CHAPTER II

LITERATURE REVIEW

2.1 Underlying Theory

2.1.1 Theory of Planned Behavior

The theory of Planned Behaviour is one of the models most frequently used in the literature to explore pro-environmental behaviour including recycling, travel mode choice, energy consumption, water conservation, food choice, and ethical investment (Stern, 2000; Staats, 2003). Armitage and Conner (2001) identified its application in 154 different contexts. The Theory of Planned Behaviour (Ajzen, 1988) assumes that the best prediction of behaviour is given by asking people if they are intending to behave in a certain way. Here we note that the intention will not express itself in behaviour if it is physically impossible to perform the behaviour or if unexpected barriers stand in the way.

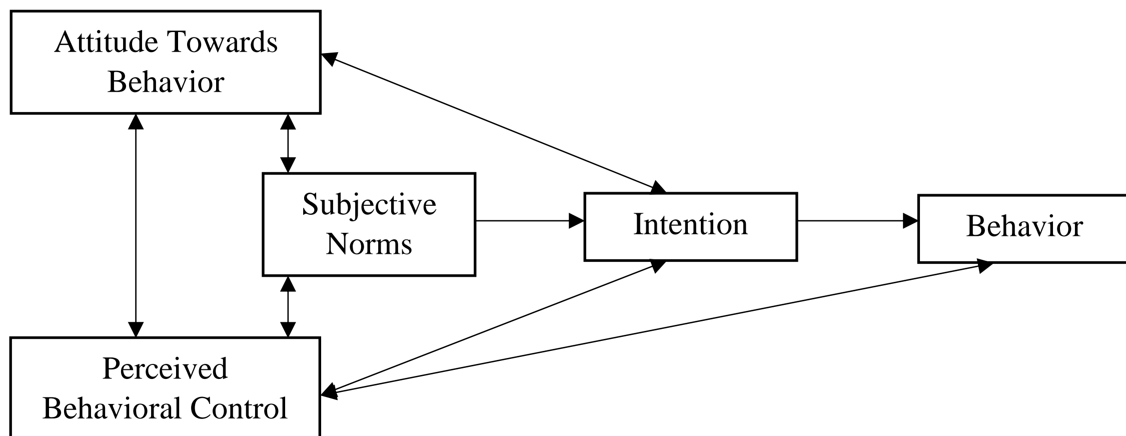
The model of the theory of Planned Behaviour assumes that consumers make decisions by calculating the costs and benefits of different courses of action and choosing the option that maximises their expected net benefits. The theory of Planned Behaviour belongs to the so-called group of 'rational choice models'. It builds on the following key assumptions: - Individual self-interest is the appropriate framework for understanding human behaviour; rational behaviour is the result of processes of cognitive deliberation; - Internal factors, especially the attitude, play the most important role.

The policy interventions that flow from this model are relatively straightforward. Policy should seek to ensure that consumers have access to sufficient information to make informed choices. Though familiar and widely used, rational

choice models have been subject to an extended critique. This critique is based on the following important claims and arguments:

- It is well known that human behaviour is extremely complex and consists of social, moral and altruistic behaviour as well as simply self-interested ones. More often, behaviour is embedded in collective and social decision-making contexts and other contextual factors. These factors continually shape and constrain individual preference.
- Habits and routines - which Simon (1957) referred to as procedural rationality - bypass cognitive deliberation and undermine a key assumption of the model.
- Emotional or affective responses appear to confound cognitive deliberation. It is well known in marketing theory, for example, that consumers build affective relationships with consumer goods.

Figure 2.1 Theory of Planned Behavior



(Ajzen, 1998)

