

# The Effects of The Whistleblowing System on Financial Statement Fraud Ethical Behavior as The Mediators

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# THE EFFECTS OF THE WHISTLEBLOWING SYSTEM ON FINANCIAL STATEMENTS FRAUD: ETHICAL BEHAVIOR AS THE MEDIATORS

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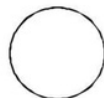
## ABSTRACT

*The purpose of this research is to analyze whistleblowing system to prevention of financial reporting fraud. Analyzing whistleblowing systems against prevention of financial reporting fraud through ethical behavior as a moderating variable. The method used in conducting this research is descriptive research using survey method. The population in this study is a student of the Faculty of Economics at Pekalongan University. Determination of the sample in this study using purposive sampling technique. By using multiple linear regression analysis tools, the following conclusions can be drawn: Whistleblowing System Positive Influence on prevention of financial reporting fraud is acceptable. Whistleblowing System Positive Influence on Trends Financial fraud through Ethical Behavior is unacceptable.*

**Key words:** Whistleblowing System, Ethical Behavior, Fraud Prevention Financial Reporting.

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## 1. INTRODUCTION

Along with the development of the increasingly complex world economy, evolving economic crime practices in various forms. Such practices in ordinary economic terms are referred to as cheating or fraud. This practice of fraud is often in the form of abuse of interest or conflict of interest, corruption, bribery, illegal gratuities, etc. Transparency International describes the Corruption Perception Index (IPK) which measures the country's corruption rate in 2016 and based on a survey of 177 countries, Indonesia received the same IPK score as 2016, ie 32. Indonesia's state losses from 2015 to 2016 recorded Rp 168.19 trillion rupiah. The loss is a loss primarily due to corruption that amounts to 1842 cases in that span of the year.

Whistleblowing system has attracted the world's attention today. This is because many big companies are cheating and finally revealed. Cunningham and Harris (2006) one of the cases revealed was the case of the Enron company. In Enron's case, Enron manipulated his financial statements in order to perform well. Enron manipulated revenues with revenues of US \$ 600 million and at that time some of the internal auditors in Enron's company failed to report the inherent disparity of the companies because they were afraid of jeopardizing their careers and they feared their safety was threatened, even though it was very dangerous to the company, investors and corporate value. Enron was in the spotlight of society at the end of 2001, when it was revealed that its reported financial condition was supported primarily by systematic, institutionalized, and creatively planned accounting fraud (Wikipedia, 2010). More ironic because it triggered a scandal with the international accounting firm (including the Big Five), namely Arthur Anderson. Arthur Anderson as external auditor and management consultant Enron did not report any deviations.

In Indonesia, awareness of the importance of whistleblower reporting and protection systems is on the rise. Some institutions, such as the National Committee on Governance Policy (KKNP) continue to promote good governance practices, including in the private sector. Large companies and have good management have also begun implementing reporting systems to receive reports from employees or whistleblowers. (Semendawai et al, 2011: 10). Albrecht (2009: 118) also states that a good whistleblowing system is one of the best tools that serves as a prevention of fraud. When an employee understands that the other employees have an easy and non-coercive way of monitoring each other and reporting allegations of fraud, these employees will be less likely to engage in such fraud.

In the act of fraud detection, in addition to applying an audit process that is quite effective in detecting fraud, whistleblowing is also one of the easiest ways to detect fraud. The existence of a report from whistleblowers is certainly not a blank report whose facts can be engineered, but to conduct a reporting in a whistleblowing system, a report must meet certain criteria so that it can be processed further. Therefore, it can be said that whistleblowing is one way of detection fraud is quite easy. Ethical behavior in the company can be created by the internal control of the management company. Internal control plays an important role in the organization to minimize the occurrence of fraud and effective internal control (Whistleblowing System) will close the chances of unethical behavior (Fauwzi, 2011).

## S2. LITERATURE REVIEW AND CONCEPTUAL FRAMEWORK

### 2.1. Financial Statement Fraud

Albrecht in his *Fraud Examination* (2009: 6) defines fraud as a general term, and encompasses all the ways that human ingenuity can be designed, forced by an individual, to benefit from others by using false information. There is no definite and volatile rule that can be defined as a general proposition in defining fraud, because it includes surprises, deceit, cunning, and unfair ways by other cheats. The only limits that can define it are those that limit human dishonesty. ACFE in Tuanakotta (2010: 195-204) divides fraud in 3 (three) types according to the acts perpetrators perform, namely:

