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The determinant of the financial fraud of the village fund management

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Abstract

We examine the relationship between compensation, morality, organizational ethical culture, and financial fraud. The respondents were fifty-two village officials in Weru Subdistrict, Central Java Sukoharjo District who were directly responsible for managing village funds. They were selected using a purposive sampling method. Data was collected by means of the questionnaire was distributed and then, the data were analyzed using Path analysis with WarpPLS software. We found that morality had a positive and significant effect on compensation and organizational ethical culture, as well as a negative and significant effect on financial fraud. Organizational ethical culture proved to have a negative and significant effect on financial fraud. Compensation does not have a significant effect on the ethical culture of the organization and financial fraud. The other result shows that the organizational ethical culture had proven to be a mediator of the relationship between morality and financial fraud. Meanwhile, there is no proven significant relationship between the suitability of compensation for financial fraud through the ethical culture of the organization. Also, the study confirmed that the morality and ethical culture of the organization are factors that can reduce the occurrence of financial fraud. Hence, the village government is expected to have better organizational morality and ethical culture.

Abstrak

Kami menguji hubungan antara kompensasi, moralitas, budaya etis organisasi, dan kecurangan keuangan. Responden adalah aparat desa di Kecamatan Weru Kabupaten Sukoharjo Jawa Tengah yang bertanggung jawab langsung dalam pengelolaan dana desa. Metode purposive sampling digunakan untuk memperoleh sampel penelitian. Metode pengambilan data yang digunakan adalah kuesioner. Analisis jalur digunakan untuk menganalisis data dengan software warpPLs. Kami menemukan bahwa moralitas berpengaruh positif dan signifikan terhadap kompensasi dan budaya etis organisasi, serta berpengaruh negatif dan signifikan terhadap kecurangan keuangan. Budaya etis organisasi terbukti berpengaruh negatif dan signifikan terhadap kecurangan keuangan. Kompensasi tidak berpengaruh signifikan terhadap budaya etis organisasi dan kecurangan keuangan. Hasil penelitian lainnya menunjukkan bahwa budaya etis organisasi terbukti menjadi mediator hubungan antara moralitas terhadap kecurangan keuangan. Namun demikian, budaya etis organisasi tidak terbukti signifikan menjadi mediator terhadap hubungan antara kesesuaian kompensasi terhadap kecurangan keuangan. Hasil penelitian mengkonfirmasi bahwa moralitas dan budaya etis organisasi merupakan faktor yang dapat mengurangi terjadinya kecurangan keuangan. Aparatur pemerintah desa diharapkan memiliki moralitas dan budaya etis organisasi yang baik.

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1. Introduction

The Indonesian government has allocated a large amount of the budget for the village government namely village allocation fund (in Indonesian called Alokasi Dana Desa/ADD). Law No. 6 of 2014 concerning villages has mandated the government for managing this fund. It aims to accelerate the village-based program equally and equitably throughout Indonesia. Wibowo (2015) explained village financial management is carried out because the village is basically a leading platform and the closest government to the people, who are strongly connected, advanced, independent and democratic.

However, some news in mass media has shown the existing misuse of village funds. This misuse has caused the unfulfilled service for people. The existing deviations that often occurred in village financial management include fictitious activities such as the mark-up for price, goods, and its total, fictitious spending, and budget use for individuals and groups. The data sample seen from the report of the Financial Supervisory Agency (BPK) on 120 villages in four districts in Central Java (Brebes, Grobogan, Temanggung, and Jepara) showed the phenomenon of deviation in village financial management. Indonesia Corruption Watch (ICW) released 110 cases of misappropriation of village funds and allocation of village funds from 2016 to 2017. It was found that the perpetrators were mostly carried out by the village head (detik.com, 11/08/2017). ICW data showed that since village funds were given, there was a significant increase in cases of misuse of village funds.

Several studies have confirmed the high fraud of village fund management is due to the low competency and quality of human resources and the low level of supervision from the community (Mondale, Aliamin, & Fahlevi, 2017; Wibisono & Purnomo, 2017). Effective understanding and supervision can have a positive impact on the increase of village financial accountability (Kadir et al., 2017; Widarnawati, Santoso, & Suparman, 2018). Meanwhile,

Abdullahi & Mansor (2015) used the fraud theory to explain the causes of corruption in public organizations and found that pressure affected corruption.

