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DETERMINANTS OF DISCLOSURE OF FINANCIAL REPORTING FRAUD AND ITS IMPACT ON THE COMPANY'S FINANCIAL PERFORMANCE AT COMMERCIAL BANKS LISTED ON THE INDONESIAN STOCK EXCHANGE

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ABSTRACT

Financial reporting fraud can occur in all organizational lines and the perpetrators can be found at the organizational structure level from the top management level to the middle level management. There are still many cases of financial reporting fraud found in banking institutions due to weak implementation of corporate governance which is indicated by weak internal supervision and weak ethical commitment. Financial reporting fraud committed by bank managers directly affects the survival / business of banking and causes a decrease in share prices and corporate reputation due to the impact of disclosure of financial statement fraudulent information that is known by the supervisory agency.

Keywords: ***Ethical Commitment, Audit Committee, Internal Audit, Financial Reporting Fraud, Corporate Financial Performance.***

INTRODUCTION

The Association of Certified Fraud Examiners (2016) places the financial and banking industries in the first position of organizations that are disadvantaged due to financial reporting fraud with a percentage of 16.8%, but the results of research conducted by Ernest and Young institutions conducted fraud surveys in Indonesia (2016) shows that the financial and banking industry in Indonesia is the second most disadvantaged industry with a percentage of 15.9%. The Financial Services Authority (FSA/OJK) noted that there were 108 cases of banking crime in Indonesia in the period 2014-2016 (Tampubolon, 2014).

Tampubolon (2016) revealed that perpetrators of fraudulent financial reporting were carried out by individuals who were authorized in decision making, and related to handling operational activities.

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The results of fraud surveys in Indonesia indicate that the perpetrators of financial reporting fraud are mostly carried out by managers with survey results of 40.3% (Ernest and Young, 2016).

Cases of financial reporting fraud are still widely found in banking institutions due to weak implementation of corporate governance (Alamsyah, 2013), and weak business ethics (Choi and Pae, 2014). Strengthening corporate governance mechanisms and commitment to business ethics needs to be improved in banking institutions to prevent and detect fraudulent financial reporting (Ilya Avianti, 2014; Choi and Pae, 2014; Rezaee and Riley, 2010).

Fraudulent financial reporting by bank managers directly affects the survival / business of banking and causes a decrease in the level of public trust in banking (Widodo, 2014). Financial reporting fraud is an activity that will have a severe financial impact on banks and will reduce the amount of money available for economic development (Chiezey and Onum, 2013).

The results previous research found that fraudulent financial reporting will reduce the company's financial performance. Johson's (2014) study revealed that companies that commit financial reporting fraud will experience a significant decrease in operating income, net profit margin and return on assets. The results of a survey conducted by COSO (2010) show that companies that commit financial reporting fraud will experience a net loss or be close to a loss, and even experience an average stock price decline of 16.7% after 2 days of announcement of fraudulent financial reporting information. Companies that commit financial reporting fraud will experience bankruptcy, delisted in the capital market (Hopwood et al, 2012).

Based on the description above, the researcher is interested in conducting research on "Determinants of Disclosure of Cheating Financial Reporting and Its Impact on the Company's Financial Performance in Commercial Banks Registered on the Indonesia Stock Exchange".

HYPOTHESES DEVELOPMENT

Companies can be considered to have ethical behavior when management is committed to promoting a code of ethics and value to employees in the organization (Valentine and Barnett, 2003). Ethical commitment must be applied at the management level to create awareness among stakeholders (ie; employees, suppliers, customers, and the community) of the organization's code of ethics and organizational policy (Callaghan, 2012). Higher ethical commitment in the company reduces the occurrence of fraudulent financial reporting, and vice versa (Choi and Pae, 2011). The results of Choi

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and Jung (2011) research found that ethical commitment was not proven to have an effect on financial reporting fraud because of variations of stakeholders consisting of investors, managers, customers, suppliers and employees.

H1: Ethical commitment influences disclosure of financial reporting fraud.

The audit committee is an important part of the company's reporting process. The primary responsibility of the audit committee is to oversee the integrity of the company's financial reporting and control procedures carried out by management to protect the interests of shareholders and other stakeholders, (PWC 2003: 4). An effective audit committee will help create financial reporting transparency, adherence to applicable regulations, and adequate internal control (Wiralestari and Dewi, 2015) and an independent audit committee can reduce fraudulent practices (Lee and Fargher, 2012; Kamarudin, 2014).