1. Financial Statement Fraud
2. Asset Misappropriation
3. Corruption

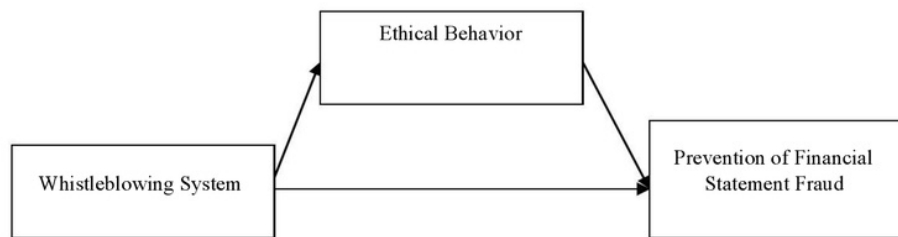


Figure 2.1 Research Model

### 2.2. Effect of Whistleblowing System on Prevention of Financial Reporting Fraud

According to the National Committee on Governance Policy (2008: 2) one of the benefits of good whistleblowing systems is the reluctance to commit violations, due to the trust in effective reporting systems. KNKG also explains the aspects of the whistleblowing system. By understanding these aspects, employees become more interested in reporting fraudulent acts.

The existence of a whistleblowing system is not only a fraud reporting channel, but also as a form of supervision. Employees are afraid to cheat because this system can be used by all employees, so fellow employees become mutually supervising each other and afraid to be reported to other employees for cheating. Thus, the employee's understanding of the whistleblowing mechanism makes the employee enthusiastic in reporting any fraud to the authority authorized to handle the report because the whistleblowing system already includes whistleblower protection. This can prevent fraud that will occur in the company.

### 2.3. Effect of Whistleblowing System on Prevention of Financial Reporting Fraud with Ethical Behavior as a Mediating Variable

Fraud Prevention through Ethical Behavior Employees' understanding of the whistleblowing system may lead employees to behave ethically, so that employees become reluctant to cheat, and will report a fraud that occurs in the company where he works. Then the fraud that occurs can be detected or can also be prevented by the presence of ethical behavior owned by employees who

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influenced their perception of whistleblowing system. Thus, employees' perception of whistleblowing system will encourage employees' ethical behavior. This ethical behavior that will prevent the fraud committed by the employees themselves.

### 3. RESEARCH DESIGN

The method used in conducting this research is descriptive research using survey method. This research was conducted at Pekalongan University. By conducting research that focuses on the object, the aim is to describe the understanding of the students of Pekalongan University about the financial reporting fraud and the role of whistleblowing system and ethical behavior as the prevention and detection of fraud. In this study, researchers sought to collect accurate data using a questionnaire. Primary data in this study include respondents' answers through the distribution of questionnaires in the form of statement items for perceptions variable regarding whistleblowing system, ethical behavior, and prevention of financial reporting fraud. The questionnaires given by the researcher are guided in completing the questionnaire as simple and clear as possible to facilitate the complete replenishment of the complete answer.

In the research instrument, the researcher uses 5 Likert Scale Scores to know Perceptions of Whistleblowing System, Ethical Behavior, and Fraud Prevention: strongly agree, agree, neutral, disagree, strongly disagree. Answer Score 1: Strongly Disagree (STS), 2 Disagree (TS), 3 Neutral (N), 4 Agree (S), 5 Strongly Agree (SS). The sample in this study is the Accounting student of Economics Faculty of Pekalongan University who has taken the course of Auditing.

#### 3.1. Prevention of Financial Reporting Fraud

Prevention of Financial Reporting Fraud is an attempt or attempt to reject or retain any form of dishonest acts which may result in real loss or loss for the company, employees and others. Prevention is done so that fraud in the company does not happen, so the company's ideals will be achieved and make the company's reputation to be good. The indicator underlying the researcher on the variable of Fraud Prevention of Financial Reporting is an indicator of fraud tree. This indicator consists of 3 main branches, namely corruption, misuse of company assets, and financial reporting fraud.

#### 3.2. Whistleblowing System

Perceptions of the whistleblowing system are understanding or interpretation of the channel for a person to report to the superior of an act of infringement or fraud committed by an internal company. In this case, the respondents express their approval or disapproval of the aspects contained in the Whistleblowing System. Independent variables are represented by Perceptions of the Whistleblowing System. Within these variables, there are 3 things that become indicators of research, namely the structural aspects of Whistleblowing System, Whistleblowing System operational aspects, and aspects of Whistleblowing System care.

#### 3.3. Ethical Behavior

In this study the variables of the mediator or intervening are the variables of ethical behavior. Ethical behavior is a behavior that conforms to generally acceptable social norms with respect to right and good actions, and can enhance one's dignity and honor. In this study, researchers used ethical behavioral indicators as proposed by Arens (2008) namely the elements of code of behavior consisting of the code of corporate behavior; general behavior of employees; activities,

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occupations and outside directorship positions; relationships with clients and suppliers; dealing with outside people and organizations; swift communication; and privacy and confidentiality.