To understand the village financial deviation, the concept of fraud pentagon can be used. It is the concept developed from the concept of fraud triangle and diamond fraud (Kusumantoro et al., 2016; Muhsin, Kardoyo, & Nurkhin, 2018). Prevention of fraud that occurs in the management of village fund allocations can also be explained in planned behavior theory and development theory (Rahimah, Murni, & Lysandra, 2018). While Amrul & Khotmi (2016) confirmed a strong influence from internal controls in anticipating fraudulent financial management trends. However, (Muhsin et al., 2018) failed to prove the concept of fraud pentagon to understand the factors influencing fraudulent behavior. The same results were also obtained by Yusof (2016). Meanwhile, Aprilia (2017) was able to find a significant influence from external factors on financial fraudulent behavior. Oktaviani, Nyoman, & Atmadja (2017) showed several factors that can influence the potential for fraud in village financial management including practices of accountability, conflict of interest, and law enforcement.

This study used the concept of fraud pentagon to examine the effect of the dimensions of arrogance on financial fraud. Fraud pentagon is a new concept developed from the concept of fraud triangle and fraud diamond. There is a new dimension in the concept of fraud pentagon, namely arrogance. Arrogance is considered an important factor that does not exist in the two previous concepts. Arrogance is a very dominant factor influencing someone to commit fraud. Arrogance reflects human greed, not easily satisfied with what is possessed. Someone who has a high level of arrogance will tend to commit fraud to fulfill all his desires.

Arrogance was developed by Tessa & Harto (2016). Arrogance is measured by compensation suitability variables. Compensation showed regardless of the level of compensation received, it will

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not be considered appropriate by village officials who have high arrogance or greed. This study also examined the dimensions of external regulatory influence in the concept of fraud pentagon was developed by Tugas (2012). External regulatory influence is measured through organizational ethical culture. The village government developing an ethical culture of the organization will encourage a positive culture and will reduce fraud in managing village funds. The theory of planned behavior is also used in testing determinants of financial fraud in managing village funds. The constructs tested are subjective norms and measured by the morality of the apparatus. Village officials who have a high level of morality tend not to commit fraud.

2. Hypotheses Development

The fraud pentagon concept was developed by Crowe Howarth in 2011 and well-known as the Crowe's fraud Pentagon theory. Fraud pentagon theory is originally from the theory of fraud triangle coined by Cressey. This theory adds two other elements of fraud, namely competence and arrogance (Tessa & Harto, 2016). Further, Tugas (2012) also offered the concept of fraud pentagon by adding external regulatory influence. It is believed that fraud will not occur if the policymaker is able to implement the rules firmly making the members of the organization able to comply.

The theory of the fraud triangle was the first theory that is able to explain the elements causing fraud. This theory was coined by Cressey in 1953. The elements of the fraud triangle consist of pressure, opportunity, and rationalization (Tessa & Harto, 2016). A new element is added namely capability in which it is then named diamond fraud. This new element is believed to be able to improve the prevention and detection of fraud. Fraud cannot occur without people having the right ability to carry out fraud (Wolfe & Hermanson, 2004).

Fraud is closely related to theft, corruption, conspiracy, embezzlement, money laundering, brib-

ery, and extortion. Furthermore, a fraud tree was formulated as a map of fraud by the Association of Certified Fraud Examiners (ACFE). This fraud tree has three branches, namely corruption, asset misappropriation, and fraudulent statements. In addition, Baader & Krcmar (2018) stated corruption, asset misappropriation, and fraudulent statements fraud are often used. Surprisingly, in the government sector, fraud in the form of corruption often occurs, especially in developing countries (Prabowo, Cooper, Sriyana, & Syamsudin, 2017). Indonesia is mentioned as one of the developing countries where corruption often occurs.