H2: The audit committee influences the disclosure of fraudulent financial reporting

Internal audit can prevent and detect fraudulent financial reporting through regular checks and reviews of the financial reporting process (Rezaee and Riley, 2010: 210). Salameh et al (2011) and Coram et al (2008) state that a more effective internal audit can reveal / prevent fraudulent financial reporting compared to internal outsourcing audits because the company's internal audit has a deeper knowledge of the company's culture, policies and procedures and have experience

H3: Internal audit affects the disclosure of fraudulent financial reporting

Fraud in financial reporting by management in banking institutions threatens business continuity in banking and causes disruption to the role of banks, where management fraud in banking creates public distrust as a result of damaged reputation (Mc Ateer and Michael, 2008). Banks that commit financial reporting fraud will be able to reduce funding sources and experience a decrease in operating income. Significant net profit margin (Johson, 2014; Chiezey and Onum, 2013).

H4: Disclosure of financial reporting fraud against the company's financial performance

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RESEARCH METHOD

The research method is a method used by researchers during an investigation to solve problems (Kothari, 2004: 08). While Suriasumantri (2010: 328) states that the research method is the methods used in the study. The research methods used in this study will be explained as follows:

a. Judging from the research objectives, this research is descriptive, namely a study that aims to explain the characteristics of research variables (Sekaran and Bogie, 2010: 105).
b. Judging from the type of study, this type of research is verificative and is explanatory research or causal study, because this study wants to find the cause or causal relationship of one or more problems such as those has been stated in the formulation of the problem (Sekaran and Bougie, 2010: 165).
c. Viewed from the side of the time horizon, this study is included in cross-sectional studies. Because in the study which is a cross-sectional study / research conducted by collecting data only once, the possibility can be daily, weekly, or monthly, in order to answer research questions (Sekaran and Bogie, 2010: 119).

Operational Variable

Table 3.1

Operational Variable

Variabel	Dimensions	Indicator	Scale
Ethical Commitment	Ethical Commitment Index	The number of Ethical Commitments carried out The number of Ethical Commitments that must be carried out	Ratio
Audit Committee	Audit Committee Meetings	Number of meetings held for a year The number of meetings required in a year by OJK	Ratio

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Internal Audit	Resources and Competence	1. Educational Background 2. Professional Certification 3. Continuous Professional Education 4. Developing and Maintaining program of quality assurance	Ordinal
	Internal Audit Interaction with Audit Committe	The frequency of Internal Audit Meetings with Audit Committee	Ordinal
Disclosure of Fraudulent Financial Reporting		The amount of Fraud Reported for ayear	Ratio
Company Financial Performance	Profitability	Operational Expense Oprational Income	Ratio

Population and Sample

Population according to Sekaran and Bougie (2010: 262) is mentioned as a group of people, events, or things that interest researchers to study. Based on this definition, the population in this study are all commercial banks listed on the Indonesia Stock Exchange, with the target population in this study being commercial banks listed on the Indonesia Stock Exchange in 2017, where the target population is according to Sekaran and Bougie (2013: 245) defined as part of elements, geographic circle, and time. Number of commercial banks listed on the Indonesia Stock Exchange as many as 42 commercial banks listed on the Indonesia Stock Exchange (see attachment)

Samples according to Sekaran and Bougie (2010: 263) are explained as part of the population. The sampling method used is sampling probability. The technique used is Random Sampling. The sample size can be determined using the formula from Taro Yamane or Slovin (Riduwan 2008) as follows:

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$$n = \frac{N}{N.d^2 + 1}$$

Information : n = Sample size sought

N = Population number

d^2 = Set precision of: 10%

Based on the formula above, in this study the sample size is:

$$n = \frac{42}{42\,.\,(0{,}1)^2 + 1} = \frac{42}{1{,}42} = 29{,}58$$

n = 30 Bank

DISCUSSION

A. Effect of Ethical Commitments on Disclosure of Financial Reporting Fraud

The results of this study support the research conducted by Choi and Jung (2011) finding ethical commitment is not proven to have an effect on financial reporting fraud because of variations of stakeholders consisting of investors, managers, customers, suppliers and employees who take part in any decision making. In addition, it shows that there is an action by the management of the company to make earnings management which is an unethical behavior because there is information that is hidden (Jo and Kim, 2007). Management uses its power to eliminate and add a certain amount in financial statements, where management freely uses accounting information systems to hide certain financial statement information (Christine, 2015).