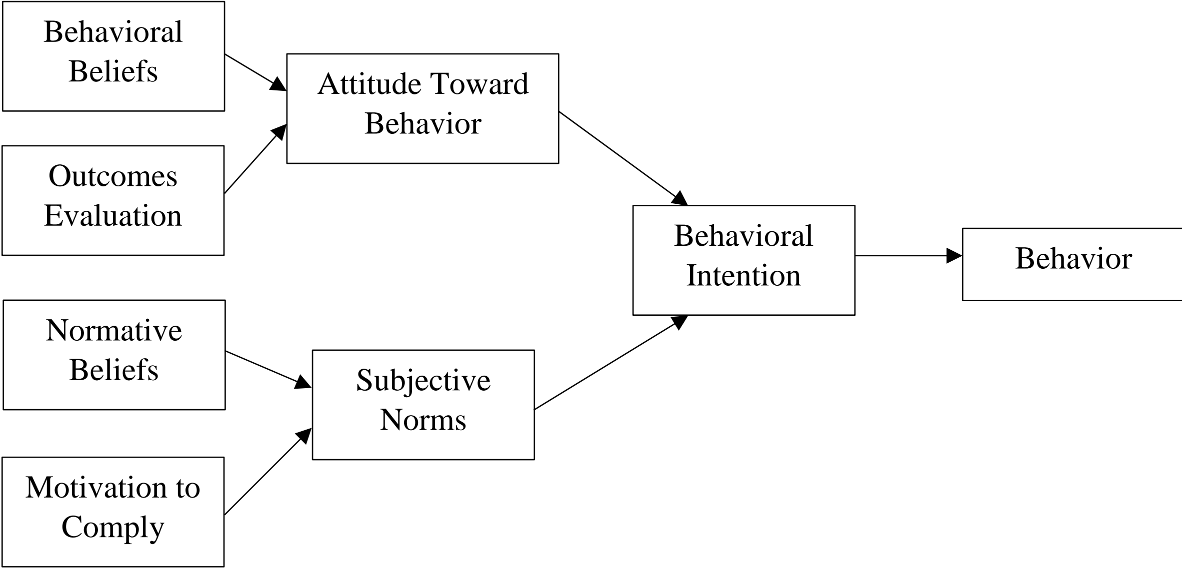
2.1.2 Theory of Reasoned Action

In research it has commonly been theorised that behaviour is understood by analyzing behavioural intentions (Doran 1991). One of the most prominent frameworks within this theoretical field is the Theory of Reasoned Action (TRA) (Ajzen & Fishbein 1980). TRA has for long provided an established academic framework (Ryan & Bonfield 1980; Madden et al. 1992; Sheppard et al. 1998) aiming to explicate behavioural intention that mediates a specific behaviour. TRA theorises that the variables attitude and subjective norm have a direct effect on behavioural intention, hence determining it. All variables except these two are further referred to as external factors, and are characterised by only having an indirect effect through attitude and subjective norm (Ajzen & Fishbein 1980; 2005). As attitude and subjective norm hence are the only variables affecting behavioral intention directly, and these have been argued to be too consumer oriented, the framework has further been criticized as being too individualistic biased (Kippax & Crawford 1993, p.253). Following this line of reasoning, the omission of a business perspective in TRA could be questioned as it gives rise to a separation between the consumer and the firm.

Both the Theory of Reasoned Action and the Theory of Planned Behavior developed out of a theoretical tradition that considered attitudes as a major influence on human behavior (Smith, 1932; Stagner, 1942; Thurstone & Chave, 1929). However, other contradictory research emerged suggesting the link between attitudes and behavior was tenuous at best (Corey, 1937; La Piere, 1934; Vroom, 1964), with some researchers even calling for abandonment of the attitude construct altogether (Wicker, 1969). However, Fishbein and Ajzen (1974) noted that the inconsistency between attitudes and behaviors could be improved by measuring attitudes and behaviors at the same level of specificity. Thus, rather than using global attitudes (e.g., attitudes toward religion) to predict specific behaviors (e.g., church attendance the following Sunday), Fishbein and Ajzen (1975) posited that researchers should focus on the specific antecedents of specific behaviors (e.g., attitudes toward church attendance the

following Sunday predicting church attendance the following Sunday). Furthermore, Fishbein and Ajzen (1975) posited that the link between attitudes and behavior might best be explained by an appeal to specific behavioral intentions. That is, attitudes about performing a behavior would predict behavioral intentions to enact the behavior, which would in turn predict behavior. In addition, because one may also take into account how others perceive one's actions, subjective norms about how to behave were also included as a predictor of behavioral intentions. Behavioral intentions were then were identified as the best predictor of behavior (Fishbein & Ajzen, 1975). In this model, attitudes toward the behavior were defined as an aggregate of readily accessible or salient beliefs about the likely outcomes of performing the target behavior, whereas subjective norms were defined as the perceived social pressure to perform or not perform the target behavior, and behavioral intentions were defined as the perceived likelihood of performing the target behavior.

Figure 2.2 Theory of Reasoned Action



(Fishbein & Ajzein, 1975)

2.1.3 Internal Control

Internal Control is the process of monitoring an accounting system/accounting information system in an active company or organization that aims to maintain the stability of the company's performance in the form of operations, finance, compliance, security, reliability and to keep away from risks and threats that could potentially harm or create a damage in the company or organization. According to AICPA, Internal Control is a process that is influenced by the board of commissioners, management personnel, and other business units, which are designed to obtain adequate confidence in achieving goals in the following matters: effectiveness and efficiency of operations, reliability of financial reporting, compliance with laws and applicable regulations. Internal accounting controls are designed in such a way as to maintain the wealth of the organization, examine the accuracy and reliability of accounting data, encourage operational efficiency, encourage compliance with management policies.

To understand the Internal Control System, it is necessary to understand what a system is before anything else. Control covers all methods, organizational policies and procedures that ensure the safety of assets of the company, along with the accuracy and the reliability of the data management and other management operations standards (Azhar Susanto, 2013). Control as managerial activities works to monitor the implementation of the plan and make improvement in accordance with the requirements (Hansen, et al. 2011). Meanwhile, Turnbull Report (1999) explains that internal control focuses on the positive character of an organization that facilitates efficiency based on improvement operations, and internal control that is applied correctly according to standards, this will add value to the company, because it is considered to follow applicable rules. Turnbull also said that perfect internal control is almost impossible to exist, because all organizations operate in environmental dynamics, which will indirectly bring new risks that are difficult to anticipate. Azhar Susanto (2013), also suggests that the purpose of Internal Control are namely:

1. Provides assurance to believe that the goal of every business activity to be achieved

2. Reduces the risk that would be faced by the company due to crime, danger, or losses caused by fraud, misappropriation and embezzlement.
3. Provides assurance that convincing and trustworthy that all legal responsibilities are met.

An internal accounting control system consists of several components, such as environmental control, risk assessment processes, information technology and communication, control and activity monitoring (Bodnar & Hoopwod, 2010). These components are designed and implemented by management to ensure that the objectives of internal control will be achieved and ensure that each internal control system is implemented specifically for the organization in each transaction cycle. Similar to what was conveyed by Romney, et al., (2012) which explains that internal control is a process because it permeates an operating activity of a company and organization and is an integral part of a management activity. Internal control is also influenced and has a major influence on the board of directors, management and other personnel whose duty is to present reasoned beliefs about achieving success in certain categories, efficiency and effectiveness of operations, reliability of reporting and compliance with applicable legal and regulatory standards. Romney, et al., (2012) also explains the objectives of Internal Control, namely:
1. Safeguarding assets, including preventing or detecting, on a timely basis, the unauthorized acquisition, use, or disposition of material assets company.
2. Maintaining records in sufficient detail to accurately and fairly reflect company assets.
3. Providing accurate and reliable information.
4. Providing reasonable assurance that the financial reporting is prepared in accordance with GAAP.
5. Promoting and improving operational efficiency, Including making sure the company receipts and expenditures are made in accordance with management and directors' authorizations.

