural, social, political, and economic structures. It means that the morality of the individual gets the space in the domain of public morality which is also embodied and supported by the public domain (Wiranata, 2005: 120-121).

Lawrence Kohlberg states that there are 6 stages of development of individual morality which are divided into 3 levels (Velasques, 2002: 28-30):

Level One: Pre-conventional stage. At these first two stages, the child is able to respond to rules and social expectations and can apply the labels of good, bad, right, and wrong.

Stage One: Punishment and Obedience Orientation. At this stage, the physical consequences of an act wholly determine the goodness or badness of that act.

Stage Two: Instrument and Relativity Orientation. At this stage, right actions become those that can serve as instruments for satisfying the child's own needs or the needs of those for whom the child cares.

Level Two: Conventional Stages. The person at this level of development does not merely conform to expectations but exhibits loyalty to the group and its norms.

Stage Three: Interpersonal Concordance Orientation. Good behavior at this early conventional stage is living to the expectations of those for whom one feels loyalty, affection, and trust, such as family and friends.

Stage Four: Law and Order Orientation. Right and wrong at this more mature conventional stage now come to be determined by loyalty to one's own larger nation or surrounding society.

Level Three: Post-conventional, Autonomous, or Principal Stages. At this stage, the person no longer simply accepts the values and norms of the groups to which he or she belongs.

Stage Five: Social Contract Orientation. At this first post-conventional stage, the person becomes aware that people hold a variety of conflicting personal views and opinions and emphasizes fair ways of reaching consensus by agreement, contract, and due process.

Stage Six: Universal Ethical Principles Orientation. At this final stage, right action comes to be defined in terms of moral principles chosen because of their logical comprehensiveness, universality, and consistency.

1.1. Accounting Fraud

According to the Association of Certified Fraud Examiner (ACFE), fraud is an intentional untruth or dishonest scheme used to take deliberate and unfair advantage of another person or group of person it included any mean, such cheats another (Karyono, 2003:3).

Audit Standard defines fraud as an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage (Hayes et al., 2014:207).

Singleton and Singleton (2010:40) state that fraud can also be associated with injury. One person can injure another either by force or through fraud. The use of force to cause bodily injury is frowned on by most organized societies; using fraud to cause financial injury to another does not always carry the same degree of stigma or punishment.

From an accounting and auditing point of view, fraud is a misrepresentation of material facts in the general ledger or financial statements. Wrong statements may be directed to outside parties of the organization such as shareholders or creditors, or to the organization itself by covering or obscuring embezzlement, incompetence, improper application of funds or theft or improper use of organizational assets by officers, employees and agents. Fraud may also be directed at the organization by outside parties, such as sellers, suppliers, contractors, consultants and customers, by way of excessive collection, billing, substitution of lower quality materials, false statements about the quality and value of purchased goods, or the amount of customer credit (Tunggal, 2008: 9).

Fraud is a perversion of moral perceptions of truth, justice of law, justice, and equality. Therefore, fraud is a morally unacceptable behavior (Tunggal, 2008: 8). According to Hayes et al. (2014: 208-209), there are two types of fraud: (1) Fraudulent financial reporting, involves intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users; and (2) Misappropriation of assets, involves the theft of an entity's assets and is often perpetrated by employees in relatively small and immaterial amounts.

Tunggal (2008: 3) states that there are two types of fraud: external and internal. External fraud is a fraud perpetrated by external party of the company, while internal fraud is an illegal act committed by employees, managers and executives of the company.

The result of the research conducted by Donald Cressey in 1950 shows that fraud often occurs because of three things: (1) Pressure (sometimes referred to as motivation, and usually a "non-shareable need"), (2) Rationalization (of personal ethics), and (3)

Knowledge and opportunity to commit the crime (Singleton and Singleton, 2010: 44).

HYPOTHESIS DEVELOPMENT

Most frauds occur when there is a weak or no internal control. Physical property storage, access to accounting records and knowledge or authority to refuse control are the main contents of fraud in ledgers and financial statements (Tunggal, 2008: 11).

People who have access to corporate assets and know internal controls and accounting, or who play the management role are the best positions to commit financial fraud in their company (Tunggal, 2008: 11). Fraud is a perversion of the moral perceptions of truth, justice of law, justice, and equality. Therefore, fraud is a morally unacceptable behavior (Single, 2008: 8).

Dr. Steve Albert states that there are two aspects that greatly affect people to commit fraud, that is, personal aspect (personal integrity & situational pressure) and aspect of enterprise environment system (opportunity). Fraud will be low when one's personal integrity is high, the company's system (opportunity) is good, and the environmental pressure to commit fraud is low (Tjahjono, 2013: 33).