To analyze the occurrence of corruption in public organizations, there are several perspectives. Prabowo et al. (2017) have developed three perspectives in analyzing the occurrence of corruption, namely the schemata theory, corruption normalization theory and moral development theory. Meanwhile, The Committee of Sponsoring Organizations of the Treadway Commission (COSO) recommends developing a strong internal control system. The internal control system used to ensure the company's wealth, accuracy and correctness of accounting data presented by the company (reliability of financial statements), operationalization of companies that are efficient and effective, and compliance with management policies, applicable laws, and regulations. The internal control system consists of several elements that mutually supports its reliability. It is confirmed that the effectiveness of the elements forming the internal control system will have a positive impact on the effectiveness of the internal control system.

The village financial management process is a whole series of activities that include planning, implementation, administration, reporting, and village finance and its accountability to the fund from the State Budget which are transferred through the Regional Government budget. This fund is used to finance government administration, implementation of development, community development, and community empowerment (Karmawan & Yanuar,

2018). Wibowo (2015) classifies risks in financial management in two groups, namely business risk and fraud risk. Business risk consists of village-level financial risk at the entity level and activity level risk. Risks that can occur in village financial management at the village government entity level include Programs and Activities in the RPJMDes, RKPDes, and APBDes that do not meet the needs of the village community. Also, the failure to implement a healthy village financial management cycle including the responsibility report of APBDes as well as inefficient and effective village asset management. The risk of the activity level includes the misappropriation of the value of the bills and cash receipts which could be not fully paid to the village treasury. Next, the risk of fraud in village financial management includes the use of village cash illegally, mark upon the procurement of goods or services, use of village assets for personal interests of village officials illegally, and also, illegal collection for fees.

The issuance of Village Law Number 6 of 2014 plays a significant role in the development in Indonesia. This law provides a great opportunity to improve the welfare of the community, especially in rural areas. A quite large allocation of village funds was given to the Village Government to manage. Village government officials, especially village heads, should have the ability to manage it. The effectiveness of village financial management will lead to good village government performance and impact on improving community welfare.

The phenomenon showed many management deviations of the village fund. The village head is argued to have the most likely to commit village financial fraud. Usually, it happens in the form of utilization of assets for personal gain. Village financial fraud must be understood from the perspective of the fraud pentagon. Fraudsters can be identified as dominant factors that influence the tendency of fraudulent behavior. Some researchers have proven this concept even though there are still various results (Aprilia, 2017; Muhsin et al., 2018; Yusof, 2016).

The fifth dimension in the Fraud pentagon -arrogance- is still interesting to test again. It is commonly understood that human greed is the main determining factor for cheating.

This study seeks to investigate the factors that influence the occurrence of trends in financial fraud in the perspective of fraud pentagon and the theory of planned behavior. One dimension of diamond fraud is arrogance or greed. In this study, it will be represented by the degree of conformity of compensation. Compensation suitability will not show the satisfaction of someone who has high arrogance. The compensation received will not be considered to be of any satisfaction. Financial fraud will still be carried out even though one's compensation is already appropriate or generally high. Thus, compensation could still have a positive influence on fraudulent funds in village funds. It is argued that village officials will tend to commit fraudulent actions in managing village funds even though he has received huge rewards.

Akhsani (2018) compensation suitability has a positive effect on the tendency of financial fraud. The results of the study stated that the higher the suitability of compensation in the agency would be then followed by the increase in the tendency of financial fraud. Fraud cannot always be prevented by the presence of appropriate compensation as can be seen in some cases of corruption in Indonesia that occurred in people who have high positions and salaries. This confirmed that corruption still happened to fulfill the desire for compensation which is regarded not enough for corruptors.

The dimension of the fraud pentagon tested in this study was external regulatory influence measured by the ethical culture of the organization. Someone who will do something is very concerned about the norms and ethics available in their environment. Village officials who will commit fraudulent actions in managing village funds will be hindered by the ethical culture built in the village administration. This means if financial fraud is deemed

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unethical, they will tend not to commit fraud in managing village funds.

Free (2015) argues fraudulent behavior comes from group rationalization because collusion involves proactively cooperating actors. This means organizational culture formed from a collection of individuals creates habits affecting the behavior of the individual itself. Organizational ethical culture is a factor that comes from outside the individual which will influence the way village officials work in managing village funds. Unethical organizational culture will provide an opportunity for someone to have the desire to cheat. The better the ethical culture of the organization means the lower the tendency of village officials to commit accounting fraud. Julyana (2015) found a negative and significant influence of the organization's ethical culture on fraudulent tendencies. The other study by Noviriantini, Darmawan, & Werastuti (2015) also confirmed the same result.

