DETERMINANT FACTOR INFLUENCING THE LEVEL OF FRAUD AND IMPLICATION TO QUALITY OF FINANCIAL REPORTING (RESEARCH AT LOCAL GOVERNMENTS INDONESIA)

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Abstract: This research contained the factors influencing the level of fraud and the implications to the quality of financial reporting. Many findings in the audit result of financial reporting of local government (LKPD) showed that there were laxity and fraud occurred in local governments. The objectives of this research were to investigate the function of internal audit, top management support to the level of fraud and the implications to the quality of financial reporting. The research used primary and secondary data of 108 respondents from 36 local governments in Central Java, Indonesia. The research was conducted in 2016. The method of data processing used was SEM PLS. The results of this research were (1) The effectiveness of the internal audit function has negative and significant influence to the level of fraud. (2) Top Management Support has negative and significant influence to the level of fraud. (3) The level of fraud has negative and significant influence to the quality of financial reporting.

Keywords: Internal audit function effectiveness, top management support, level of fraud, quality of financial reporting.

1. INTRODUCTION

Financial reporting is an important part of accounting process for measuring and assessing of an entity’s performance (Belkaoui, 2012). The common objective of financial reporting is to give information about financial position of reporting entity, that is information about economic resource of entity and claim to entity rapporteur (FASB, 2010), to show responsibility of management for the use of resource which is free from fraud and to lay open information of finance according to real situation (Belkaoui, 2012) and to be able to fulfill requirement of all decision makers to use it (Staubus, 2005). Furthermore, qualified financial reporting will yield worthwhile information for its users, that is information fulfilling characteristic of qualitative information or characteristic of qualified information of finance. (IPSASB, 2014;
Belkaoui, 2012; Jonas and Blanchet, 2000; Mc Daniel, et al., 2002; SFAC No. 8, 2010; Tasios and Bekiaris, 2012).

Financial reporting also functions as responsibility (accountability) and a tool to increase the value of the entity. In general, financial reporting which is qualified and clear of elements of fraud makes more precise economics decision for the users (Kaplan et al., 2010). Fraud and scandal of accountancy happens because of some factors, among other things is the weakness of the mechanism of corporate governance (Cohen et al., 2004). Fraud can also occur because of either false, incomplete or bias information of financial statement of a company (Boynton et al., 2006). The false information occurs because two possibilities, namely the existence of fraud and mistakes (errors). Mistakes are done involuntary and without intention to harm whereas fraud is conducted on purpose (Messier et al., 2008; Coram et al., 2006).

In Indonesia, problem of fraud has progressively increased after governance reform started since the Law (UU) No 32 year 2004 was in effect. The law consists of the change of governance management of which used to be centralized into decentralized pattern. Local governments are given extensive authority to manage and use the local potency of the area with real responsibility. The law obliges the central government and local government to make financial report in every account for execution of national and local government budget.

The fact is, after more than a decade, decentralization shows varied phenomenon. In one side, it shows positive results compared to there a before decentralization such as economic growth improvement of the area, transparency and local government political empowerment, administration and also economic (Adi, 2005), but on the other side, there are a lot of indications of authority abuse after decentralization.

Phenomenon that has been occurring from the data of Reporting Center and Monetary Transaction Analysis (PPATK) mentions that the uncovering of corruption case in local governments have been bigger compared to central government (Wasisto Raharjo, PPATK, 2013). Denny Indrayana (2014) as the Vice Minister of Law and the Human rights stated that by January 2014, there were 318 heads of local governments and vice head of local governments of 524 people being accused of corruption. The survey result of public sector integrity conducted by Corruption Eradication Commission (KPK) in 2013 also showed that the average value of local government integrity index was below the central government, that equals to 6.82 while the central government’s integrity index equals to 7.37. The value shows the effort to improve public service sector and service unit in Local government hasn’t been optimum in fighting corruption.

