

The Role Of Creative Accounting, Corporate Governance And Impression Management Against Internal Control Systems And Accounting Fraud In Financial Reporting

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The Role Of Creative Accounting, Corporate Governance And Impression Management Against Internal Control Systems And Accounting Fraud In Financial Reporting (Case Studies On Public Entities In Indonesia)

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Abstract

This research was conducted to answer the question "Can the accuracy of the Financial Statements be trusted?" Accounting fraud in financial reporting raises great doubts and losses for investors, creditors and other stakeholders. As a result, users get wrong information on the condition of the entity due to efforts to hide relevant² and accurate information, which results in users taking wrong analysis and decisions. The purpose of this study is to determine the effect of creative accounting, corporate governance and impression management on internal control systems and accounting fraud in financial reporting. Where the internal control system variable becomes an intervening variable that connects creative accounting, corporate governance and impression management on accounting fraud in financial reporting. The samples taken in this study were staff, ²⁷ ployees and employees of the accounting, and finance department in a public entity. This study uses Structural Equation Modeling (SEM) with SmartPLS 3.0 software. The results of the analysis can be concluded that creative accounting has an effect and corporate governance has an effect on accounting fraud. Meanwhile, corporate governance affects the internal control system.

Keyword: Creative Accounting, Corporate Governance, Impression Management, Internal Control System, Accounting Fraud

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INTRODUCTION

In early 2018, PT Sunprima Nusantara Financing (SNP Finance) became the spotlight of financial authorities and the public. The finance co⁶mpany that is under the auspices of the Columbia Group looks on paper in good shape. However, the company's condition changed 180 degrees. The company's debt rating changed drastically from stable to idSD (selective default) on May 9, 2018 because one of the Medium Term Notes (MTN) coupons issued by SNP failed to pay. As a result, the Financial Services Authority (OJK) suspended SNP's business activities because the company failed to pay MTN interest of Rp. 6.75 billion, on May 14, 2018 through the Let⁶ter of the Deputy Commissioner for Supervision of IKNB II No. S-247 / NB.2 / 2018. It is suspected that SNP Finance did not submit financial reports correctly, aka fictitious, so the rating company and ¹³ auditors did not issue warnings or warnings before default occurred.

This financial report issue is very vital and often becomes a hassle for a company if it is not managed properly. Accounting fraud in financial reporting is not a new problem. Starting in the early 2000s, there were many cases from large and well-known

companies such as the Enron, WorldCom, Bank Lippo, Xerox cases, to the rejection of PT Telkom's financial statements by the SEC (Securities and Exchange Commission). On average, the main problem lies in financial scandals, entity failures, manipulation of financial statements, errors in auditing financial reports and the possibility that management has opportunistically exploited information asymmetry to influence users' perceptions of company performance for self-serving. Where in the literature it is called impression management.

The Indonesian Accounting Association (2019) in the Professional Standards for Public Accountants, SA Section 316 explains that accounting fraud is (a). Misstatement or deliberate omission of amounts or disclosures in financial reporting and (b). Misrepresentation that arises as a result of improper treatment of institutional assets or assets. Meanwhile, the ACFE (Association of Certified Fraud Examiners) defines accounting fraud more broadly, namely by all means in which incorrect accounting can be done, and which is used to gain advantage over other parties.

CONCEPTUAL FRAMEWORK AND HYPOTHESIS

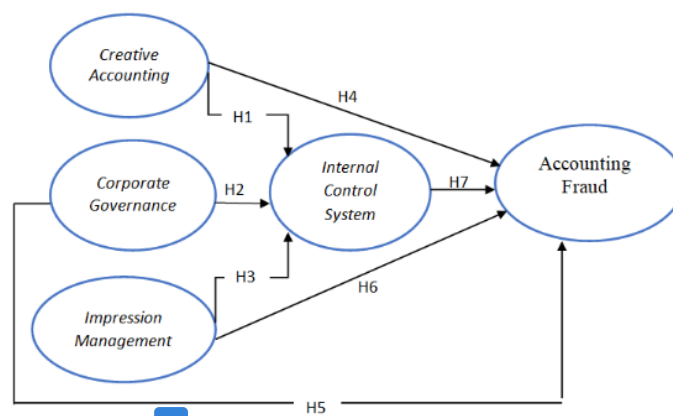


Figure 1. Conceptual Framework

Source: Researcher (2020)

Based on the conceptual framework described above, the following hypotheses can be put forward:

- H1: Creative accounting affects the internal control system in financial reporting?
- H2: Corporate governance affects the internal control system in financial reporting?
- H3: Does impression management affect the internal control system in financial reporting?
- H4: Creative accounting affects accounting fraud in financial reporting?
- H5: Corporate governance affects accounting fraud in financial reporting?
- H6: Impression management affects accounting fraud in financial reporting?
- H7: Does the internal control system affect accounting fraud in financial reporting?