6. Encouraging adherence to prescribed managerial policies.
7. Complying with applicable laws and regulations.

The development of government internal control in Indonesia was marked by the issuance of Government Regulation (PP) number 60 of 2008 concerning the government's internal control system (SPIP). Internal control system according to PP SPIP is an integral process in actions and activities carried out continuously by the leadership and all employees to provide adequate confidence in achieving organizational goals through effective and efficient activities, reliability of financial reporting, safeguarding state assets, and adherence to legislation.

According to experts, Arens, et al.,(2014) who reviewed the policies and procedures of Internal Control, control within an organization is intended to promote the effectivity and efficiency use of its resources to optimize the company's goals. Consequently, the control may be defined as methods, policies and procedures that help organizations ensure that the risks can be minimized and goals/objectives have been achieved. Internal Controls are a system of checks and balances designed to prevent and detect fraud and errors. While most companies have reviews these systems in place, many have never completely documented them, neither had an independent auditor to attest reviews of their effectiveness (Kieso, et al.,2011). Arens, et al,.(2014) also describes the definition of Internal Control as a system consists of policies and procedures designed to provide management with reasonable assurance that the company is capable to achieves its objective and goals.

Wilkinson, et al., (1999) describes a similar case that the internal control as a process and a structure is of great concern to accountants. Meanwhile, Dull, et al., (2012), describes the internal control, namely: internal control is a process - effected by an entity's board of directors, management, and other personnel designed to provide reasonable assurance regarding achieving objectives in the following categories:

efficiency and effectiveness of operations, reliability of reporting, and compliance with applicable laws and regulations.

In addition to these, Sawyer, et al., (2005), states that the control is meant to improve the company, directing, controlling and supervising various activities with the aim of ensuring that the company's goal is reached. Nearly similar, Hilton, et al., (2000) suggests, which that control is a policy or procedure that helps the organization ensure that its goals and objectives are met. Sawyer, et al., (2005) also suggests that Internal Control as an organization plan and all coordinated methods and measurements applied in the company to secure the assets, check the accuracy and reliability of accounting data. From some description above, the internal control can be considered as a system, or a process, which is conducted by the board of directors, management and other personnel that are intended to provide reasonable assurance of achieving the objectives in the following categories: efficiency and effectiveness of operations, ensuring reliable accounting reports, and encourage adherence to company policy. There are three objectives of good internal control - all established in the COSO Internal Control - Integrated Framework in 2013. They are:

1. Effectiveness and efficiency of operations.
2. Reliability of financial reporting
3. Compliance with applicable laws and regulations.

Internal Control, according to Boediono (2012), not only related to accounting standards in the financial statements. Boediono (2012) thinks, the scope of Internal Control is very broad. Internal monitoring team is expected to play a role to boost performance. Controls or Internal control were good until until the financial reporting will result in exceptional performance (Agus Martowardojo, 2011). Furthermore, Li and Vay (2009), shows that the internal quality control has an economically significant effect on internal management reports and thus, spake reviews that these decisions are based on figures. Coram et al. (2008) explained that organizations that have an internal

audit function would be better able to detect accounting fraud. The internal control system provides mechanisms to detect the occurrence of an accident, both when fraud occurs, even before it occurs. Meanwhile, Bastian (2015) states that accounting controls are part of the internal control system, including organizational structures, methods, and measures that are coordinated primarily to maintain the wealth of the organization and check the accuracy and reliability of accounting data. That is, accounting information, as a product of the accounting system, can be a tool for detecting fraud.

2.1.4 Individual Morality

Kamus Besar Bahasa Indonesia (KBBI) defined moral as good teachings that are generally accepted bad about problems, attitudes, obligations, and so on. While moral is having good and bad considerations, good character. According to Bertens (1993: 7), morality (from latin moralist adjectives) has a meaning that is basically the same as "moral", we speak "morality of an act" means that the moral aspect is a good or bad deed. Morality is the moral / overall nature of principles and values relating to good and bad. Moral is the term humans refer to humans or other people in actions that have positive values

The term moral comes from Latin. The single form of the moral word is mos, while the plural form is mores, each of which has the same meaning, namely customary customs. If we compare with the meaning of the word ethics, etymologically, the word ethics is the same as the moral word because the two words have the same meaning, namely customary customs. The meaning of the word moral is the values and norms that become a guideline for someone or a group in regulating their behavior. Whereas only the original language distinguishes "ethics" from Greek and "moral" from Latin. Morality (from the Latin moralist adjective) means basically the same as 'moral', there is only a more abstract tone. Morality is a moral or overall principle and values that are both good and bad.

Salam (2002: 2) explained similarly, racial morals from other words mores. Mores come from the word mos which means morality, character, or behavior. Meaning that moral can be interpreted as decency. Budiningsih (2004: 24) stated that morality occurs when people take good because they are aware of their obligations and responsibilities and not because they seek profit. So morality is an attitude and good deeds that are truly selfless. According to Amin (1992: 52) the reason behind management fraud is that managers do not care about morals (unscrupluous) such as helping conflicting interests. By knowing the nature and characteristics of humans who are most likely to commit fraud, the company can reduce the possibility of Accounting Fraud.

Amrizal (2004) in Friskila (2010) said, in an organization fraudulent actions can occur because of a lack of positive employee awareness of the wrongdoing, even being seen as normal or pretending not to know it. Positive awareness of the work environment is needed in building a strong ethical behavior and organizational culture. The low level of caring and low morale fosters acts of fraud which in the end can damage and even destroy the organization. Wilopo (2006) also said, management equity is also related to accounting fraud tendencies. The more management pays attention to broader and more universal interests than the interests of the company, especially the personal interests, the higher the morality of management so that management tries to avoid accounting fraud tendencies. Wilopo uses the theory of moral development, the stages of moral development is a measure of a person's high and low morals based on the development of moral reasoning as expressed by Kohlberg (1969). The measurement of management morality comes from a moral model of development developed by Kohlberg (1969) and Rest (1979) in the form of a Defining Issues Test instrument. This instrument is in the form of an ethical dilemma. Management morality is measured through 6 (six) items that measure every stage of management morality through a case of accounting ethics dilemma. Each stage of

management morality is shown on a scale of one to five. The measurement results for this accounting ethics dilemma are a reflection of the management's morality. The six stages are divided into three levels: pre-conventional, conventional, and post-conventional stages.