The efforts to improve the management of the country’s finance based on standard of performance of auditors’ opinion by Monetary Board Of Examiners of Republic of Indonesia (BPK RI) about the equity of presentation of financial report...
of local government have been improving, yet it hasn’t reached the expected goals. In 2009, only 3% local government obtained fair opinion without exemption and became 47% of local governments in 2014. Ministry of Home Affairs, Tjahyo Kumolo (2014) mentioned that in semester 1 only 36% of local governments are capable to justify financial report properly. This matter disagreed with government’s goals, as according to statement of vice president Budiono (2012), about three hundred local government (64%) should have got fair opinion without exemption (WTP).

Survey conducted by ACFE (2014), showed the weakness of internal control is the main cause of fraud. Doyle, et al., (2007). The system of internal control is the foundation of qualified financial reporting. The objective of internal control system can be reached by internal audit as the guarantee of the accomplishment of objectives of internal control (Sawyer, 2009; Mihret And Yismau, 2007; INTOSAI, 2010). The effective function of internal audit is the one that can reach internal audit objective, that is to improve internal effectiveness and efficiency of control in an organization (Cangemy and Singleton, 2003; Cohen and Sayag, 2010; Eden and Moriah, 1996). According to Rezaee and Riley (2010), internal audit improves organizational operation and lessens the possibility of negative matter included in financial reporting which cannot be counted on.

Besides internal audit, Weells (2004) stated that one of the most influential matters to occupational fraud is top management support. From another point of view, superior officials as parts of an organization as decision makers, also have an effect on the prevention and detection of fraud. (Rezaee, 2010). The National Commission on Fraudulent Reporting (the Tread way Commission, 1987) reported causality factor connecting fraudulent behavior and the deception of financial reports. Tone of the top plays important role in creating an environment where the fraud of financial reporting may take place.

Rezaee and Riley (2010) stated that quality of good reporting, including the reliability of financial reporting, free from the mistakes/ error of presentation caused by error and fraud, when the balance of function of system governance takes place. This system consists of top management team, internal auditor, external auditor, board of directors, audit committee, and other institutions which issue regulations about financial reporting. The factors will form “six legged stool” to support responsible management and reliability of accountancy data. Other researchers relate fraud with quality of financial reporting conducted by Agrawal and Chadha, (2005); Jonas And Blancet, (2006); Belkaoui (2012); Asare, 2003; Tak Isa, (2011).

Based on the description that has been presented, the authors considered it is important to do some research as outlined by research factors influencing on level of fraud and its implications on quality of financial reporting. The purpose of this study was to determine and to obtain empirical evidence and to get an answer how much is the influence of effectivity of the function of internal audit and top
management support in the level of fraud and the implications to the quality of financial reporting.

This paper will be organized after this section into some explanations as follows: the literature review, conceptual framework, study model and hypothesis, conclusion, implication include references.

2. LITERATURE REVIEW

Internal Audit Function Effectiveness

The International Federation of Accountants (IFAC, 2010) stated that the function internal audit effectiveness includes review executed systematically, assessment and reporting for reliability and effectiveness of applying system of internal operation, finance, operational management and budgeting. Meanwhile internal audit function according to International Standard of Auditing (ISA) 610 (2009) and The International Standards of Supreme Audit of Institutions (ISSAI) 1003 (2010) is an appraisal activity established or provided as a service to an entity. This function includes examining, evaluating and monitoring the adequacy and effectiveness of Internal control. Moeller (2010) stated that the functions of qualified internal audit include: the level of compliance with IIA standards, the ability to make an audit of plan (ability in planning inspection), execute audit findings, communicate audit findings. The functions of internal audit will be effective if they add value to the organization (IIA, 2011; Hiro Tugiman, 1997; Nagy And Chenker, 2002; Allegrini et al., 2006) and reach the desired target (Cohen and Sayag, 2010). The objective of internal Audit is to improve organizational effectiveness and efficiency (Eden And Moriah, 1996).

Based on opinions from various existing study and source, internal audit function effectiveness is the level of achievement of organizational function of internal audit in conducting qualified inspection, through professional skills of internal auditor, conducting organizational management, and giving contribution to value added for organization. (Moeller, 2010; Hiro, 2006; IIA, 2010; Cohen and Sayag, 2010; Mihret and Yismaw, 2007).