The theory of planned behavior explains one of the factors which influence one's planning action is the subjective norm. In this study, the norm will be represented by the morality of the apparatus. Officials having a high level of morality tend not to commit fraud. Noviriantini et al. (2015) found apparatus morality had a negative effect on fraudulent tendencies. Wijayanti & Hanafi (2018) also confirmed that individual morality had a significant effect on accounting fraud tendencies. The research hypotheses are:

- H_1 : compensation has a positive and significant effect on financial fraud
- H_2 : organizational ethical culture has a negative and significant effect on financial fraud
- H_3 : morality has a negative and significant effect on financial fraud
- H_4 : organizational ethical culture is the mediator of the relationship of compensation to fraud
- H_5 : organizational ethical culture is the mediator of the relationship between morality and fraud

The theory of planned behavior explains that a person's behavior will be shaped by the norm's view. Organizational ethical culture will be influenced by a morality that has been formed before. The morality of the apparatus will also affect the arrogance and ethical culture of the organization. The good morality of the apparatus will form a good personality of the village apparatus and will eventually build a good ethical culture of the organization. As such moral officers will tend not to be arrogant or greedy because they will pay attention to the interests of others or the environment instead of theirs.

Organizational ethical culture is also influenced by compensation. Compensation reflects the attitude of acceptance of the results obtained. Someone who is not greedy (not arrogant) will form a more ethical apparatus. Officials who are not easily satisfied with what is received from work tend to be more selfish. A person's morality will further influence ethical behavior if he has low arrogance. The research hypotheses are:

- H_6 : morality has a positive effect on compensation
- H_7 : morality has a positive effect on the ethical culture of the organization
- H_8 : compensation has a negative effect on the ethical culture of the organization
- H_9 : compensation is a mediator of the relationship of morality to the organizational ethical culture

3. Method, Data, and Analysis

This research was carried out in Weru Sub-district, Sukoharjo Regency, Central Java province, Indonesia. The population included the village officials; the village administrative officers, territorial executors, and technical implementers. The 52 respondents were determined using purposive sampling involved those responsible and were directly related to village financial management. Thus, pre-

cisely, the respondents were the village head, the village secretary, the village treasurer, and the head of activity who managed village funds (the head of planning/development affairs).

The dependent variable in this study is the financial fraud of village fund management. The financial fraud of village fund management is measured to what extent village officials tend to commit financial fraud, namely, deliberate misrepresentation in financial statements and misrepresentation of improper treatment. Financial fraud is measured based on the indicators used by Yani, Rasuli, & Hardi (2016); (a) a tendency to manipulate, falsify, or change accounting records or supporting documents, (b) the tendency to misrepresent or eliminate events, transactions or significant information from financial statements; (c) tendency to intentionally apply accounting principles incorrectly; (d) tendency to make false financial statements due to theft (misuse/embezzlement) of assets that make the entity pay for goods/services which are not received, and (e) the tendency to make false financial statements due to improper treatment of assets and accompanied by false records or documents and this can involve one or more individuals between management, employees or third parties.

The compensation is defined as one's satisfaction or compatibility towards the salary or wages as remuneration given by their institutions for the contributions. Compensation is measured by indicators (Wilopo, 2006) namely; (a) financial compensation, (b) institutional recognition of success in carrying out tasks, (c) promotion, (d) completion of tasks, (e) achievement of targets, and (f) personal development. Apparatus morality is the ability of a state apparatus or employee to distinguish between right and wrong. The morality of the apparatus is objective and rational thinking from the human conscience. Indicators of measuring morality of the apparatus (Yani et al., 2016) are compliance with social norms, (b) conscience, (c) justice, (d) freedom, (e) no bribery in any form, and (f) loyalty to work.

