The Effect of Good Corporate Governance on the Internal Fraud in Sharia Business Unit in 2017

Riyahul Jannah*
University of Muhammadiyah Tangerang
riasmpn3curug@gmail.com

Ayu Irmasari Raharjanti
IAIN Surakarta

Abstract. The fraud case has penetrated Sharia banking, both Bank Umum Syariah (BUS) and Unit Usaha Syariah (UUS). In the Good Corporate Governance (GCG) report, the bank only published the number of cases released> 100 million for fraud involving banking companies. This study uses 10 of the 20 UUS registered with the Financial Services Authority. The sample was obtained based on purposive sampling by looking at the publication of GCG reports on the banking site. Using the GCG self-assessment values processed by the simple SPSS 23 linear regression formula, it was found that Good Corporate Governance was not obtained against the Internal Fraud Unit of the Sharia Business.

Keywords: good corporate governance, internal fraud, Islamic, financial institution

INTRODUCTION

The Financial Industry development, both banks and non-banks, has increased, especially in the banking sector. One of them is the Sharia Business Unit, hereinafter referred to as UUS.

Based on Law No. 20 of 2008 concerning Sharia Banking, UUS is a work unit of a Conventional Commercial Bank head office that functions as the parent office of an office or unit carrying out business activities based on Sharia Principles. It may also refer to a work unit in a branch office of a bank abroad conducting conventional business activities that function as the parent office of Sharia sub-branch offices or Sharia units.

The Sharia Business Unit that holds its head office is particularly helping to develop its potential. Therefore, it is expected that UUS will immediately spin-off or separate into BUS so that the number of Sharia Banks is growing in Indonesia [1]. This is in accordance with the Financial Services Authority (OJK) recommendation that all UUS owned by BPD can be merged into one, eventually becoming a large and strong Sharia Bank [2].

Spin-off or not, UUS still has the obligation to implement the principles of Good Corporate Governance (GCG) in accordance with Bank Indonesia Regulation No. PBI. 11/33 / PBI / 2009 concerning the implementation of Good Corporate Governance (GCG) for Sharia Commercial Banks and Sharia Business Units. GCG is implemented to ensure the operation and service of UUS goes well. However, the implementation of Sharia banking tasks in accordance with GCG guidelines does not guarantee freedom from fraud [3].

Bank Indonesia (BI) issued Circular No. 13/28 / DPNP on December 9, 2011, concerning the implementation of anti-fraud strategies for commercial banks (conventional and Sharia). According to BI, fraud is an act of deviation or intentional omission to deceive or manipulate banks, customers, or other parties that occurs in a bank environment or uses bank facilities to cause banks, customers, or other parties to suffer losses and/or fraud. In this case, perpetrators obtain financial benefits either directly or indirectly.

Fraud also happens in international organizations. According to The Association of Certified Fraud Examiners (ACFE), fraud is intentional unlawful acts committed for a specific purpose (manipulation or giving false reports to other parties) by people from within or outside the organization to gain personal or group benefits that directly or indirectly harm other parties [4].

Data from FSA on fraud in Indonesia from 2014 to 2016 shows that there were 108 banking cases, of which 55% came from credit cases, 21% were engineering records, 15% embezzlement of funds, 5%, transfer of funds, and 4% procurement of assets (OJK 2016). Fraud cases presented to the public mostly happened to Islamic Commercial Banks (BUS). However, if they are not followed up, it can also affect UUS.
One of the cases happened in Central Java Regional Development Bank (BPD Jateng). There was a fictitious credit case worth Rp. 94 billion. According to the bank's admission, this happened because of the weakness of internal control supervision. The case involved an outside party from the Regional Disaster Management Agency (BPDB) and credit analyst staff at the Central Java Regional Islamic Boarding School UUS. At the same bank, the Central Java BPD Surakarta refused to take responsibility for the loss of customers' savings of Rp 6 billion. It happened because the case had become the perpetrators' responsibility, namely former BPD Central Java Surakarta UUS officials Teguh Pranomo and Bagus Joko Suranto, convicted of corruption cases.

Research on Good Corporate Governance

There are two variables: X (Internal control and Good Corporate Governance) and Y (Fraud) [3]. Anugerah conducted research on the role of Good Corporate Governance in the prevention of fraud [5]. The used of same variable Y and the Internal Control system, asymmetry of information, and organizational justice as variable X [2].

Najib & Rini (2016) uses variable X, sharia compliance, and Islamic Corporate Governance against fraud in Islamic Banks [6]. The addition of variable X by Rahmayani & Rahmawaty (2017) was Internal Control and Islamic Corporate Governance, with the difference being that Islamic Corporate Governance was only two proxies used [3]. The latest research that uses Good Corporate Governance variables on fraud was conducted by Lidyah (2018) on Islamic Corporate Governance, Islamic Financial Performance Index on Fraud of Islamic banks [7].

Previous research has been subjected to Sharia banks so that researchers will use the Sharia Business Unit as the object of the 2017 period. The aim was to determine the effect of Good Corporate Governance on fraud in the Sharia Business Unit in 2017.

Agency Theory

Agency theory is an attempt to understand and solve the problem of the incompleteness of information when entering into a contract. This theory explains that there are more benefits for the agent than the principal of the information obtained. In the agency, there are two problems. The first is bad choices. They occur from the beginning made by the principal, not knowing the capabilities of the agent, causing the principal to choose the bad agent [8]. Second is the moral hazard. This happens when the contract agreed upon by the principal and agent. On the other hand, the agent knows that there are conditions that are not fulfilled [8]. Mitnick explains the moral hazard in four circumstances [9]:

1. Monitoring disability. It is when the principal does not supervise the agent's behavior, resulting in information inequality between the principal and agent.
2. Undesirable behavior. It is the result of risky agent actions, which can be beneficial or detrimental to the principal.
3. Undesirable outcome. It is the benefit obtained from other parties' costs for personal gain after contract approval.
4. Morals disability. It is when agents tend to be dishonest and ignorant.