RESEARCH METHODS

This research is a quantitative study using an explanatory research design. The type of data used in this study is primary data. The data were collected through a

purposive sampling process which is nonrandom or nonprobability. Respondents of this study were staff employees and employees of the accounting and finance department in a public entity. The population in this study are all go public entities in Indonesia that are listed on the Indonesia Stock Exchange (BEI).

The variables to be analyzed in this study are grouped as follows:

Exogenous Variables (X) include:

1. Creative Accounting (X1) The measurement uses five indicators, namely: Output Financial Statements, Potential company performance, technical accounting work, The influence of external factors that affect company profits, Information about company activities.
2. Corporate Governance (X2) The measurement uses four indicators, namely: Justice, Transparency, Accountability, Accountability.
3. Impression Management (X3) The measurement of this variable uses four indicators, namely: self-enhancing attribution, self-defensive attribution, bias in the explanation of accounting language and the intensity of impression management (Aerts 1994)

Intervening Variable (Y1)

4. Internal Control System
Measured by five indicators: effectiveness of the application of authority and responsibility, attention to recording transactions, effectiveness of physical controls, accuracy of the Accounting System, and level of monitoring and evaluation.

Endogenous Variable (Y2)

5. Accounting Fraud in Financial Reporting with five indicators, namely: manipulation; falsification or alteration of accounting records / supporting documents, misrepresentation or omission of events; intentionally misapplying accounting principles; misrepresentation of financial statements due to misuse of embezzlement; and misrepresentation of financial statements as a result of improper treatment.

TECHNICAL ANALYSIS OF DATA

This research uses analysis of Structural Equation Modeling (SEM) based on Partial Least Square (PLS) using smartPLS 3.0 software to test the formulated models and hypotheses. The PLS technique is carried out in two stages, namely:

1. Perform measurement model test, namely testing the validity and reliability of the constructs of each indicator.
2. Perform a structural model test that aims to determine whether there is an influence between variables/correlations between constructs as measured using the t test of the PLS.

RESULTS AND DISCUSSION

Structural Model Analysis

1. Evaluate the Outer Model

Validity and Reliability Test

Testing the validity of the Structural Equation Modeling (SEM) model is done by testing Convergent Validity and Discriminant Validity. The convergen validity test is to see the value of the outer loading. The following is the outer loading value of the PLS structural model scheme, after removing several indicators that do not meet the convergent validity requirements (<0.5) previously.

Table 1.
Results of Outer Loading Revision PLS Analysis

Variable	Indicator	Outer Loading
Creative Accounting (X1)	X1.1	0.650
	X1.2	0.690
	X1.3	0.557
	X1.4	0.735
	X1.5	0.533
Corporate Governance (X2)	X2.2	0.738
	X2.3	0.852
	X2.4	0.895
Impression Management (X3)	X3.1	0.701
	X3.2	0.580
	X3.3	0.772
	X3.4	0.615
Internal Control System (Y1)	Y1.1	0.548
	Y1.3	0.830
	Y1.4	0.835
	Y1.5	0.764
Accounting Fraud (Y2)	Y2.1	0.530
	Y2.2	0.634
	Y2.3	0.686
	Y2.4	0.707
	Y2.5	0.654

Source: processed data (2020)

Then the new PLS structural model scheme (revised model) which can be shown in Figure 2. is as follows:

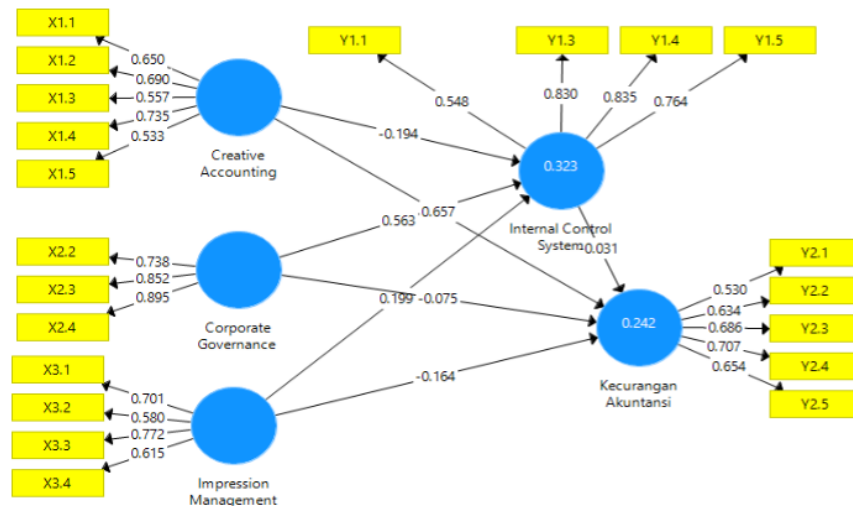


Figure 2. Revised PLS Model Path
Source: Processed Data (2020)

Furthermore, the discriminant validity testing was carried out by observing the discriminant validity through the Average Variant Extracted (AVE) method. The following is the AVE value in this research variable,

Table 2
PLS Analysis Results Average Variant Extracted (AVE)

Variable	AVE
Creative Accounting (X1)	0.691
Corporate Governance (X2)	0.507
Impression Management (X3)	0.550
Internal Control System (Y1)	0.568
Accounting Fraud (Y2)	0.516

Source: processed data (2020)

Then the next step is to prove that the variables in this study are reliable. First, perform the Composite Reliability test where a variable can be declared to meet composite reliability if it has a value > 0.6. It is strengthened by using the Cronbach alpha value, where a variable is declared reliable if it has a value > 0.6. The following are the composite reliability and Cronbach alpha values of each variable in this study:

Table 3
Results of PLS Composite Reliability and Cronbach Alpha Analysis

Variabel	Composite Reliability	Cronbach Alpha
<i>Creative Accounting</i> (X1)	0.869	0.778
<i>Corporate Governance</i> (X2)	0.772	0.634
<i>Impression Management</i> (X3)	0.764	0.697
<i>Internal Control System</i> (Y1)	0.837	0.738
Accounting Fraud (Y2)	0.879	0.645

Source: processed data (2020)

Based on table 3 above, it can be seen that all variables have a composite reliability value and a Cronbach alpha value > 0.6. So, it can be concluded that the variables in this study have a good level of reliability.

2. Evaluate the Inner Model

Determination Coefficient Test

Path coefficient evaluation is done by using coefficient determination (R-Square) to measure how much the endogenous variable is influenced by other variables. Data processing is carried out, the R-Square value is obtained as follows:

Table 4
PLS Analysis Results R-Square Value

Variabel	R-Square	Keterangan
<i>Internal Control System</i> (Y1)	0.323	> 0.00
Accounting Fraud (Y2)	0.242	> 0.00

Source: processed data (2020)

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Based on the data in table 4, it can be seen that the R-Square value of the Internal Control System (Y1) variable is 0.323. The acquisition of this value explains that the Internal Control System (Y1) can be explained by the independent variable creative accounting, corporate governance, impression management, which is 32.3%. Meanwhile, the R-Square value obtained by the Accounting Fraud variable (Y2) is 0.242. This explains that Accounting Fraud (Y2) can be explained by independent variables including creative accounting, corporate governance, impression management which is 24.2%.

Predictive Relevance Test

2

Predictive relevance can be seen from the Q-Square value. The results of the calculation of the Q-Square value in this study are as follows:

$$\begin{aligned} Q^2 &= 1 - [(1 - R^2) \times (1 - R^2_2)] \\ Q^2 &= 1 - [(1 - 0,323) \times (1 - 0,242)] \\ Q^2 &= 1 - (0,677 \times 0,758) \\ Q^2 &= 1 - 0,5132 = \mathbf{0,486} \end{aligned}$$

2

Based on the results of the above calculations, the Q-Square (Q2) value is 0.486. This shows the great diversity of research data that can be explained by the research model is 48.6%. While the remaining 51.4% is explained by other factors / variables that are outside this research model. Thus, from the results obtained, this research model can be stated as having good Predictive Relevance.