Top Management Support

Management support according to Mathis and Jackson (2006:114), is anything given and specified by a company to support the working process. According to Mandayanake (2014) top management support is a sequence of actions conducted by top management that brings profit by involving in managerial role. According to COSO (2013), if the performance of the head of organization is good, hence all main components of management will be built in and permeated in management process. COSO admits a “tone on the top”, therefore the head of the organization
remains to be emphasized to take very important role in running the organization. Rezaee and Rilley (2010) stated that management is responsible to make sure quality, integrity, and reliability from finance and business report. In the case of reporting processes finance, management can prevent, and detect the existence of financial fraud in company.

Top management support is whatever is given and specified by management in order to provide resources and management commitment to support activity in an organization through detection of fraud and prevention (Mathis and Jackson, 2004; Cohen and Sayag, 2010; Mihret and Yismau, 2007; Rezaee and Rilley, 2010). While dimension in the form of ready support of resources (human, equipments/technology, budget), and the commitment of management to strengthen internal audit in preventing and detecting fraud.

Level of Fraud

Level of fraud is a specific factor of deception, violation of trust by the wrong presentation in the form of fraudulent financial statement, miss appropriation asset, and corruption that cause risk of finance in company (Arens, 2014; IIA, 2013: ACFE 2014: Belkaoui 2012, Beasley et al., 1996; Dorminey, 2012; Ricchiute, 2006; Singleton and Singleton, 2010). ACFE (2014) classified occupational fraud by using term “fraud tree”. On the other side, Arens et al., (2014) classified fraud into 2 main categories: fraudulent financial reporting (an intentional misstatement or omission of amounts or disclosures with the intent to deceive users) and misappropriation of asset (fraud that involves theft of an entity’s assets).

Moeller (2010) stated that existence of fraud can be seen by looking at the symptoms as indirect evidence, along with the change of life style or behavior, suspicious documentation, complaints from customers or clients or suspicion from colleagues. The existence of fraud can be reflected through the appearance of certain situational characteristic, like environmental condition, and somebody’s behavior which is an indicator of fraud or often called red flag. ACFE, (2010) stated that red flag is not always an indication of fraud, but red flag usually appears in every case of fraud. The dimension from the level of fraud is symptom and red flag fraudulent financial reporting, miss appropriation of asset and corruption. (Arens, 2014; Ricchiute, 2006; Singleton and Singleton, 2010; Dorminey, 2012).

Quality of Financial Reporting

Kieso et al., (2012:4) financial reporting is the accuracy of financial reporting to inform the information about the company operation, especially to the expected cash flow so that investors can make investment decisions. Verdi (2006), stated that the quality of financial reporting as “the precision with which financial reports convey information about the firm’s operations, in particular its cash flows, in of order of to
inform equity investors”. Other researchers define the quality of financial reporting as “the extent to which the financial statements provide true and fair information about the underlying performance and financial position”, (Tang et al., 2008). However, Jonas and Blanchett (2000), stated that “... quality financial reporting is full and transparent financial information that is of note of designed to obfuscate or mislead users”. From some previous statements, it can be concluded that financial reporting quality is the extension of qualified information conducted by an entity about the result of company operation to be used by consumers as decision taker. (Kieso (2012); Suwardjono (2006:190); Verdi (2006), Tang et al., (2008); Jonas and Blanchett (2000).

3. STUDY MODEL AND HYPOTHESIS

Based on the theoretical framework just described, then the model of the research is as below:

![Figure 1: Theoretical Framework of The Study](image)

**The Influence of Internal Audit Function Effectiveness to Level of Fraud**

The Influence of internal audit function effectiveness to the level of fraud has been tested empirically by so many researches. According to Rezaee and Riley (2010: 206), the prevention and the detection of fraud is done by internal auditors who take parts in assessing organizational effectiveness, giving input to improve continuously better performance, and conducting observation on quality, integrity and reliability on financial reporting. Emanuel et al., (2013) stated that internal audit in Kogi effectively can check fraud and fraudulent activity in Public Sector. Internal control in the state is very weak; unreliable auditing procedure and financial reporting due to political matters and the weak skills of auditing staff.