Welton (1994) states that an individual's ability to resolve ethical dilemmas is influenced by the level of reasoning in his mind. People with low levels of moral reasoning behave differently with people who have a high level of moral reasoning when facing ethical dilemmas. All the while according to Rest and Narvaez (1994) in Liyanarachchi (2009), the higher the level of one's moral reasoning, the more likely it is to do the right thing. In the lowest stage (pre-conventional), individuals will take an action because they are afraid of the laws / regulations that exist. In addition, individuals at this moral level will also view their personal interests as the main thing in carrying out an action. In the second stage (convenional), individuals will base their actions on the approval of their friends and family as well as the norms in the community. At the highest stage (post-conventional), individuals base their actions by paying attention to the interests of others and based on their actions on universal laws.

Research by Welton (1994) found that in each stage of Kohlberg, individuals have their own views on the version of the right thing according to him. Individuals in stage 1 feel that the right thing is what interests the individual. Individuals in stage 2 assum e that the right thing is the result of a balanced exchange, agreement and a balanced bargaining position. Individuals in stage 3 feel that the right thing is related to the hope of trust, loyalty, and respect from friends and family. Individuals in stage 4 assume that the right thing is to make contributions to communities, groups or institutions. Individuals in stage 5 and stage 6 consider that truth is fundamental to ethical principles, equal human rights and dignity as a living being (Novita, 2012).

Liyanarachchi (2009) also explained that the level of individual moral reasoning will influence their ethical behavior. People who have a low level of moral reasoning behave differently from people who have a high level of moral literacy when they face ethical dilemmas. The higher the level of one's moral circulation, the more likely the individual is to do 'the right thing'. Individuals will take action because they are afraid of the laws / regulations that exist if they are at the lowest (pre-conventional) stage. In addition, individuals at this moral level will also view their personal interests as the main thing in carrying out an action. In the second stage (conventional), the individual will base his actions on the agreement of friends and family and also on the norms that exist in society. At the highest stage (post-conventional), individuals base their actions by paying attention to the interests of others and based on their actions on universal laws.

2.1.5 Ethical Value

Ethics are the moral principles that an individual uses in governing his or her behaviour. Ethics refers to a discipline in which matter of right and wrong, good and evil, virtue and vice are systematically examined (Brinkmann, 2002; Ogbonna & Appah, 2012). Ethics looks at human behavior, moral principles and the effort to separate good from bad.

When trying to recognize common matters being dealt with, within the corporate environment, professional bodies' codes of ethics is the right place to look. These codes characterize what can be considered to be the image of business ethics. Codes of ethics should principally address the particularities of high risk activities and are built on the collective integrity of a profession as a resolution for the group's acknowledgment of the moral dimension. Ethical obligation in the corporate world is not all-inclusive, but what can be done is to consider any phenomenon that within a definite situation inspires ethical behavior (Micewski & Troy, 2006). Jenfa (2000); Nwagboso (2008) and Ogbonna & Appah, (2012), observed that professional ethics

offers accountants with these benefits: it aids the accountant to regulate the affluence of his behavior in his professional association; it provides clients and potential clients a basis of having confident that the professional frankly wishes to serve them well and places service above financial reward; this guide the kind of professional attitude the accountant must maintain if he is to thrive. It guarantee clients that standards of competence, independence and integrity shall remain the goal of the accountant; it allows member bodies and regulatory authorities to accomplish their obligation of ensuring that the professional accountants have the know-hows and capability expected of them by employees, clients and the public and public interest is safe and the integrity of the profession is enriched.

According to Johannes Brinkman (2002), ethics is the discipline that exhibits the matters related to evil and good, wrong and right, and vice and virtue. Therefore, ethics are used to examine moral principles, human behavior, and their efforts to distinguish between good and bad. The development of ethical codes within organizations can secure the fidelity of business transactions and financial processes, which in turn, affect employee performance, relationship, and credibility of the company.

Ethics in accounting is mainly known as applied ethics, which strongly emphasizes human and business ethics, judgments, moral values, and their application in accountancy. Generally, the major ethical drivers of accounting are an appropriate practice and a good standard of professionalism. According to Micewski and Troy (2006), the ethical responsibility within the business world is not holistic, but lies under the particular context of ethical behavior. A majority of the corporations in the world have instituted ethical issues in the accounting processes, which increases the potential for conflict of interest. Breach of ethical rules within the corporate finance practice, through financial misstatements, usually damages an organization’s reputation, customer satisfaction levels, and the trust of investors on the company.

Accounting is a profession that relies greatly on the basis to show a high sense of responsibility and stewardship, and this stress the need for all members to be steered by professional code of conduct (Nwagboso, 2008). These guidelines are summarized as below:

- Integrity: A professional accountant should be honest in their professional relationships and transactions
- Objectivity: Professional accountant should take into professional judgment and the realities your business and not allow prejudice, bias, conflict of interest or influence of others on the professional judgment and affect her work
- Professional competence and due care: Professional accountant should perform the service that it is possible to afford. A Professional accountant should have knowledge and skills in their professional development, new methods and techniques and etiquette to the level at which the employer or the employer has to ensure that the professional services efficiency
- Confidentiality: A professional accountant should the information obtained in the course of professional services without explicit permission of the employer or the employer's confidential and disclose such information unless or without the professional legal duty exposing the information on be permitted.
- Professional behavior-courtesy: A professional accountant should deal with each other when carrying out their duties, act with courtesy and respect. Must also comply with laws and regulations and to refrain from actions that would discredit the profession.

