

# Determinants of Fraud Based on Islamic Paradigm: Case Study in Islamic Financial Services Cooperatives

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**Abstract** - Islamic financial institutions conducting its operations based on the principles of Islamic Shariah. In fact, cases of fraud still become a problem to be solved in the Islamic financial institutions. This study examined the determinant of fraud in Islamic Financial Services Cooperatives based on Islamic paradigm. The study was conducted in BMT ANDA Salatiga, Central Java, Indonesia. Data analysis technique used is multiple regression analysis. The results showed that there is negative and significant effect of tilawah on employee fraud. Other results showed that the opportunity has positive and significant impact on fraud. While the dimensions of pressure and rationalization are not proven to have significant effect on employee fraud.

**Keywords** - Islamic Paradigm, Tilawah, Pressure, Rationalization, Opportunity

## I. INTRODUCTION

Internal control system plays an important role for an entity. The main aim of this system is to increase compliance against the laws and regulations. Some authorities have formulated a model system of internal control, including the Committee Sponsoring Organizations of the Tread way Commission (COSO), KPMG,

The International Standards of Supreme Audit Institutions (ISSAI), and Basle Committee on Banking Supervision [1, 2]. However, the implementation of internal control system model is still not optimal. Kusumantoro et al [3] showed an evidence such as the case of PT Kimia Farma which did overstatement of its reported income and cases of embezzlement by Citybank, Bank Negara Indonesia, Bank International Indonesia (BII) and Viktoria Bank.

Islamic banks or Islamic financial institution is a bank or other financial institution that use the principles of sharia as the main principles in all operations of the entity. Fraud cases also occur in Islamic banks. For instance, the case of fictitious credits in Bank Syariah Mandiri and Bank Jateng Syariah. Kusumantoro et al [3] stated that one factor led to the ineffectiveness of internal control system is excluded God in the process. Moreover, most system emphasize on the surveillance among humans. This system is also implemented in Islamic financial institution.

According to Chartered Institute of Management Accountants (2009), fraud is the act of deception to create profit for themselves by dishonest and make another person's loss. A motivation for someone to do fraud is an

incentive or pressure to commit the fraud itself, the opportunity to commit fraud, as well as the attitude or rationalization to justify the acts of fraud. These three factors are known as fraud triangle. In addition, there is GONE theory, in which a person commit fraud because of greed, opportunities, need, and exposure. Greed and Need are the factors related to the individual of fraud perpetrators (also called individual factors), while Opportunity and Exposure factors are the factors in accordance to the organization as a victim of fraud (also known as general factor) [4]. Of the fourth fraud triggers above, the most decisive factor is greed. This is because if the opportunity, exposure, and need is weak but greed factor is high, then fraud is unlikely occurred, and vice versa. If the factor of opportunity, exposure, and need is powerful and the greed factor is weak, then the company will be susceptible to experienced fraud.

Moral related to a person's behaviour is called ethics. In ethics development, there are several theories. Beekun (1997) divide ethical theories into six categories, there are relativism, utilitarianism, universalism, rights, distributive justice, and eternal law. On the theory of relativism, ethics is considered relative and depends on the interests and personal needs, whereas utilitarian stated that the basis for determining the ethics is a consideration of cost and benefit, universal considers that an action is ethical if it is universal, regarded same in all places, and the standard view comes from motivation of decisions and actions. In addition, right emphasizes the ethics based on the fulfilment of individual rights. Moreover, distributive law insists on fair distribution of wealth, and eternal law using basic revelation or scripture as the determination of ethical action [5, 6].

## **II. RESEARCH METHODS**

This study aimed to examine the factors that influence fraud with Islamic-based Paradigm and Fraud Triangle. Fraud triangle theory is used in this study by three main factors, there are pressure, rationalization and opportunity. Moreover, pressure is measured

by nine constructs. Rationalization is assessed using eight constructs, while the opportunity is measured by twelve constructs. Furthermore, the population and sample are employees of BMT ANDA in Salatiga, Central Java. Questionnaires are distributed to the sample to collect the data. Finally, the data is analysed using descriptive analysis and multiple regression analysis.