According to Singleton and Singleton (2010: 54), fraud is the most prevalent in organizations that have no controls, no trust, no ethical standards, no profit, and no future. Hayes et al. (2014: 208) states that there are three factors that cause fraud, namely (1) incentives / pressure, such as a financial need; (2) opportunity, the person committing the fraud sees an internal control weakness and believes internal control can be overridden; and (3) rationalization.

Dewi (2012), in her research, states that there is an interaction between individual morality and internal control. Individuals with low morality tend to commit accounting fraud under condition of no internal control.

Based on the theory and previous research explained above, the hypotheses can be formulated as follows:

H1: There is a difference in the tendency of accounting fraud between individuals with low morality and individuals with high morality.

H2: There is a difference in the tendency of accounting fraud between the presence of internal control and absence of internal control.

H3: There is an interaction between internal control and individual morality.

RESEARCH METHOD

This research uses experimental method. Experimental research is a type of research that emphasizes the aspect of causal relationships among research variables. Experiments are implemented actively by manipulating the research object and then observe the results of such manipulation (Nahartyo and Utami, 2016: 7). The samples of this study are 85 final-semester accounting students of Maranatha Christian University.

This study uses experimental design in the form of factorial design. Factorial design is an experimental design used to examine the effect of two or more independent variables simultaneously (Nahartyo and Utami, 2016: 102). The independent variables in this study are internal control (with and without internal control elements) and individual morality (high and low moral level), while the dependent variable is accounting fraud.

The normality test is performed to find out whether the samples drawn are from normally distributed population. Normality test can be done using Kolmogorof-Smirnov (Sugiyono and Susanto, 2015: 321). Levene's test of homogeneity of variance is calculated using SPSS to test Anova's assumption that each group (category) of the independent variable has the same variance (Ghozali, 2013: 74).

The test instrument used in this research is a two-way ANOVA. Two-way ANOVA is used to test factorial design with two independent variables (Ghozali, 2008: 115). Independent variables in this study are internal control and individual morality.

RESULTS AND DISCUSSION

The results of experimental design are presented in table as follows:

Table 1
Experimental Design

Level of Moral Reasoning	Elements of Internal Control	
	Present	Absent
High	32	34
Low	12	7

Based on the above table, it can be seen that the respondents are divided into four groups: (1) Group 1: 32 people belonging to high moral level group under condition with internal control, (2) Group 2: 34 people belonging to high moral level group under condition without internal control, (3) Group 3: 12 people belonging to low moral level group under condition with internal control, and (4) Group 4: 7 people belonging to low moral level group under condition without internal control.

Here are the descriptive statistics of the experimental design:

Table 2
Descriptive Statistics

Dependent Variable: Fraud

MORAL	Internal Control	Mean	Std. Deviation	N
Low	Present	3.9167	1.97523	12
	Absent	3.2857	1.97605	7
	Total	3.6842	1.94515	19
High	Present	2.5000	1.50269	32
	Absent	2.7941	1.85504	34
	Total	2.6515	1.68699	66
Total	Present	2.8864	1.74164	44
	Absent	2.8780	1.86004	41
	Total	2.8824	1.78893	85

Kolmogorov-Smirnov test is used to see if the data are normally distributed. Here are the results obtained using SPSS:

Table 3
Results of Normality Test
One-Sample Kolmogorov-Smirnov Test

		Unstandardized Predicted Value
N		85
Normal Parameters[a,b]	Mean	2.8823529
	Std. Deviation	.74614804
Most Extreme Differences	Absolute	.121
	Positive	.063
	Negative	-.121
Kolmogorov-Smirnov Z		1.120
Asymp. Sig. (2-tailed)		.163

a. Test distribution is Normal.
b. Calculated from data.

Based on the above table, it can be seen that the significance value is 0.163 greater than 0.05, so it can be said that the research data are normally distributed.

Levene's test of homogeneity of variance is used to see if the group has the same variance. Here are the results:

Table 4
Homogeneity Test
Levene's Test of Equality of Error Variances[a]

Dependent Variable: Fraud

F	df1	df2	Sig.
1.242	3	81	.300

Tests the null hypothesis that the error variance of the dependent variable is equal across groups.
a. Design: Intercept + MORAL + PI + MORAL * PI

Based on the above table, it can be seen that the significance value of 0.3000 > 0.05, which means that the group has the same variance and meets the ANOVA assumption.