The role of accountants in regards to the timely and accurate preparation of financial reports is of significant importance to decision-making by investors, managers, and other senior management officials. Adherence to ethics in accounting also aids in ensuring compliance of internal control systems with standards. Therefore,

accountants can identify and measure resource wastage, investigate, and perform roles that can contribute to the improvement of policy formation and fraud identification in an organization (Elias, 2002). Unethical behaviors not only degrade the reputation and credibility of an individual, but the company as well, increasing the likelihood of criminal activities that could result in the decrease in profit levels (Sims, 2003).

Financial ethics is usually regarded as the greatest problem of the accounting profession. The fraudulent activities, in the financial set-up, occur when accountants and managers do not adhere to the standards of earnings management ethics. In such cases, managers and accountants alter financial information. This alteration usually entails the addition of predetermined results in the financial statements, which gives different results than the actual ones. This behavior of earnings manipulation within the accounting profession is usually referred to as earnings management (Ronen & Yaari, 2007). It leads to doubt, especially when fraudulent activities or data infringement take place. The social norms or the organizational culture linking earnings management ethics, play an extensive role in determining the norms observed in an organization. It is believed that the acts, amendments and the articles of Sarbanes-Oxley Act may help in bringing the ethical standards within the financial set-ups (Strohm, 2006). Failure to decrease organizational tolerance, to the levels of earnings management in response to the Sarbanes-Oxley Act, will result in a substantial discrepancy between an organization's culture and societal norms for earnings management behavior. Moreover, the professed control over ethical behavior includes factors related to the direct involvement of managers and accountants in earnings management.

Unethical behavior can be defined as behavior that is illegal or violates the moral standards of society. Actions of such behavior at the workplace would include stealing from the company, falsifying documents, sexually harassing colleagues, or paying bribes. Still, the line between ethical and unethical behavior is not always easy

to draw, and the task is even more difficult if we take into account the differences in moral standards between societies and cultures.

2.1.6 Accounting Fraud

Fraud in accounting can occur due to several conditions as explained by Cressey (1953) in Tuanakotta (2007: 207) mentioning the Fraud Triangle Theory, that corruption is caused by the existence of 3 factors namely pressure, opportunity and rationalization (razionalization). Generally accounting fraud is related to corruption. In corruption, actions that are commonly carried out include bribery, conflicts of interest, unauthorized gratitude, and economic extortion. Fraud behavior is explained by the Theory Triangle Fraud. Someone cheats because of pressure, opportunity and rationalization. According to Dorminey et al. (2012), the rationalization and pressure factors are characteristics of the perpetrators of accounting fraud that cannot be observed because it is impossible to know what the perpetrators are thinking when going to commit accounting fraud. According to Lou and Wang (2009) this rationalization is proxied by the gap in management integrity and bad relations between managers and auditors. In addition, the presence of opportunities or opportunities can cause the perpetrator to freely commit fraud. This can occur because of the weak internal control system within the government agency.

Meanwhile, Singleton and Singleton (2010) define fraud as a crime, where cheating is a general term that includes a variety of human shrewdness where one individual takes advantage of another through a wrong picture. Then, cheating is a mistake, where cheating is a deliberate action in giving a report about material facts that are wrong, so someone makes a wrong decision because they consider the facts to be true. There are two types of crime, namely:

- Fraud as a crime. Examination is a general term that includes a variety of human shrewdness where one individual takes advantage of another through the wrong picture.
- Fraud as a mistake. Objection is a deliberate act of giving a report about material facts that are wrong, so that someone makes a mistake in making a decision because they consider the facts to be true.

Expert, Amrizal (2004) underlines that basically the practice of accounting fraud will continue repeat in an entity if:

1. Internal control is absent or weak or carried out loosely and ineffectively.
2. Employees are employed without thinking about their honesty and integrity.
3. Employees are regulated, improperly exploited, misused or placed with great pressure to achieve financial goals and objectives that lead to action fraud.
4. The management model itself is fraudulent, inefficient and / or ineffective and not obey the laws and regulations that apply.
5. Employees who are trusted to have personal problems that cannot be solved normally financial problems, family health needs, excessive lifestyle.
6. The industry in which the company is a part, has a history or tradition of cheating.

In addition to all the definitions, fraud definition according to The Association of Certified Fraud Examiners (ACFE) is as, an intentional untruth or a dishonest scheme used to take deliberate and unfair advantage of another person or group of persons. It includes any means, such as surprise, trickery, or cunning, by which one cheats another. All the while, Albrecht et al. (2012: 9) stated that an easy way to classify fraud is to distinguish between fraud into 2 categories namely, fraud committed against organizations, such as the fraud committed by employees, where the victim of fraud are existing employees in the organization. The second type of fraud is that

committed in the name of the organization, for example, fraud on the financial statements by management to manipulate financial statements so that looks good. Victims of this fraud are the investors who own shares of the organization.

The Association of Certified Fraud Examiner (ACFE) Fraud classified into three (3) types, namely:

1. Abuse Asset (Asset Misappropriations), an act of theft or misuse of the organization's assets;
2. Corruption (Corruption), perpetrators of fraud using his powers improperly in carrying out business transactions in order to gain advantage for themselves or others, which are incompatible with their duties or violate the rights of others;
3. Fraud Report (Fraudulent Statement), including falsification of financial statements of the organization.

Fraud is a serious threat to the organization and should be prevented as early as possible. Fraud prevention methods that are commonly used by management in accordance with BPK (2008: 38), are:

1. Determination of the anti-fraud policy

   Policy organizational unit must contain a high ethical tone and should be able to create a work environment that is conducive to preventing acts of fraud and other economic crimes.
2. standard prevention procedures

   The commitment of management and policies of an organization is a key factor in preventing and detecting fraud. However, it must be equipped with preventive handling procedures in writing and set by default as the supporting medium. In general, prevention procedures should include:

   a. Internal control, among others, is the separation of functions so as to create conditions of mutual checks between functions.

b. System review and adequate for the operation of computer systems, allowing the computer to automatically detect fraud.