Church et al., (2001) stated that internal auditors recognize various significant variations of fraudulent financial reporting. There is a positive link between internal experience of auditor and the trust of clients in the detection of fraud. The survey result of KPMG (2010) also explained that, factors causing the increase of fraud are the weakness of internal audit, the degradation of ethical and failure in preventing and detecting fraud.
Hypothesis 1: There is a negative influence between the effectivity of internal audit function and the level of fraud in local governments.

Influence of Top Management Support to Level of Fraud

Zahra et al., (2007) researched the influence of top management support to the level of fraud, the cause and the effect of fraud done by top management. The fraud of top management can include mistakes done on purpose in financial reporting. Managers can make scheme to hide or describe what the company does or how the company does it. Ramamoorti (2008) expressed that there is an influence of top management support to fraud. Top management support can be in the form of coherent action to respond to incidents so that the employees realize serious management support to handle fraudulent problem in organization. COSO (1992) outlined that in an organization, tone of the top is necessary as one of matters that includes moral guidance about what is right or wrong and way to decrease fraud.

Research containing the influence of executive opinion in an organization connected to fraudulent financial reporting(Teresa, 2006). Executives are responsible to company culture, finance incentive, moral behavioral in fraudulent financial reporting. Bull, Ivan (1991) researched the relationship of board of the director with fraudulent misstatement of financial statement. Management Support in an organization, the effectiveness of internal auditor and the observation is the way of to prevent fraud. Krawiec (2005) in his research result said that in an organization, there are three mechanisms namely the organizational culture, and incentive reward system, and top management support to overcome organizational misconduct in the company.

Hypothesis 2: There is a negative influence between top management support and level of fraud in local governments.

Influence of Level of Fraud to Financial Reporting Quality

Agrawal and Chadha (2005) highlighted the wave of scandals of accountancy in international finance community and the influence to the quality of financial reporting. According to Rezaee and Rilley (2010) with the prevention and detection of fraud in financial reporting conducted by internal auditors and auditing committee, the observation on quality, integrity and reliability of financial reporting will be kept well. Jonas and Blancet (2006) stated that the factors which can degrade quality of financial reporting are: earning management, income smoothing, financial restatement, and the accountancy insincerity

Belkaoui has an opinion (2012) that financial report cannot be made up or designed because it can give bias and misleading information such as those that happened in the practice such: (a) The selective financial misrepresentation
hypothesis, (b) income smoothing, (c) earning management, (d) creative accounting, and (e) accounting fraud which can degrade the quality of financial reporting. Tak Isa (2011) linked fraud in financial reporting in real economics. Prevention and early detection of fraud in financial reporting with control mechanism and strengthen accountancy standard. Accurate financial information, transparency and reliability will give opportunity to investors in determining investment decision.

Hypothesis 3: There is negative relationship between the level of fraud and the quality of financial reporting in local governments.

4. MATERIAL AND METHODS
The method used is verificative research and explanatory research or causality in that this research aims to determine that one variable causes changes to another variable (Sekaran and Bougie, 2013: 98). The study using cross-sectional studies/research study which is conducted by only once collecting data, could be daily, weekly, or monthly, in order to answer the research statement (Sekaran and Bougie, 2013: 106).

Methods of Data Analysis
This research used primary and secondary data. Primary data was collected using a questionnaire as a research instrument and secondary was derived from BPK RI as audit agency. After doing the tabulation of data, then it was analyzed by the method of Structural Equation Modeling (SEM) with Partial Least Square (PLS). The respondents in this research are 108 people with analysis unit of 36 local governments in central Java, Indonesia. The respondents are the head of inspectorate, the chairmen of auditing team dan the local government unit leaders, and treasurers. This research was carried out 2016.

Operationalization of Variables
1. Effectiveness of Internal Audit Function (X1), dimensions of the effectiveness of the internal audit function by Cohen (2010); Moeller (2010); Hiro (1997); IIA (2010) is the internal audit quality, auditor professional capability, organizational settings, and contribution of value-added internal audit.

2. Top management support (X2), the dimension of top management support is the support of resource availability and management commitment. (Mathis and Jackson (2004), Cohen and Sayag (2010). Mihret and Yismau (2007) Rezaee and Rilley (2010)).

