



The Influence of the Bystander Effect and Internal Control on the Trend of Accounting Fraud at Village Credit Institutions in Jembrana Regency

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Abstract—Financial statement fraud or accounting fraud is any intentional act or omission that results in materially misleading financial statements. Previous research has shown that variables that influence the tendency of accounting fraud, such as the bystander effect and internal control. This study aims to examine and explain the effect of the bystander effect and internal control on the tendency of accounting fraud. The research was conducted at the Village Credit Institution (LPD) in Jembrana Regency, with the respondents being managers and employees working at the LPD. Data were collected using a questionnaire and analyzed using variant-based SEM and processed using Partial Least Square (PLS).

The results of the study found a bystander effect, and internal control had a significant effect on the tendency of accounting fraud.

Keywords—tendency of accounting fraud, bystander effect, internal control.

I. INTRODUCTION

Fraud is a social and economic problem that poses a very serious and expensive threat to businesses around the world [1], because it can involve various stakeholders in the company, from top managers, shareholders, employees, suppliers, to auditors [2]. Thus, the role of audit and internal control is needed in the prevention and detection of fraud [3]. The Association of Certified Fraud Examiners (ACFE) found financial statement fraud to be the least reported fraud, but has very serious consequences for organizations [4].

The phenomenon of fraud occurred at the Village Credit Institution (LPD) in Bali. The Village Credit Institution (LPD) is the only traditional village economic institution that carries out multifunctionality in order to strengthen the existence of traditional villages in Bali. LPDs in Bali have experienced problems in the last three years which have caused as many as 158 LPDs to be declared bankrupt and no longer operating. Three aspects of the problem, namely regulatory aspects, inadequate financial governance and a weak internal control system or not implementing procedures properly, lead to irregularities and fraud in practice, which in turn causes LPD management to be unhealthy (Baliberkarya.com, 2021)

Previous research tested several variables that were predicted to be factors that influenced the tendency of fraud to occur with inconsistent results. The bystander effect is a social phenomenon where the more other people are present in an emergency situation, the less likely that other person's presence will help someone who is in an emergency situation. Bystanders may choose to ignore it, because they are worried about their personal safety or want not to be involved [6] so that the bystander effect has a positive and significant effect on the tendency of accounting fraud. The higher the bystander effect, the higher the tendency for accounting fraud [7], [8], [8], [9] Other studies have shown that, when there is strong evidence suggesting the existence of fraudulent acts, individuals with their own knowledge are more likely to report than when others are aware of fraudulent acts (bystander effect). However, the bystander effect was not found when the evidence of fraud was weak [1]. On the other hand, the results of research by [9], [10], show that the bystander effect does not have a significant effect on the tendency of accounting fraud.

The internal control system has an important role to prevent fraud [11]. The results of previous studies indicate that the effectiveness of internal control has a negative and significant effect on the tendency of accounting fraud [12] and weak internal control is one of the factors that causes fraud [13], [14]. However, the results of other studies show that the internal control system has no effect on accounting fraud [15], [16].

This study aims to examine the effect of the bystander effect and internal control on the tendency of accounting fraud. The study was conducted on LPDs in Jembrana Regency, because the number of unhealthy LPDs increases every year. In 2021 there are two LPDs that are no longer operating, which is caused by accounting fraud by manipulating financial statements, and misappropriation of funds for personal interests (Baliberkarya.com, 2021).

II. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

A. Literature Review

The well-known theory of crime developed by Becker (1968), predicts that fraud can be prevented by increasing the

probability that fraud can be detected. Based on this theory, the decision to engage in criminal activities, such as fraud, requires a cost-benefit analysis. If the expected benefits of a crime are less than the expected costs, namely the possibility of being caught, then a rational individual will choose not to be involved in the crime [17].

According to Albrecht et al. (2004) stated that research that discusses aspects of fraudulent behavior generally focuses on various management theories, especially agency theory [18]. Agency theory by Jensen and Meckling (1976), assumes the principle of agency relationship between shareholders and management, where top managers act as agents whose personal interests are naturally not aligned with the interests of the company and shareholders. According to Davis, et al., (1997), agency theory assumes that management is usually motivated by self-interest and self-preservation, so that management (executives) will commit fraud because it is best for personal and short-term interests [18].

Financial statement fraud or accounting fraud is any intentional act or omission that results in materially misleading financial statements [4]. Cressey (1953) found three elements of fraud: 1). elements of pressure/motivation arising from financial difficulties; 2). the element of opportunity arising from internal control weaknesses that allows the problem to be carried out and hidden; and 3). rationalization or verbalization that is just a mind game, allowing the fraudster to feel comfortable with his actions, or even as a victim of an unfortunate situation [19].