3. There is a procedure to detect fraud automatically (built-in) system, which includes the exis-tence of adequate procedures for reporting fraud are discovered and procedures were adequate to deposit each individual involved in fraud.

Lord Hirshall in the case of (Derry vs. Peek 1889) defines fraud as a misrepresentation made knowingly or without belief in its truth. Alongside, Micheal (1987) also defines fraud as any behavior by which one intends to gain advantage over the other. In family encyclopedia (1980) from its own perspective defines fraud as, an intentional criminal deception for the purpose of inducing another to part with something of value or to acquire something less than apparent value.

International Internal Audit Statement on internal audit also defines fraud as the "encompassing an array of irregularities and illegal act characterized by internal deception, it can be perpetrated for the benefit of the detriment of the organization by person outside as well as inside the organization. Also, the internal audit guideline (I.A.G) defines fraud "as a particular type of irregularity involving the use of deceit to obtain illegal or unjust advantage". The above definitions have therefore fully incorporated what fraud is all about.

Legally therefore, fraud may constitute embezzlement on larceny or both. It may be misdemeanor or a felony and it is always a crime or a tort. Fraud which so ever perspective one looks at it, should be accepted that it is an action which involves the use of deceit and seeks to alter the truth so as to deprive a person of something which he is entitled.

Despite the differences in the various definitions given above seems to emphasize the fact that fraud entails that it is an intentional perversion of truth in order

to induce another to part with valuable thing or right. In any case of fraud, there is an intentional misrepresentation of the truth or fact by an individual or group of individuals knowing same to be false which another party relies upon.

The consequences of financial statement fraud can be very unpleasant, sometimes even dramatic. The most common reasons for such fraud are managers' personal benefits. Those benefits are always gained at the cost of other interest groups, so managers are able to enjoy favourable results only in the short-run. In the longterm consequences are negative and mostly affect those who do not participate in the financial fraud. Damage can be direct and measurable in terms of realized loss or omitted gains, as well as indirect such as omitted dividends or capital gains. Opportunity costs in terms of omitted gains because the best investing alternative was rejected are good examples of certain damage which is not easily measurable. Financial statement fraud may be accomplished through:

1) Falsification of material facts, documents or business transactions,
2) False presentation of events, transactions, accounts, and other important information which is included in a financial report,
3) Deliberate wrong use of accounting principles, policies or procedures which serve to evaluate, recognize and record business transactions,
4) False presentation of financial information in financial reports. (Wells, 2005, p. 324).

Damage to the accounting profession due to financial statement fraud, although hardly measurable, is certainly significant. Despite enormous efforts this profession puts in establishing qualitative regulation, it is still impossible to develop perfect rules, and there is also creative interpretation of rules, as well as the unethical behavior of managers, accountants, and auditors. Lost trust in the quality of the financial reporting system and reliability of auditing opinion is an inevitable consequence. Since financial statements may have hidden losses, there is a huge risk for those who make decisions

on the basis of such information. Consequently, information risk increases the costs of accounting information.

Another aspect of the trusting culture is the belief that the business is too small to be targeted (Gagliardi, 2014). This is not true, because smaller organizations face the same vulnerability as their larger counterparts. However, because smaller businesses usually have less liquidity they are often experience a greater effect. Smaller businesses also have easier access to physical assets, which can put a business greatly at risk (Grollman & Colby, 1978).

In addition, because smaller businesses have fewer employees, many internal controls are more difficult to implement (Carland et al., 2001; Johnson & Rudesill, 2001; Wells, 2003; Kapp & Heslop, 2011; Laufer, 2011; Gagliardi, 2014). This means that internal controls, which are important for organizations of anysize, tend to be weaker within small private businesses. Because each employee tends to wear more hats, the implementation of internal controls systems is affected greatly. A good example of this is the difficulty in implementing segregation of duties, which will be discussed more within the literature review.

Staffing constraints also usually mean that small businesses lack awareness of fraud on the part of business owners and thus also lack fraud training for employees (Grollman & Colby, 1978; Laufer, 2011). Because the talents of most owners do not lie within finance or accounting realms, there is a lack of understanding of the relationship between internal controls and fraud. This in turn means that there is usually less management oversight, which is extremely important in preventing and detecting occupational fraud (Grollman & Colby, 1978).

According to Robertson (1996) fraud “consists of knowing or making material misrepresentation to a fact with an intention to inducing someone to believe to suffer a loss or damage. Fraud, involves the use of deception to obtain an unjust or illegal financial advantage (Okezie 1995). Agbadua (1980 as cited in Ogidefa, 2008) also

opined that fraud is an anti economic process and must properly be dealt with. Ade (1982) sees fraud as a virus which spreads from the banking sector to other economic activities and organization even the government. EFCC Act (2004) defines fraud as illegal act that violates existing legislation and these include any form of frauds, narcotic drug, trafficking, money laundering, embezzlement, bribery, looting and any form of corrupt malpractices and child labour, illegal oil bunkering and illegal mining, tax evasion, foreign exchange malpractice including counterfeiting, currency, theft of intellectual property and piracy, open market abuse, dumping of toxic waste and prohibited good (Aduwo, 2016). This definition is all-embracing and conceivably includes financial crimes in corporate organization and those discussed by various authors (Khan, 2005; William, 2005).

The Institute of Professional Practises Framework (Sommer, 2014) defines fraud as any illegal act characterized by deceit or concealment or violation of trust which do not directly depend on the use of violence, perpetrated in firms to obtain money, property, or services; to avoid payment or loss of services; or to secure personal or business advantage.