3. Level of Fraud (Y), are specific factors of fraud, breach of trust by misstatements characterized in the form of fraudulent financial statement, misappropriation
 assets, and corruption that led to the company’s financial risk (Arens 2014; IIA, 2013: ACFE 2014: Belkaoui 2012, Beasley et al., 1996; Dorminey, 2012; Ricchiute, 2006; Singleton and Singleton, 2010).

4. Level of fraud (Z) is specific factor of fraud, the violation of trust with the wrong presentation in the form of fraudulent financial statement, miss appropriation asset, and corruption that cause the financial risk in a company (Arens, 2014; IIA, 2013: ACFE 2014: Belkaoui 2012, Beasley et al., 1996; Dorminey, 2012; Ricchiute, 2006; Singleton and Singleton, 2010). Dimensions of the level of fraud are symptom and red flag of fraudulent financial reporting, missappropriation asset, and corruption.

5. RESULTS

This research tested the effectiveness of internal audit function, Top management support to the level of fraud and the implications to the quality of financial reporting by using method of data processing of SEM Partial Least Square. There are two models formed namely measurement model and structural model.

Measurement Model (Outer Model)

Measurements using Partial Least Square estimation method, obtained full path diagram models, measure the influence of the effectiveness of internal audit function and the top management support to the level of fraud and the implications to the quality of financial reporting.

Figure 2: Full Model
The Influence of The Internal Audit Function Effectiveness, Top Management Support To Level of Fraud Dan the Implications to the Quality of Financial Reporting
Table 1

<table>
<thead>
<tr>
<th>No</th>
<th>Var</th>
<th>Dimension</th>
<th>Loading factor</th>
<th>( R^2 ) (O^2)</th>
<th>Dimension</th>
<th>AVE</th>
<th>CR</th>
<th>Construct</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
<td>(5)</td>
<td>(6)</td>
<td>(7)</td>
<td>(8)</td>
<td>(9)</td>
</tr>
<tr>
<td>1</td>
<td>X1</td>
<td>KA</td>
<td>0.925</td>
<td>0.067</td>
<td>0.86</td>
<td>Valid</td>
<td>Reliable</td>
<td>0.866</td>
</tr>
<tr>
<td>2</td>
<td>X2</td>
<td>KPAI</td>
<td>0.972</td>
<td>0.019</td>
<td>0.95</td>
<td>Valid</td>
<td>Reliable</td>
<td>0.863</td>
</tr>
<tr>
<td>3</td>
<td>X3</td>
<td>PO</td>
<td>0.890</td>
<td>0.038</td>
<td>0.79</td>
<td>Valid</td>
<td>Reliable</td>
<td>0.874</td>
</tr>
<tr>
<td>4</td>
<td>X4</td>
<td>KNT</td>
<td>0.931</td>
<td>0.038</td>
<td>0.87</td>
<td>Valid</td>
<td>Reliable</td>
<td>0.916</td>
</tr>
<tr>
<td>5</td>
<td>X5</td>
<td>SD</td>
<td>0.924</td>
<td>0.018</td>
<td>0.85</td>
<td>Valid</td>
<td>Reliable</td>
<td>0.898</td>
</tr>
<tr>
<td>6</td>
<td>X6</td>
<td>KM</td>
<td>0.934</td>
<td>0.019</td>
<td>0.87</td>
<td>Valid</td>
<td>Reliable</td>
<td>0.908</td>
</tr>
<tr>
<td>7</td>
<td>Y1</td>
<td>FFR</td>
<td>0.881</td>
<td>0.067</td>
<td>0.78</td>
<td>Valid</td>
<td>Reliable</td>
<td>0.916</td>
</tr>
<tr>
<td>8</td>
<td>Y2</td>
<td>MA</td>
<td>0.977</td>
<td>0.008</td>
<td>0.96</td>
<td>Valid</td>
<td>Reliable</td>
<td>0.842</td>
</tr>
<tr>
<td>9</td>
<td>Y3</td>
<td>CO</td>
<td>0.942</td>
<td>0.028</td>
<td>0.89</td>
<td>Valid</td>
<td>Reliable</td>
<td>0.924</td>
</tr>
<tr>
<td>10</td>
<td>Z1</td>
<td>REL</td>
<td>0.916</td>
<td>0.026</td>
<td>0.84</td>
<td>Valid</td>
<td>Reliable</td>
<td>0.829</td>
</tr>
<tr>
<td>11</td>
<td>Z2</td>
<td>AND</td>
<td>0.948</td>
<td>0.016</td>
<td>0.90</td>
<td>Valid</td>
<td>Reliable</td>
<td>0.898</td>
</tr>
<tr>
<td>12</td>
<td>Z3</td>
<td>DPT DIBD</td>
<td>0.898</td>
<td>0.034</td>
<td>0.81</td>
<td>Valid</td>
<td>Reliable</td>
<td>0.874</td>
</tr>
<tr>
<td>13</td>
<td>Z4</td>
<td>DPT DIPHIM</td>
<td>0.874</td>
<td>0.041</td>
<td>0.76</td>
<td>Valid</td>
<td>Reliable</td>
<td>0.977</td>
</tr>
</tbody>
</table>