B. Hypothesis Development

1) *The effect of the bystander effect on the tendency of accounting fraud*: Bystander effect is a variable that has an influence on the tendency of fraud, because there is neglect of the occurrence of fraud, as a result of concerns about personal safety, or wanting not to be involved [6], so that the bystander effect has a positive and significant influence on the tendency of accounting fraud. The higher the bystander effect, the higher the tendency for accounting fraud [7] and [8]. On the other hand, the bystander effect is not found when the evidence of fraud is weak [1]. The bystander effect has no significant effect on the tendency of accounting fraud [9] and [10]. The hypothesis proposed in this study:

H1. Bystander effect has a significant positive effect on the tendency of accounting fraud.

2) *The Effect of Internal Control on the Trend of Accounting Fraud*: The internal control system in a company or organization has an important role to prevent fraud (Rashid & Chnar Abdullah, 2022), so that the effectiveness of internal control has a negative and significant effect on the tendency of accounting fraud (Astuti et al., 2017). Weak internal control is one of the factors that causes fraud (Setyaningsih & Nengzih, 2020) (Bell & Carcello, 2000). However, the results of other studies show that the internal control system has no effect on accounting fraud (Vamela & Setiyawati, 2021) (Setiawan, 2018). The proposed hypothesis is:

H2. Internal control has a significant negative effect on the tendency of accounting fraud.

III. RESEARCH METHODS

A. Population and Sample Selection

The population in this study were all LPD employees and managers in Jembrana Regency. According to data obtained from the Village Credit Institutions Empowerment Institution (LPLPD) of Jembrana Regency, the number of LPDs in Jembrana Regency is 64 LPD units, with a total of 407 employees. The number of samples is 162 people, taken using stratified proportionate random sampling technique.

B. Data Collection, Measurement and Analysis Techniques

Data were collected in two ways, namely using questionnaires and interviews. The questionnaire contains a number of questions to the respondents related to the indicators measured. Respondents were asked to agree or disagree with each statement, then converted into numbers using a Likert scale with 5 intervals, from 1 is strongly disagree to 5 is strongly agree.

Validity and reliability tests were conducted using 30 respondents, before the questionnaire was distributed. Measuring the validity of the instrument in this study, Pearson correlation was used with Sig. (2-tailed) 0.05, if the correlation value is below 0.05, it means that the data obtained is valid. Reliability test was performed using Cronbach's alpha (α) statistical test. The construct or variable is reliable, if the Cronbach's Alpha value is greater than 0.70.

The hypothesis was tested using variant-based SEM, processed using PLS (Partial Least Square) with a significance level of 0.05.

IV. RESULT AND DISCUSSION

A. Test Research Instruments and Models

A test of the validity and reliability of the instrument was carried out on 30 respondents. The results of the instrument validity test using 30 indicators in the questionnaire, showed that the Pearson correlation coefficient was more significant than 0.30 with the significance value of each indicator being less than 0.05, so all items in the questionnaire were valid. The Cronbach alpha coefficient, for the variable bystander effect (X1), internal control (X2), and the tendency to accounting fraud (Y), has a value greater than 0.70, thus the questionnaire is reliable.

The Smart PLS output shows that each indicator has a loading factor greater than 0.7, meaning that the indicators used in this study have met convergent validity. The value of Average Variance Extracted (AVE) for the construct bystander effect (0.717), internal control (0.636), and the tendency of accounting fraud (0.662), is greater than 0.5, so all constructs are valid or meet convergent validity.

The cross loading value for all indicators on the bystander effect variable (X1), internal control (X2), and accounting

tendency (Y), is greater than 0.70, in addition, the correlation coefficient of the latent variable with itself is higher than the correlation coefficient. between itself and other latent variables, then all indicators are valid or meet the discriminant validity.

The composite reliability value of the bystander effect (0.938), internal control (0.924), and the tendency to accounting fraud (0.955), as well as the Cronbach alpha value of the bystander effect (0.921), internal control (0.905) and the tendency to accounting fraud (0.949) were greater by of 0.7, so the reliability for all constructs is high and reliable.

The R² value of the Y variable (tendency to accounting fraud) is 0.439, so the influence model of X1 (bystander effect) and X2 (internal control) on Y (tendency of accounting fraud) is 0.439, the model can be interpreted as moderate. The predictive-relevant value can be obtained by the formula: $Q^2 = 1 - (1 - R1^2) (1 - R2^2) \dots (1 - Rp^2)$ is 0.193 greater than 0, meaning the model has predictive relevance. It can be interpreted, only 19.3% of the variation in the accounting fraud trend variable (Y), can be explained by the variables used in the model, while 80.7% is explained by other factors.