Accounting fraud has developed in various countries including Indonesia. In the USA accounting fraud has developed widely (Sobel, 1997: 1) Spathis (2002) explains that in the USA accounting fraud caused enormous losses in almost all industries. The disadvantage of accounting fraud in the capital market is the decline in the level of management accountability (Pritchard, 1999), making shareholders increase the cost of monitoring management. Generally accounting fraud is related to corruption. In corruption, actions that are commonly carried out include manipulating records, disappearing documents, and mark-ups that are detrimental to the country's finances or the country's economy.

2.2 Previous Studies

Table 2.1 Previous Study

Author & Year	Research Title	Purpose	Variables	Conclusion & Result
Santy Setiawan, 2018	The effect of Internal Control and Individual Morality on the tendency of Accounting Fraud	Determine the effect of Internal Control and Individual Morality on the tendency of Accounting Fraud.	Internal Control (X_1), Individual Morality (X_2), Accounting Fraud (Y)	Internal Control has no significant effect on Accounting Fraud, Individual Morality has a significant effect on Accounting Fraud.
Predita Arie Ayu Putri, Soni Agus Irwandi, 2016	The determinants of Accounting Fraud	To retest the effect of Internal Control effectiveness, Compensation System Suitability, Information Asymmetry, Adherence to Accounting Rules and Management Morality on Accounting Fraud Tendency	Internal Control (X_1), Compensation System Suitability (X_2), Information Asymmetry (X_3), Adherence to Accounting Rules (X_4), Management Morality (X_5), Accounting Fraud (Y)	Internal Control, Compensation System Suitability, Information Asymmetry, Adherence to Accounting Rules, and Management Morality all have a significant effect on Accounting Fraud Tendency.
Luminita Ionescu, 2010	Analysis of Corruption, Fraud and Internal Control	Analyzing the correlations between all three constructs, Corruption, Fraud and Internal Control	Corruption (X_1), Fraud (X_2), Internal Control (Y)	There are significant effect of Corruption and Fraud on Internal Control.

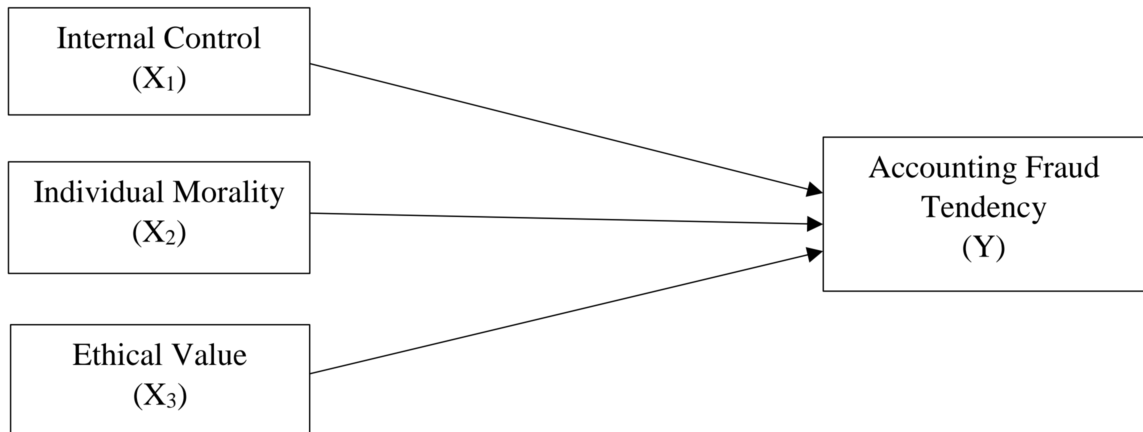
Loveday A. Nwanyanwu, 2018	Accountants' Ethics and Fraud Control in Nigeria: The Emergence of a Fraud Control Model	Analyzing the Ethical Code and Fraud Control on the Emergence of Fraud Control in Nigeria	Ethics (X_1), Fraud Control (X_2), Emergence of Fraud Control (Y)	There is a significant effect of Ethics and Fraud Control on the Emergence of Fraud Control
Paul Jaijairam, 2017	Ethics in Accounting. (Empirical Study of Accounting Firms in Bronx, New York)	Analyzing the Impact of Ethics in Accounting Practices.	Ethical Code (X_1), Sarbanes Oxley Act (X_2), Executive Responsibility (X_3), Accounting Practice (Y)	There is a significant effect of Ethical Code, Sarbanes Oxley Act and Executive Responsibility on Accounting Practices
Kristoffer R. Jackson, Daniel V. Holland, Chad Albrecht, Dave R. Woolstenhulme, 2010	Fraud Isn't Just For Big Business: Understanding the Drivers, Consequences, and Prevention of Fraud in Small Business	Analyzing the Impact of Fraud on Small Businesses, presenting the classical theory of fraud and describe how pressure, opportunity and rationalization facilitate fraudulent activity.	Classical Fraud Theory (X_1), Pressure (X_2), Opportunity (X_3), Rationalization (X_4), Protection Against Fraud (X_5), Fraud (Y)	There is a significant effect of Classical Fraud Theory, Pressure, Opportunity, Rationalization and Protection Againt Fraud on Fraud in Small Businesses.
Jasmine Smith, 2016	Accounting Information Systems: Ethics, Fraudulent Behavior, and Preventative Measures	Analyzing the effect of Ethics, Fraudulent Behavior and Preventative Measures on Accounting Information System.	Ethics (X_1), Fraudulent Behavior (X_2), Preventative Measures (X_3), Accounting Information System (Y).	There is a significant effect of Ethics, Fraudulent Behavior, Preventative Measures on Accounting