Source: Primary data processed (2016)

Based on the evaluation measurement model second order, it can be concluded that, (1) the relationship of the four dimensions EFAI to construct EFAI having the biggest estimation value is KPAI that equals to 0.972; (2) the relationship of both dimension DMP to construct DMP having the biggest estimation value is management commitment that equals to 0.936; (3) the relationship of five dimensions TK to construct TK having the biggest estimation value is management asset that equals to 0.942; (4) the relationship of four dimensions KPK to construct KPK having the biggest estimation value that equals to 0.948.

The four variables used a reflective measurement model; the measurement used the validity of dimensions. Dimensions of a construct rated as good, if it has a limit of validity convergence AVE worth 0.5 upwards. Second, the reliability of the dimensions. According to Hair et al., (2014: 103). Reliability of a dimensional views of the value of \( R^2 \) each dimension. Dimensions with \( R^2 > 0.5 \) are considered to have good reliability, between 0.3 and 0.5 poor reliability, and below 0.3 is considered unreliable. Third, Dimensions per construct validity convergence. The
construct validity of convergence is good if it has a value greater AVE 0.5 (Hair et al., 2014: 103).

**Structural Model (Inner Model)**

Structural model is a model that links the latent variables exogenous to endogenous latent variables or endogenous variable relationship with the other endogenous variables. Here’s a summary of the values used in the structural model.

<table>
<thead>
<tr>
<th>Sub Structure</th>
<th>Cause</th>
<th>Effect</th>
<th>Estimate</th>
<th>T test</th>
<th>P value</th>
<th>VIF</th>
<th>R Square</th>
</tr>
</thead>
<tbody>
<tr>
<td>First</td>
<td>IAF</td>
<td>LOF</td>
<td>-0.491</td>
<td>3.583</td>
<td>0.000</td>
<td>2.178</td>
<td>0.808</td>
</tr>
<tr>
<td></td>
<td>TMS</td>
<td>LOF</td>
<td>-0.474</td>
<td>3.507</td>
<td>0.000</td>
<td>2.173</td>
<td></td>
</tr>
<tr>
<td>Second</td>
<td>LOF</td>
<td>QFR</td>
<td>-0.780</td>
<td>11.863</td>
<td>0.000</td>
<td>1.000</td>
<td>0.609</td>
</tr>
</tbody>
</table>

Source: Primary data processed (2016)

The effectiveness of internal audit function and top management support give influence to the level of fraud as much as 80.8%. The rest 19.2% are explained by other factors. While the level of fraud affects the quality of financial reporting as much as 60.9% the rest is explained by other factors as much as 39.1%.

**Sub structure 1:** The Influence of Internal Audit Function Effectiveness And Top Management Support to Level Of Fraud.

<table>
<thead>
<tr>
<th>Endogenous Constructs</th>
<th>Exogenous Constructs</th>
<th>Error variance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Level of Fraud</td>
<td>IAF</td>
<td>-0.491</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(3.583)</td>
</tr>
<tr>
<td></td>
<td>TMS</td>
<td>-0.474</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(3.507)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>0.192</td>
</tr>
</tbody>
</table>

The test result shows that the coefficient of the influence of internal audit function effectiveness equals to -0.491, while if seen from $P$ value 0.000 < 0.05 so it can be concluded that the effectiveness of internal audit function has negative influence to the level of fraud in a significant level 95%. Ho was rejected and Ha was accepted.
Table 5
Result Test of Influence Top Management Support to Level of Fraud.