This shows that management is not committed in carrying out the ethics listed in the company's code of ethics (Healy and Palepu, 2003). This behavior is an unethical behavior, where company management acts misuse of position / position (abuse position), abuse of power (abuse power), abuse of organizational resources (abuse resources), and behavior that does nothing or no action

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(Thoyibatun, 2009). Thus unethical behavior has led to increased cases of fraudulent financial reporting.

Based on the Gone Theory, a person's factors carry out unethical behavior that causes someone to commit fraud because of factors greed, opportunity, need and exposure (Karyono, 2013). Luxurious behavior, being close to buyers / suppliers, and ingenious attitudes or behaviors is the highest position for someone to commit unethical actions (ACFE, 2016). Thus the results of this study explain the phenomenon that financial reporting fraud is still widely found in banking institutions due to weak business ethics (Choi and Pae, 2014).

B. Testing the Influence of the Audit Committee (X2) on Disclosure of Fraudulent Financial Reporting (Y)

The results of this study indicate that there is an influence of the audit committee on disclosure of fraudulent financial reporting. An effective audit committee will help create financial reporting transparency, adherence to applicable regulations, and adequate internal control (Wiralestari and Dewi, 2015) and an independent audit committee can reduce fraudulent practices (Lee and Fargher, 2012; Kamarudin, 2014).

Felo et al (2003) and Chtourou et al (2001) show that good corporate governance which has a larger audit committee composition, the audit committee with its resources will devote more time and effort to ensuring that the information disclosed in financial statements are more accurate and free from material misstatements. Abbott et al (2004), Vafeas (2005) and Xie et al (2003) say that companies that have adequate audit committee members can improve the efficiency of the supervisory function in terms of financial reporting integrity. Ideally, a company has a 3-4 member audit committee.

C. Testing the Influence of Internal Audit (X3) on Disclosure of Fraudulent Financial Reporting (Y)

The results of this study found that internal audit did not affect the disclosure of fraudulent financial reporting can explain the phenomenon that financial reporting fraud is still widely found in banking institutions due to weak implementation of corporate governance caused by weak internal supervision (Halim, 2013). Internal audit is a good corporate governance mechanism that has the responsibility to reduce financial reporting fraud (Ilya, 2014).

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Internal audit or interaction with the audit committee / board of commissioners related to the selection of an aggressive accounting policy in financial reporting by the board of directors or management has not been fully effective so that internal audit has not been optimal in detecting fraudulent financial reporting (Nuraini, 2016). In addition, Arens et al (2014) revealed that internal audit focuses more on operational audits and employee fraud not on fraud committed by top management which is related to fraudulent financial reporting. Examination of the reliability of financial statements is more left to external auditors.

D. Testing the Effect of Disclosure of Financial Reporting Fraud (Y) on Company Financial Performance (Z)

The results of this study indicate that disclosure of financial reporting fraud has an influence on the company's financial performance. This indicates that if fraudulent financial reporting information is detected by the supervisor of the financial services authority, the internal audit, whistleblower and disclosure by the media will have an impact on the company, namely a decrease in stock prices, dishonorable dismissal (Nuraini, 2016). The results of COSO's research (2010) state that financial reporting fraud is in a negative reaction by the market which results in an average decline in stock prices by 16.7% after 2 days of announcement of information / disclosure of fraudulent financial reporting by the media. Companies that commit financial reporting fraud will get negative sanctions from customers due to damaged reputation, namely a decrease in performance (Mc Ateer and Michael J, 2008).

CONCLUSION

The indicated management is not committed in carrying out the ethics stated in the code of ethics of the company, where they use power to take actions that are not in accordance with those contained in the company's code of ethics. applicable regulations, and adequate internal control. Indicated internal audit has not conducted an examination of the policy of the board of directors related to the selection of accounting policies in the preparation of financial statements. In addition, disclosure of fraudulent financial reporting detected by the supervisory agency will give a negative reaction by the market in the form of a decrease in stock prices and a decrease in respect for the company's performance.

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SUGGESTION

To fulfill the characteristics of the scientific research namely replicability and generalizability, it is advisable for other researchers to conduct research again by adding other variables that are allegedly influencing disclosure of fraudulent financial reporting and financial performance such as, the board of commissioners, internal audit objectivity, red flag. Furthermore, it can conduct research with different populations and samples using a qualitative approach.

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