B. Hypothesis Testing and Discussion

Bootstrapping procedure was used to test the research hypotheses, with the results of the analysis as shown in Table 1.

TABLE I. PATH COEFFICIENT

Effect	Original Sample	T Statistic	P Values	Significance
X1 → Y	0,132	1,988	0,047	Sig ^a
X2 → Y	-0,664	9,831	0,000	Sig

^a. Sig = significance

1) *The Influence of the Bystander Effect on the Trend of Accounting Fraud.* : The results of the study as presented in Table 1 show that the bystander effect (X1) has a significant positive effect on the tendency of accounting fraud (Y), thus H1 is accepted.. The path coefficient is positive at 0.132 indicating that there is a positive relationship between the bystander effect and the tendency of accounting fraud. This means, the higher the level of bystander effect, the higher the tendency for accounting fraud to occur. The results showed that respondents felt that there was no benefit in disclosing the occurrence of fraud, because the costs to be borne by them were greater, such as feeling threatened by their work, so they did not need to interfere. In addition, they feel that someone is already responsible and oversees the fraudulent act.

The results of this study support the well-known theory of crime, because rational individuals will choose not to be involved in fraud, if the costs are higher than the expected benefits of disclosing a fraud [17]. The results of this study are in line with research by [7] and [8], where the higher the bystander effect, the higher the tendency for accounting fraud. However, in contrast to the results of research by (Asiah & Setyorini, 2017) and (Masdiantini et al., 2021), that the

bystander effect has no significant effect on the tendency of accounting fraud.

2) *The Effect of Internal Control on the Trend of Accounting Fraud* : Hypothesis H2 is accepted, because internal control has a significant negative effect on the tendency of accounting fraud. According to the results of the study, there is a negative relationship between internal control and the tendency of accounting fraud, which means that the more effective the internal control, the lower the tendency for accounting fraud. Vice versa, if the internal control is weaker, it will increase the tendency of accounting fraud. The results of this study indicate that internal control has been running well, in accordance with established procedures, so it does not provide opportunities for accounting fraud, and minimizes agency conflicts that can be carried out by LPD employees.

The results of this study support the theory of fraud. Cressey (1953) in his fraud triangle theory, states that opportunity is one of the factors as a condition that gives someone to cheat [19]. Periodic monitoring, both of physical assets and important records, establishes rules must report to managers if there is fraud, and always evaluates the duties performed by employees, so there is no opportunity for accounting fraud. Aspects of fraudulent behavior, in general, mainly focus on agency theory. Agency theory assumes that management is usually motivated by self-interest and self-preservation, so that management will commit fraud, because it is best for personal and short-term interests (Albrecht et al. , 2015). Effective internal control carried out by the LPD management as an agent, which is able to prevent fraud, will gain the trust of the community in the customary village as the principal, will prevent agency conflicts.

The results of this study are in line with research by [11], [12], [13] and [14], the internal control system has an important role to prevent the occurrence of fraud so that the effectiveness of internal control has a negative and significant effect on the tendency of accounting fraud. However, contrary to the results of research by [15] and [16] which show, the internal control system has no effect on accounting fraud.

V. CONCLUSIONS AND SUGGESTIONS

A. Conclusions

The bystander effect has a significant positive effect on the tendency of accounting fraud in LPDs in Jembrana Regency, because there is no benefit to revealing fraud that can worsen the situation, so it is better not to interfere, besides that, there are already other people who will be responsible and supervise the fraudulent actions.

Internal control has a significant negative effect on the tendency of accounting fraud at LPDs in Jembrana Regency, because internal controls have been running well, such as checking all important records and documents, physical inspection of LPD assets, the existence of rules that must report to the manager if there are fraudulent acts and routine evaluation carried out by the LPD leadership on the tasks performed by employees.

B. Suggestions

LPDs in Jembrana Regency need to regularly hold seminars, workshops to socialize ethical behaviors that should not be carried out by both employees and LPD management that encourage fraud. With continuous socialization, these ethical behaviors will become norms that must be adhered to so that they become organizational culture. In the future, if this behavior has become entrenched among LPD management and employees, it will strengthen internal control and will eliminate the existence of bystanders, but encourage whistleblowers.

The results of the study show that the bystander effect and internal control variables have a low influence on the tendency of accounting fraud, so there are other variables that actually have a greater influence on the tendency of accounting fraud in LPDs in Jembrana Regency. Thus, for further research, it is necessary to explore the variables that have a greater influence, such as variables of social and ethical values or local wisdom that cause fraud, which results in the existence of LPDs going bankrupt, so that research will be useful for LPDs in Jembrana Regency.

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