The test instrument used in this study is a two-way ANOVA. Here are the results of hypothesis testing using SPSS tool:

Table 5
Results of *Two-Way ANOVA Test*
Tests of Between-Subjects Effects

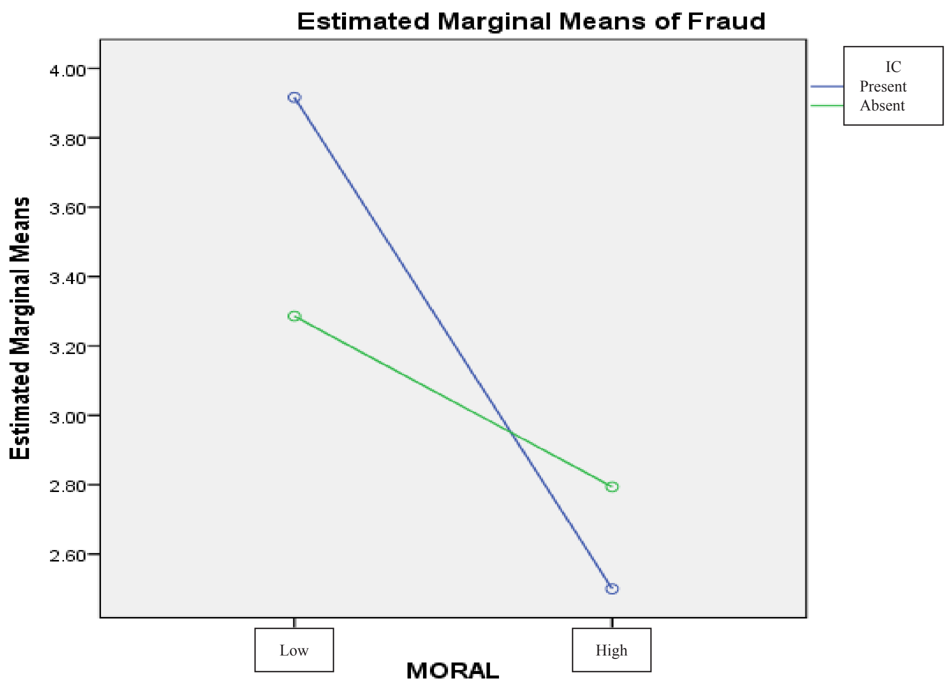
Dependent Variable: Fraud

Source	Type III Sum of Squares	Df	Mean Square	F	Sig.
Corrected Model	18.919[a]	3	6.306	2.044	.114
Intercept	544.400	1	544.400	176.453	.000
MORAL	12.695	1	12.695	4.115	.046
PI	.396	1	.396	.128	.721
MORAL * PI	2.983	1	2.983	.967	.328
Error	249.904	81	3.085		
Total	975.000	85			
Corrected Total	268.824	84			

a. R Squared = .070 (Adjusted R Squared = .036)

The next analysis can be seen from the graph plot as follows:

Figure 2
Graph Plot



The graph above shows that individuals with low morality have a greater tendency to commit accounting fraud than those with high morality.

The results of the first hypothesis testing based on the results in table 5 show that the significance value is 0.046 < 0.05, so the hypothesis is accepted. This means that there is a difference in the tendency of accounting fraud between individuals with low morality and individuals with high morality. It can also be seen from Figure 1 that shows that the individuals with low morality have greater tendency to commit accounting fraud than the individuals who have high morality. The results of this study are consistent with Kohlberg's morality theory which shows that individuals with high morality (post-conventional) have orientations on ethical principles. The results of this study are also in line with the research conducted by Dewi (2016) which shows that there is a difference in the tendency of accounting fraud between individuals with low morality and individuals with high morality.

Results of the second hypothesis test based on the results in table 5 show that the significance value is 0.721> 0.05, so the hypothesis is rejected. This means that there is no difference in the tendency of accounting fraud between individuals under condition with internal control element and individuals under condition without internal control element. This is because accounting fraud occurs not only caused by the presence or absence of internal control, but also the presence of ethical factors, as revealed by Arens (2015) that the fraud occurs because of pressure, opportunity, and rationalization. This research is not in line with the research conducted by Dewi (2016) which shows that there is a difference between the individual under condition with internal control element and the individual under condition without internal control element.

Results of the third hypothesis test based on the results in table 5 show that the significance value is 0.328 > 0.05, so the hypothesis is rejected. This means that there is no interaction between individual morality and internal control. Individual morality is the greatest cause a person to commit accounting fraud. Fraud is a perversion of moral perceptions of truth, justice of law, equity and equality. Therefore, fraud is morally unacceptable behavior (Tunggal, 2008: 8). This study is not in line with the research conducted by Dewi (2016) which shows that there is an interaction between individual morality and internal control.

CONCLUSION

Based on the test results, it can be concluded that there are differences in the tendency of accounting fraud between individuals with low morality and individuals with high morality. Individuals who have low morality tend to be more likely to commit accounting fraud than individuals who have high morality. However there is no difference in the tendency of accounting fraud between individuals under conditions with internal control element and individuals under condition without internal control element. This means that the tendency of accounting fraud is not affected by the presence or absence of internal control. The result of this study also shows that there is no interaction between individual morality and internal control element. This means that individuals who have low morality have greater tendency to commit accounting fraud either in the condition with internal control or in the condition without internal control.

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