Organizational ethical culture is a pattern of ethical attitudes and behaviors from individuals and members of organizational groups to form an organizational culture in accordance with the goals and identity of the organization. This culture becomes a guideline and influences the way individuals work which has existed from generation to generation. The measurement of organizational ethical culture was developed from Chandra & Ikhsan (2015). Measurement of organizational ethical culture variables are conducted with indicators namely; (a) visible role models, (b) communication of ethical expectations, (c) ethical training and standard seminars of organizational demands, (d) penalties for unethical actions, and (e) ethical protection mechanisms.

To collect the data, questionnaires from previous research were adjusted and were distributed to the respondents. Analysis of the data used in this study was a descriptive statistical analysis and analysis of SEM (structural equation model). Descriptive analysis was applied to describe the village financial fraud variable and describe the research variable. While SEM analysis aimed to investigate relationships between variables more precisely using the WarpPLS software.

4. Results

The hypothesis testing in this study applied SEM analysis with WarpPLS software. The test results showed the values of the composite reliability coefficients in the variables of compensation, morality, culture, and fraud were 0.878, 0.820, 0.818, and 0.549. Meanwhile, the values of Cronbach's alpha coefficients - compensation, morality, culture, and fraud are equal to 0.835, 0.765, 0.752, and 0.802. Solimun, Fernandes, & Nurjannah (2017) stated that data has composite reliability > 0.8 and Cronbach aloha > 0.6 has reliability higher. Thus, the research instrument has met the requirements of validity and reliability.

The model testing used the Average path coefficient (APC) criteria, Average adjusted R-squared

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(AARS), Average R-squared (ARS), VIF (AVIF) Average block, and Average full collinearity VIF (AFVIF). The model test results showed APC = 0.346, P = 0.002; ARS = 0.354, P = 0.001; and AARS = 0.327, P = 0.003. The P value of APC, ARS, and AARS indicates the model has met the requirements (Solimun et al., 2017). As such the hypothesis testing can be continued. Other results indicate AVIF = 1.291, acceptable if ≤ 5 , ideal ≤ 3.3 ; AFVIF = 1.498, acceptable if ≤ 5 , ideal ≤ 3.3 . AVIF and AFVIF values also meet the ideal limit so that the model was confirmed fit.

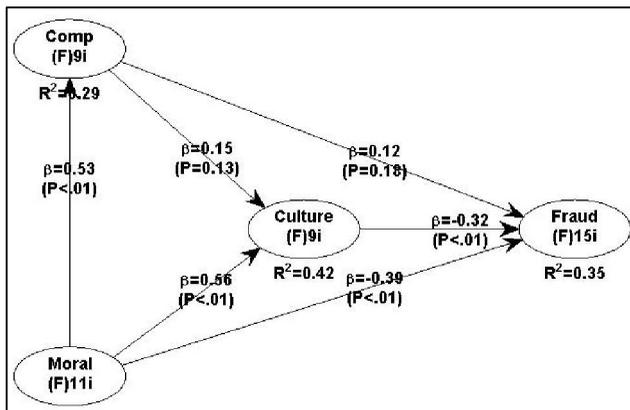


Figure 2. Path diagram

The results of the hypothesis testing- the path analysis result- is in figure 2 showed that the probability of compensation for fraud is 0.18 and more than 0.05 (alpha or significant level). The path coefficient is 0.12. Compensation has no significant effect on financial fraud. The P culture value of fraud is <0.01 with a path coefficient of -0.32. Organizational ethical culture has a negative and significant effect on financial fraud. Then, moral has a P-value of <0.01 and a path coefficient of -0.39 to fraud. The morality of the apparatus proved to have a negative and significant effect on financial fraud. The results also showed morality has not only a positive and significant influence on compensation (P-value <0.01 and path coefficient of 0.53) but also on the ethical culture of the organization (P-value <0.01 and path coefficient of 0, 56).

Further, figure 2 implies the ethical culture of the organization proved to be a mediator of the relationship between apparatus morality and financial fraud. The relationship of morality to the ethical culture of the organization and the relationship of the organization's ethical culture to fraud is significant. The mediation referred to partial mediation because the direct influence of morality on financial fraud is also significant. The ethical culture of the organization is not proven to be a mediator of the relationship of compensation to financial fraud. Only the direct relationship of the organization's ethical culture towards financial fraud has proven to be significant. Compliance with compensation is also not proven to be a mediator of the relationship between apparatus morality and the ethical culture of the organization because there is no significant effect of compensation on the organization's ethical culture.