<table>
<thead>
<tr>
<th>Path Coef</th>
<th>$T_{count}$</th>
<th>$P$ value</th>
<th>Ho</th>
<th>Ha</th>
</tr>
</thead>
<tbody>
<tr>
<td>-0.474</td>
<td>3.507</td>
<td>0.000</td>
<td>Rejected</td>
<td>Accepted</td>
</tr>
</tbody>
</table>

The test result shows that the coefficient of top management support equals to -0.474, while if seen from $p$ value 0.000 < 0.05 so it can be concluded that top management support has negative influence to the level of fraud in a significant level 95%. Ho was rejected and Ha was accepted.

Sub Structure 2: The Influence of Level of Fraud To The Quality of Financial Reporting.

Table 6
Structural Equation, The Influence of The Level of Fraud to the Quality of Financial Reporting.

<table>
<thead>
<tr>
<th>Endogenous Constructs</th>
<th>Exogenous Constructs</th>
<th>Error variance</th>
</tr>
</thead>
<tbody>
<tr>
<td>QFR</td>
<td>LOF -0.780 (11.863)</td>
<td>0.391</td>
</tr>
</tbody>
</table>

The level of fraud affects the quality of financial report as much as 60.9%. While the rest 39.1% is explained by other factors.

Table 7
Result Test of Influence Level of Fraud to The Quality of Financial Reporting.

<table>
<thead>
<tr>
<th>Path Coef</th>
<th>$T_{count}$</th>
<th>$P$ value</th>
<th>Ho</th>
<th>Ha</th>
</tr>
</thead>
<tbody>
<tr>
<td>-0.780</td>
<td>11.863</td>
<td>0.000</td>
<td>Rejected</td>
<td>Accepted</td>
</tr>
</tbody>
</table>

The test result shows that the coefficient of level of fraud to quality of financial reporting equals to -0.474, while if seen from $p$ value 0.000 < 0.05 so that it can be concluded that level of fraud has a negative influence to the quality of financial reporting in significant level 95%. H0 was rejected and Ha was accepted.

6. DISCUSSION

Influence of Internal Audit Function Effectiveness to Level of Fraud

The first hypothesis in this research is that internal audit function effectiveness has negative influence to level of fraud. Result of hypothesis test showed the value of coefficient of the influence of internal audit function effectiveness equals to -0.491 with the level of significance 95%. Hence, Ho was refused and Ha was accepted. The result of this research gives empirical evidence that the bigger is internal audit function effectiveness, the lesser the level of fraud at Regency/Town in Provinsi
Central Java will be. This matter is in agreement to theory proposed by Rezaee and Riley (2010:133) that activity of internal auditor prevents and detects the fraud in an organization. The same case survey conducted by KPMG (2010) also explained that, the weakness of internal audit is the main factor causing the increased number of fraud. Other arguments stated that Auditor can lessen the possibility of the fraud in financial reporting. (Beasley et al., 2000). Furthermore, the same research as Church et al., (2001), Tak Isa et al., (2012), Burnaby et al., (1998) that internal audit function can decrease the level of fraud.

Seen from the influence of internal auditor function to the level of fraud with the influence coefficient equals to -0.475 valued as moderate. Although internal audit function has been effective, there are some weaknesses due to many auditory findings on LKPD. (Hadi Purnomo, 2011) and the positions of government internal supervisor (APIP) which are under government agency leader, either regional leaders or ministers make the internal auditors less independent to do the examination. (Azwar Anas, 2014). Other weaknesses are caused by the lack of auditors, lack of additional education and certification trainings followed by auditors.