## **4. RESULTS AND DISCUSSION**

### **4.1. Effect of Whistleblowing System on Prevention of Financial Reporting Fraud**

The results support the first hypothesis that Perceptions of the Whistleblowing System affect prevention of financial reporting fraud. It can be seen from B value of research coefficient that is equal to 0,519. The first hypothesis is accepted because the research t value of 3.121 is greater than t table at the 5% significance level of 2,042 ( $3,121 > 2,042$ ), besides the significance probability value of 0.004 ( $< 0.05$ ) also indicates that the student perception variable regarding Whistleblowing System have a significant positive effect on fraud prevention of financial reporting, and the influence of Student Perception on Whistleblowing System to Prevention of financial reporting fraud can be seen from Beta value that is 0,508 or 50,8%. The results of this study reinforce previous research conducted Irvandy (2014) stating that whistleblowing system significant effect on fraud prevention.

According to KNKG (2008), whistleblowing system must consist of at least three aspects, namely structural aspects, operational aspects, and maintenance aspects. In the results of this study, it is evident that respondents understand the three aspects that can then affect the whistleblowing system, while research by researchers conducted on companies that have not implemented whistleblowing system. This can be interpreted as the object of this research object to support the application of whistleblowing system, because it is proven to be able to prevent fraud.

According to KNKG (2008), whistleblowing system must consist of at least three aspects, namely structural aspects, operational aspects, and maintenance aspects. In the results of this study, it is evident that respondents understand these three aspects that can then affect the B research coefficient of 0.564. The second hypothesis is accepted because the research t value of 2.510 is greater than t table at the 5% significance level that is 2.042 ( $2,510 > 2,042$ ), besides the significance probability value of 0.018 ( $< 0.05$ ) also indicates that the Student Perception variable Regarding the Whistleblowing System have a significant positive effect on Ethical Behavior, and the influence of Perception About Whistleblowing System to Ethical Behavior can be seen from Beta value that is equal to 0,429 or 42,9%. The results of this study support the theory of Arens (2008) which states that whistleblowing system can create a positive work environment, so it can support employee behavior to comply with and obey the company's ethical values.

The respondents understanding of the whistleblowing aspects of the system has been shown to influence their ethical behavior. This is because respondents feel supervised by their own coworkers so that employees become more obedient and adhere to the code of conduct applied by the company, and do not want to break it. Based on the above statement, it can be concluded that the higher the perception about whistleblowing system, then they will be more obedient and obedient to the code of corporate behavior, so that they become ethical behavior.

### **4.2 The Influence of Whistleblowing System on Prevention of Financial Reporting Fraud through Ethical Behavior as a mediating variable**

The results of this study do not support the second hypothesis that Perceptions of the Whistleblowing System affect Prevention of Financial Reporting Fraud through Ethical Behavior. This is based on the calculation of the test sobel stating that there is no influence of mediation

because the value of  $t_{\text{research}} = 1.6825$  smaller than  $t_{\text{table}}$  with a significance level of 0.05 that is equal to 2.042. This can be interpreted as the fourth hypothesis that Perceptions of the Whistleblowing System affect Fraud Prevention through Ethical Behavior is not proven.

The second hypothesis is not proven because the theory used in this research is the theory proposed by Arens (2008) which states that financial reporting fraud can be prevented by creating a positive environment that all employees behave ethically, which can be driven by whistleblowing mechanism. However, according to KNKG (2008) in the Whistleblowing System Guideline, states that whistleblowing systems can encourage participation in reporting all forms of fraud including corruption to those who handle it. In addition, research from various institutions, such as the Organization for Economic Co-operation and Development (OECD), the Association of Certified Fraud Examiners (ACFE) and the Global Economic Crime Survey (GECS) concluded that one of the most effective ways to prevent and combat all types of cheating such as corruption and fraudulent financial statements are through whistleblowing mechanisms.

Based on this, Whistleblowing System is not proven to affect Fraud Prevention through Ethical Behavior. This is because the whistleblowing system is more aimed at prevention of financial reporting fraud.

### **4.3 CONCLUSIONS**

Based on the analysis and discussion that has been described previously it can be deduced as follows:

4. Whistleblowing System Positive Influence on Fraud Prevention Financial Reporting is acceptable
5. Whistleblowing System Positive Influence on Trends Financial fraud through Ethical Behavior is unacceptable.

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GENERAL COMMENTS

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