Uji Goodness of Fit

The results of the Goodness of Fit (GoF) test can be obtained from the root average value of the AVE value with the average root value of R-Square (Tanenhaus, 2004). According to Tanenhaus (2004) the GoF value is said to be "small" if the value is equal to 0.1, "medium" if the value is equal to 0.2, and "large" if the value is greater or equal to 0.38. The following is the calculation of the Goodness of Fit value:

$$\begin{aligned} GoF &= \sqrt{AVE \times R^2} \\ GoF &= \sqrt{0.565 \times 0.2825} \\ GoF &= \sqrt{0.1596} = \mathbf{0.399} \end{aligned}$$

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Based on the results of the calculation of Goodness of Fit above, the value is 0.399, so it can be said that the GoF value is > 0.38 or the GoF value is in the large value category. Testing of R2, Q2 and GoF has been done before, so it can be seen that the model formed in this study is robust or good. So, hypothesis testing can be done

Hypothesis test

In testing the hypothesis using the Smart PLS program, the criteria for the research hypothesis can be declared accepted if the T-Statistics value is > 1.96 or P-Values < 0.05, this is because in this study using an alpha value or a significant level of 5% or 0.05. Following are the results of the path coefficient (path coefficient) obtained from the results of data processing used to answer the hypothesis of the direct effect in this study.

Table 5
Hypothesis Test Results - Direct Effect

Hypothesis	Direct Influence	T-Statistics	P-Value	Conclusion
H ₁	<i>Creative accounting → Internal control system</i>	0.303	0.762	Rejected
H ₂	<i>Corporate governance → Internal control system</i>	7.266	0.000*	Accepted
H ₃	<i>Impression management → Internal control system</i>	0.297	0.767	Rejected
H ₄	<i>Creative accounting → Accounting Fraud</i>	3.221	0.001*	Accepted
H ₅	<i>Corporate governance → Accounting Fraud</i>	2.039	0.042*	Accepted
H ₆	<i>Impression management → Accounting Fraud</i>	0.593	0.545	Rejected
H ₇	<i>Internal control system → Accounting Fraud</i>	0.239	0.812	Rejected

Source: processed data (2020)

Note: *) The significance level of 5%

**) The significance level of 10%

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The findings of this study indicate that creative accounting has a significant effect on accounting fraud. In fact, it has the support of the research of Smith, Tiras and Vichitlekarn (1997). In this study, it is stated that creative accounting is designed by management based on the aspects of the considerations of all components in management because the financial statements consider its usefulness for stakeholders, shareholders and managers. So that the various interests must be fulfilled primarily based on internal objectives.

Merchant and Rockness (1994) also stated that management has a wide space for movement and there is a gap to take advantage of the policy choice process in accounting methods with creative engineering. One example is determining the use of the inventory valuation method in times of inflation. The determination of inventory will be faced with a situation where the inventory value will be reported at cost, at sale, lower cost or market (lowcom), fair value, or using the general price level. In a situation with a very high price increase, management will contradict the real condition if the inventory value is reported at cost and low com, which will be in harmony if the determination is reported at the general price level or fair value. This provides a creative situation for management to use at sale, at cost, lowcom or general price level.

It can be concluded that in fact management has a tendency to include a "loss" or "gain" in extra ordinary accounts and include this component due to consideration factors. This is what causes accounting fraud to occur and is related to creative accounting.

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Several concepts on corporate governance, among others, are proposed by Shleifer and Vishny (1997), which states that corporate governance is related to ways or mechanisms to convince capital owners to obtain returns that are in accordance with the investments that have been invested. Iskandar et al (1999) stated that corporate governance refers to a framework of rules and regulations that allow stakeholders to make companies maximize value and to obtain returns. In addition, corporate

governance is a tool to guarantee directors and managers (or insiders) to act in the best interests of outside investors (creditors or shareholders) (Prowson, 1998).

CONCLUSIONS AND SUGGESTIONS

Conclusion

Based on the results of the hypothesis analysis in this study, it was explained that the impression management and internal control system had no significant effect on accounting fraud financial reporting. Meanwhile, creative accounting and corporate governance have a positive effect on accounting fraud in financial reports.

Some of the reasons for thinking described above, it can be concluded that from a theoretical point of view creative accounting and corporate governance can influence company management to commit accounting fraud in financial reporting. Therefore, the company should be able to create an effective supervisory system based on the distribution and balance of power between members of the board of directors, commissioners, shareholders and supervisors and also involves the accountability process of company management for decisions made and performance achieved.

Suggestion

Studies and research in the field of behavioral accounting, especially those related to accounting fraud, are very wide open and very much needed in Indonesia. This study opens horizons and insights on the need for a cross-dimensional approach in solving concrete problems in Indonesia. The suggestions that can be conveyed are as follows:

1. The development of accounting theory, especially regarding accounting fraud.
2. Efforts to prevent the practice of manipulating accounting should open entities in implementing a system of internal control
3. It is better if the internal control system in the form of supervision and control is not only carried out continuously but also needs to be studied on an ongoing basis

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