				Information System.
Madan Lal Bhasin, 2013	Corporate Accounting Fraud: A Case Study of Satyam Computers Ltd.	Analyze and Examine in-dept of the Satyam Computer's "creative accounting" scandal.	Accounting Fraud	The accounting fraud scandal in Satyam Computers Ltd was mostly triggered by unethical behavior and the lack of moral view adapted by the people running the company.
Lenka Chorvatovičová, Darina Saxunová, 2016	Usefulness of Financial Statements and Annual Reports in the process of Accounting Fraud Detection.	Presenting a comprehensive report on possible forms of fraudulent activities concerning financial statements, and to summarize or propose possible procedures to detect accounting fraud from publicly available financial statements concentrating on the assets misappropriation	Accounting Fraud	Accounting Fraud Detection can be processed faster and affect the usefulness of financial statements and annual reports based on the effectiveness of company's accounting policy that affect the flexibility of accruing and deffering revenues and expenses.
Beverly Jackling, Barry J. Cooper and Philomena Leung, 2007	Professional accounting bodies' perceptions of ethical issues,	Given the calls for increased ethics education following recent corporate	Professional Accounting Bodies (X_1), Ethical Issues (X_2), Ethical	Respondents identified a number of important challenges

	causes of ethical failure and ethics education.	collapses, aims to examine the significance of ethical issues that challenge the profession and, more specifically, professional accounting bodies.	Values (X_3), Ethical Failure (X_4), Ethical Education (X_5), Accounting Ethic Codes (Y)	including conflicts of interest, earnings management and whistle-blowing. The findings also demonstrate strong support for participation in prescribing the nature of ethics education by members of professional accounting bodies.

2.3 Research Framework

Figure 2.3 Research Framework



2.4 Hypotheses Development

2.4.1 The effect of Internal Control on Accounting Fraud Tendency

According to Ansori, et al. (2018), Internal Control is the key to organization in achieving its goal. With internal control running effectively, it creates the certainty of an organization being prevented from various forms of deviations and frauds that will obstruct the course of organization wheel. Joseph et al, (2015) in their study also recommended that the policy and procedure of effective and efficient internal control shall be applied correctly to prevent fraud in an organization. The fraud can easily occur in an organization that has weak and ineffective internal control system.

Meanwhile Stacey Mirinaviciene (2014) in her study stated that inefficient or non-existing internal control mechanisms have caused small businesses numerous problems and losses. Detailed analyses of fraud prevention techniques, employee training, and the implementation of internal control methods is critical. Implementing adequate internal control procedures such as employee hotlines can be very effective if the effort receives sufficient management attention. Based on her study analysis, the most important factors in decreasing fraud and its impact on businesses and the economy as a whole is fraud prevention. Fraud prevention can not only decrease damages from it but also eliminate fraud completely, if those interventions are applied properly. Selected data mining techniques can help in early detection of fraud indicators and minimize fraud instances. Fraud prevention does not have to require extensive resources from businesses to be effective.

Dragomir Dimitrijevic, *et al*. (2015) in their study stated that Preventive techniques used by internal control ease the job of detecting frauds. These techniques are a necessary part of the overall process, because if used correctly, the chances of fraud detection increase. They should be treated with much attention, because their adequate implementation increases the quality of business performance and control. Internal control should gradually implement new methods for fraud prevention.

Nevertheless, internal control should at least consult other controls while handling fraud inorder to increase the quality of a company’s defense mechanisms.

H_1: There is an effect of Internal Control System on Accounting Fraud Tendency

2.4.2 The effect of Individual Morality on Accounting Fraud Tendency

Junaidi and Maulidani Ubaidillah (2018), in their study explained the importance of individual morality and the importance of morality because it affect individual’s action that’s taken within. They also stated in their study that individual with high-internalized moral norms are less likely to commit a fraud, and vice versa, individual with low internalized moral norms are more likely to commit a fraud. Based on their developed theory, individuals develop opinions about moral issues according to their innate opinion of wrong/right, opinions of influencing individuals around them and opinions of others through the individual’s perception and experiences in expected outcomes.

Meanwhile, Predita Ayu Putri along with Soni Agus Irwandi (2016) explained very thoroughly in their study on the importance of moral and the level of morals in each individuals could easily prevent fraudulent behavior as it is helping an individual seeing what’s right and wrong in different situations. Good implementation of morality in each individuals helps the company or corporate to prevent damage by accounting fraud in their workplace.

H_2: There is an effect of Individual Morality on Accounting Fraud Tendency

2.4.3 The effect of Ethical Value on Accounting Fraud Tendency

In his study, Loveday Nwayanwu (2018) stated that consequently, a fraud control model was developed highlighting the national value system factor in fraud management. The people’s behavioural pattern and philosophy anchored on ethical

considerations should reflect honesty, integrity and value of knowledge. Meanwhile, Jasmine Smith (2016) in her study explained the relations of Ethical Value and Accounting Fraud, by stating that In the accounting discipline, professional standards have been created to inhibit accounts from engaging in unethical behavior. Such standards play an important role in accounting because accounting processes aid management in decision-making processes that impact a wide range of other individuals and the organization as a whole.A cornerstone of ethical behavior is an understanding of how one's personal behaviors and actions impact the welfare of the other individuals. Ethical guidelines can help individuals avoid harming others and to act in ways that have the potential to help or aid others. Some government regulations are designed to minimize some forms of unethical behavior and also enact laws to deter illegal behavior. In society, social norms are often implied ethical guidelines that tend to change in response to different environments, communities, and the passage of time.

Paul Jaijaram (2017) also expressed his concern towards Ethical Value on Accounting Fraud through his study, declaring that A majority of the corporations in the world have instituted ethical issues in the accounting processes, which increases the potential for conflict of interest. Breach of ethical rules within the corporate finance practice, through financial misstatements, usually damages an organization's reputation, customer satisfaction levels, and the trust of investors on the company. Ethical value is really important in a business, especially for accountants, seeing as accountants are responsible for producing accurate, concise, and timely financial reports, must uphold the highest standards of ethical responsibility

H_3: There is an effect of Ethical Value on Accounting Fraud Tendency