## **III. RESULT AND DISCUSSION**

The description of research variables shows that the causal factors of fraud indicate less good numbers. This result is reinforced by the findings of employees' high pressure and rationalization. Both high factors may create fraud even though this situation is weakened by the weak opportunity. Religious activities of employees in this study is assessed by their recitations (tadarus/read the Koran). The result shows that most employees read the Koran 0.86 chapter in a day, or equivalent as 17.2 pages per day. This activity is accompanied by 3 times tahajud praying within a week.

Before hypothesis testing, we conducted reliability test, validity test, and classical assumption test. Moreover, the results indicate that the data has met all the classical assumption test. The next test is a multiple regression test for decision making related to the acceptance or rejection of the hypothesis developed.

The result of ANOVA Test showed that the value of F count is 14,902 with a significance level of 0.000. Hence,  $H_0$  is rejected and  $H_a$  is accepted. It means that fraud is affected by Koran recitations, pressure, rationalization and opportunity simultaneously. Furthermore, the coefficients table describes that there are some variables with significance value more than 0.05 and a few variables have a significance value less than 0.05.

The partial significance test shows the variables that have a significance value  $> 0.05$  is pressure and rationalization. This significance value indicates a rejection of the null hypothesis. Thus, statistically, there is no

partial significant relationship between pressure and fraud, as well as the rationalization and fraud. Nevertheless, Koran recitations and opportunity have a significance value  $< 0.05$ . It means an acceptance of null hypothesis. Therefore, there is a partial significant relationship between Koran recitation and fraud, and the correlation of pressure and fraud.

Descriptive research results show that the level of rationality and pressure of BMT employees is relatively strong, while opportunity level is low. High level of rationality and pressure led fraud to be occurred. However, the results showed a low level of potential fraud. In this research, the potential fraud is carried out by low level of assets misuse in BMT. In addition, the research result shows very good religious activity involving ritual worship and social activities. The worship activities that consist of daily praying, tahajud praying, religion gathering, and Koran recitation have largely been carried out by employees. Furthermore, employees also have activities involving social worship, such as silaturahmi activities, social activities, and infaq well.

Inferentially research results show that the pressure does not have a significant effect on fraud. This result is different from the results of researches conducted by [7, 8, 9]. Skousen et al. [7] stated that pressure, which is measured by four proxies, did affect fraud. This finding is also reinforced by the findings of [8] and [9]. Moreover, rationality is proved to have no significant impact on fraud. The result of this study is similar with [9], and in contrast to [7, 8].

The level of opportunity and Koran recitations have a significant effect on fraud. These findings corroborate the research results of [9] and [7] who found that ineffectiveness of monitoring activity has a negative influence on financial statement fraud. In addition, the research result also proves that Koran recitations have a negative impact on fraud. Recitations may increase readers' faith and will further raise awareness to always act in

accordance with Islam. These results are consistent with the word of Allah in Al Isra verse (17) 9, which means:

"Indeed, this Qur'an It gives guidelines to the straight path and give glad tidings to the believers who do righteous deeds and there is great reward for them." (QS. Al-Isra' (17): 9).

These findings are reinforced by the opinion of [10], who considered that several factors as the cause of fraud including religious, cultural, legal and socio-economic conditions of the company.

#### **IV. CONCLUSIONS**

Based on the results, the level of pressure and rationality of BMT employees is high, whereas the level of opportunity is low. The results also indicated that the potential for fraud as measured by the potential misuse of BMT assets is low. In addition, hypothesis testing results show that the level of opportunity and employees' Koran recitations have significant influence on fraud, while the pressure and rationality do not have a significant impact on fraud. Moreover, recitations and fraud have negative correlation. That is, the higher the recitations, the lower the fraud occurred.

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**(Arranged in the order of citation in the same fashion as the case of Footnotes.)**

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