5. Discussion

The influence of compensation, morality and organizational ethical culture on financial fraud of village fund management

The results showed only apparatus morality and organizational ethical culture had a significant effect on financial fraudulent tendencies in village officials in Weru District, Sukoharjo Regency. Meanwhile, the suitability of compensation does not prove to have a significant effect. This confirms that the dimensions of external regulatory influence on the concept of fraud pentagon and the subjective norm dimensions of the theory of planned behavior are predictors of village officials' financial fraud in village fund management. Morality and ethics are quite urgent because it will reduce the tendency of village officials to commit fraud. It is fortunate that village officials still strongly hold ethical values and norms because they believe making fraud is unethical and immoral. Further, they also consider cheating would bring a negative impact on themselves and the community.

Compensation was not proven to have a significant effect on fraud because the apparatus was not arrogant. They receive the income received as an apparatus. Compensation reflects the level of arrogance of apparatus. Apparatus does not prioritize personal interests so they tend not to commit fraud in managing village funds. The utilization of village funds is for the benefit of village development.

This study is in line with previous findings which indicate the ethical culture of the organization has a significant negative effect on fraud (Julyana, 2015; Noviriantini et al., 2015) and morality has a negative and significant effect on fraud (Noviriantini et al., 2015; Wijayanti & Hanafi, 2018). While Akhsani (2018) found a positive and significant effect on the suitability of compensation for financial fraud. It is confirmed that village officials consider compensation received as appropriate.

The influence of morality on compensation and organizational ethical culture

The study also showed apparatus morality had a positive and significant effect on the suitability of compensation and the organization's ethical culture. The morality of the apparatus will create a kind of personality and attitude of the apparatus to be not greedy and arrogant. In the case of compensation received, village officials confirm that any amount will be well received because it is a mandate and responsibility. Village officials do not need to look for additional earning in an improper or fraudulent manner. Also, the morality of the apparatus will influence the ethical culture of the organization. The good morality of the apparatus will encourage the creation of an ethical culture of the organization more easily. In this case, village officials have values and will adhere to the existing norms and ethics by themselves. They will be able to work well together and avoid opportunism that only benefits themselves and their groups. They are more concerned with the benefit or development of their

respective villages.

The ethical culture of the organization proved to be a mediator of the relationship between morality and fraud. The morality of the apparatus proven having a direct influence on the tendency of financial fraud will have a stronger influence if accompanied by an ethical culture of the organization. As such they will have stronger commitment and responsibility so that they will not commit fraud in managing village funds. They will hold important values and ethics as well as maintain trust and integrity well.

6. Conclusion

This study concluded apparatus morality and organizational ethical culture were found to have a negative and significant influence on financial fraud in managing village funds. The results confirm the dimensions of external regulatory influence in the concept of fraud pentagon and the theory of planned behavior. This means village officials who have good morality will tend not to commit fraudulent acts. The ethical culture of organizations that are well established will also make village officials avoid fraud. Morality is also proven to be able to influence the ethical culture of the organization. And the organization's ethical culture is able to mediate the relationship between apparatus morality and financial fraud. Further, the results showed compensation does not prove to significantly affect financial fraud. While apparatus morality has a positive and significant effect on compensation suitability.

Organizational ethical culture and morality are quite urgent in village funds management. The village government is expected to develop a good ethical culture of the organization. The existence of regulations would help the government officers to create an ethical culture of the organization. A role model such as a village leader such as the sub-district head, regent and governor would be able to encourage the formation of a better ethical culture of the organization in administering the village gov-

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ernment. Organizing training and workshops on morality and ethics will also be useful to create a positive impact on the organization.

The limitation of this study is the limited number of research respondents. The next researcher can expand the object and the number of respon-

dents. The measurement of research variables is also the next limitation. Need more in-depth study to measure the research variables are more appropriate. The use of TPB theory and fraud pentagon could also be extended by presenting all the dimensions in the concept of fraud pentagon.

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