**The Influence of Top Management Support to Level of Fraud**

The second hypothesis in this research is that the top management support has a negative influence to the level of fraud. The result of hypothesis test conducted to test whether it is different than zero. The coefficient value of top management support equals to -0.474. From the test, it can be concluded that top management support has a negative influence to the level of fraud. The result of this research gives an empirical evidence that the stronger is the top management support, the lesser level of fraud will be. This matter is in agreement to Rezaee and Riley (2010), stated that in process of financial reporting, management can prevent, and detect financial fraud in the institution. Seen by the resources required by management in the form of technology and equipments, and the budget for internal auditors the number of auditors and the budget auditor for internal auditor are very necessary (Cohen and Sayag, (2010); Alzeban and Gwilliam (2011); Mathis and Jackson (2004; 114)).

The result of this research is supported by stewardship theory that defines the situation where the managers are not motivated by individual objectives, but organizers whose motives are coherent with the principal objective and developed as a management alternative for the agency theory (Davis, Donaldson and Schoorman, 1997). Ramamoorti (2008) mentioned the influence of top support management to the level of fraud. Top management support can be in the form of strict actions in response to fraud so that the employees realize serious support of management to handle problems of deception in organization. Baloyi (2005) expressed that top management support is a mean of preventing, detecting fraud by employees. Krawiec (2005) in his result of research mentioned that in one organization there
are three mechanisms namely the organizational culture, incentive and reward system, and top management support to overcome organizational misconduct in a company. COSO (1992) described in organization the existence of a tone of the top is required as one of moral conducts about what is right or wrong and a way of decreasing fraud. Tone of the top also prevents fraud by making sure the value system owned by all organizational members. (Thomas et al., 2003). As also mentioned in Gillet and Udin (2005); Albrecht et al., (2004)

The Influence of Level of Fraud to the Quality of Financial Reporting

The third hypothesis in this research is that the level of fraud has a negative influence to the quality of financial reporting. The result of hypothesis test was conducted to see if it is different than zero. The coefficient value of level of fraud has negative influence to the quality of financial reporting it is explained that all changes in one standard deviation of governmental management will change quality of financial reporting that equals to 0.78 standard deviation. Result of this research gives empirical evidence that the lower the level of fraud is, the better quality financial reporting will be in Regency/ Towns in Central Java Province.

Result of this research is in line with Rezaee and Riley (2010:206) that with detection and prevention existence fraud in financial reporting done by internal auditors, hence the quality observation, and reliability of financial reporting will be kept well. Jonas and Blancet (2006) stated that one of factors which can degrade reporting keuangan is accounting fraud). Belkaoui (2012) also stated that financial reporting may not be altered or designed because it can give bias and misleading information as occurs in the practices of: (a) The selective financial misrepresentation hypothesis, (b) income smoothing, (c) earning management, (d) creative accounting, and (e) accounting fraud which can degrade financial reporting quality. Tak Isa (2011) also connected fraud in financial reporting in real economics. Preventing and early detecting of financial reporting by controled mechanism and strengthen accountancy standard, accurate finance information, transparent and reliable.

The influence of level of fraud to quality of financial reporting is also seen from finding result from governmental financial reporting inspection result. Most of the are missappropriation asset especially deals with remaining asset, which is still consideres akun exempted account or assumed factious in the opinion of financial reporting of local governments. This matter is related to the number of asset problems faced by local governments.

7. CONCLUSION

Based on the of data of analysis and discussion of research results, it can be concluded of as follows the effectiveness of an internal audit function, top management
support have negative influence significantly by 95% on the level of fraud. If both factors are good, fraud can be decreased. Furthermore, with the low level of fraud, the quality of good financial reporting can be achieved. The conclusion from this research supports the theory of agency and stewardship theory. That is to lessen existence of internal issue of the management of finance, the level of fraud must be decreased by improving the internal audit function and top management support.

8. IMPLICATION

This research is addressed to give input to local government in lessening the level of fraud and improving financial reporting quality. The function of internal audit which is less independent happens it is still under regional leaders. It is necessary to improve the ability and experience of auditor followed along with functional position of auditors (JFA) and or to attend certified trainings on fraud. Support of top management is very required as prime mover for movement against fraud. Policy conducted should not be only normative but also as an example for other subordinate officials, the importance of effective whistleblower and pact of integrity at maximum level can decrease the level of fraud.

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