Good Corporate Governance

According to Zarkasyi, Good Corporate Governance (GCG) is a banking management system designed to improve bank performance, protect the interests of stakeholders, and improve compliance with laws, regulations, and ethical values [10]. Therefore, to build public trust in Islamic banks and ensure compliance with Islamic principles, GCG implementation is required as a condition for Islamic banks to develop properly and healthily.

The GCG Guidelines use five principles, or commonly abbreviated as TARIF [11], namely:
1. Transparency: openness in disclosing material information and transparency in decision making.
2. Accountability: clarity in the division of functions and the implementation of the responsibilities of each section so that the company can be managed effectively.
3. Responsibility: management following applicable laws and regulations and in compliance with corporate principles.
4. Independency: the management carried out professionally with sufficient competence and without any conflict of interest of any party.
5. Fairness: equality given to shareholders in accordance with the rights and agreements based on the applicable law.

The company's implementation is based on GCG principles, be it a Sharia Commercial Bank or Sharia Business Unit. There are differences in the implementation of GCG on BUS [12]:
1. Implementation of the duties and responsibilities of the board of commissioners and directors
2. Completeness and implementation of the duties of the committees and functions that carry out BUS internal control
3. DPS implementation of duties and responsibilities
4. Implementation of the compliance, internal audit, and external audit functions
5. The maximum limit for channeling funds
6. Transparency of BUS financial and nonfinancial conditions

UUS at least manifests the following things in the implementation of GCG [12]:
1. Implementation of the duties and responsibilities of UUS directors
2. Implementation of the duties and responsibilities of the Sharia Supervisory Board (DPS)
3. Fund distribution to customers of core financing and fund financing by core depositors
4. Transparency of UUS financial and nonfinancial conditions

Good GCG implementation can minimize fraud in a company. This is consistent with Anugerah’s research (2014) that by understanding and considering principles, functions, and the role of the audit committee, GCG will prevent or reduce fraud.

So, the research hypothesis is:
H1: Good Corporate Governance has a positive effect on the prevention or reduction of fraud in the Sharia Business Unit.

METHODS

The independent variable used in this study is good corporate governance. GCG data can be seen from the composite self-assessment values in the 2017 period. The composite values can be seen from UUS GCG reports. Next, the dependent variable is a fraud, particularly internal fraud committed by UUS employees.

The research population is all Sharia Business Units (UUS) registered with the Financial Services Authority (OJK) in 2017. UUS was chosen as the research object because there are cases faced by UUS. There are no studies using UUS objects as case studies. The samples were selected using a purposive sampling method, namely sampling technique with certain considerations [2] based on the following criteria:
1. Included in Sharia Business Units (UUS) registered with the 2017 FSA period.
2. The UUS published the GCG report on the 2017 official website.
3. The UUS disclosed data relating to the value of self-assessment and the amount of internal fraud.

The analysis tool uses simple linear regression analysis to test the effect of the dependent variable with one independent variable. The regression equation model used can be formulated as follows:

\[ Y = a + bX_1 + e \]

Note:
Y = Fraud
a = constant
b = regression coefficient
X1= Good Corporate Governance

RESULTS AND DISCUSSION

Based on the data obtained from Sharia Banking Development Statistics (OJK 2018), 22 UUS were involved based on researchers’ criteria. The researchers used 10 UUS as samples with cross section data research, so the number of study samples was 10. After the data were obtained, the researchers conducted several tests related to simple linear regression using SPSS 23 software. These tests included descriptive statistical tests, classic assumption tests (tests for normality, multicollinearity, autocorrelation, and heteroscedasticity).

Table 1. Hypothesis Test Results

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<td>Adjusted R-Square</td>
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Based on the coefficient of determination test, the value of the adjusted R-Square is 0.136 or 13.6%. This means that GCG, as an independent variable, can only explain the dependent variable of 13.6%. Whereas, 86.4% is explained by other variables mixed from GCG. The F test of 2.421 with a sig of 0.159 shows that GCG has no effect on fraud because the sig value is more than 0.05. Similar to the F test results, the GCG sig value also showed no significant effect on fraud. Regression results on GCG variables have a significance value of more than 0.05, which is 0.159. Then it can be concluded that the variable of Good Corporate Governance (GCG) does not affect the Syariah Business Unit fraud, or H1 is rejected.

CONCLUSION

Based on the analysis of data processing, it was concluded that Good Corporate Governance does not affect fraud. Because it only has an Adjusted R-
Square value of 13.6%, further research can add other variables that potentially influence fraud. Then for further research, it can also expand objects in other Non-Bank Financial Institutions or SRBs. Different periods of the Sharia Business Unit in Indonesia can also be included.

Based on the results of the discussion, some conclusions and limitations in this study. The following suggestions are offered:

Academic advice:
1) Future researchers can conduct research not only at Islamic Commercial Banks but also at other banks. It is recommended to expand by adding different Islamic financial institutions, such as Sharia Business Units, Sharia Rakyar Financing Agency, and Sharia Insurance.
2) Future researchers are recommended to use other different proxies to measure Islamic Corporate Governance and internal control variables.
3) It is recommended that future researchers increase the period of the study to obtain maximum results.

Practical advice:
1) Sharia banking institutions should pay attention and improve governance based on sharia principles to reduce internal fraud in banking activities and conduct better supervision.
2) For other Islamic financial institutions, it should be able to improve the internal control system and implement an effective anti-fraud strategy to prevent and detect indications of fraud, especially internal fraud.

REFERENCES


