The Effect Of Ineffective Monitoring In Detecting Fraudulent Financial Reporting With Family Firm As Moderator

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ABSTRACT

Ineffective monitoring is one of the opportunities for fraud to occur. This study aims to determine indications of fraudulent financial reporting due to ineffective monitoring in family companies in Indonesia. The sample used in this study is a company in the manufacturing sector. The independent variables in this study are ineffective monitoring of the independent board of commissioners and institutional ownership. Meanwhile, the dependent variable is financial reporting fraud which is measured using the F Score. The moderating variable used is the family firm as measured by family share ownership and family members on the company's board of directors. The results of the study based on a sample of 310 issuers were that ineffective monitoring of independent commissioners had no effect on fraudulent financial reporting and ineffective monitoring of institutional ownership had a significant negative effect on fraudulent financial reporting. The family firm variable which is proxied by family share ownership is not able to moderate the effect of ineffective monitoring both on the independent board of commissioners and institutional ownership on fraudulent financial reporting. Meanwhile, family firms that are proxied by family members in the composition of the board of directors strengthen the effect of ineffective monitoring on institutional ownership on fraudulent financial reporting. However, family members on the board of directors cannot moderate the relationship of ineffective monitoring of the independent board of commissioners to the manipulation of financial reporting.

Keywords: Ineffective Monitoring, Family company, Financial Reporting Fraud

1. Introduction

Financial statements are accounting information that reflects the company's financial condition. Financial information is a product of management and financial statements are a reflection of the company's performance. Financial reports for management can be used for performance evaluation, and the basis for decision making, both short term and long term. Financial statements are information that must be accounted for by managers for company activities to stakeholders. (Belkaoui, 1993). Management functions as a control structure and is very responsible for accounting transaction activities.

The company publishes its financial statements, actually wanting to show its condition in the best condition. This can lead to fraud in the financial statements. When the financial statements are materially misstated, the information in the financial statements is invalid. The existence of fraudulent financial statements occurs because of intentional or carelessness in doing something or not doing something that should be done, which causes the financial statements to be materially misleading (Tuannakotta, 2007).

Soselisa and Muchlasin (2008), define fraud as an intentional or reckless act either in the form of a deliberate act or negligence that results in a material error in the financial statements so that the financial statements contain misleading information. Research results from the Association of Certified Fraud Examiners (ACFE) Global show that every year an average of 5% of the company's revenue becomes a victim of fraud . In 2016 the total loss caused by fraud reached USD 6.3 billion with an average loss per case of more than USD 2.7 million. This causes the information contained in the financial statements to be invalid and can mislead users of financial statements in making decisions.

Most of the fraud is by manipulating the books (Heriyati, 2011). Ernst & Young (2003) found that more than half of the perpetrators of financial statement fraud are management . The number of accounting scandals has caused various parties to speculate that management has committed fraud in the financial statements (Skousen, Wright, & Kevin, 2009) . This refers to the theory of fraud risk factors developed by (Cressey, 1953) namely pressure, opportunity, and rationalization, which is often referred to as the Fraud Triangle .

Classification of opportunities or opportunities according to SAS No. 99 on financial statement fraud into three categories, nature of industry, ineffective monitoring and organizational structure. Weak supervision or monitoring provides an opportunity for managers to misbehave. Ineffective monitoring is one of the opportunities that allows fraud to occur. Opportunities are created because of weaknesses in internal control. Opportunity that allows fraud to occur. The results of research by Rachmania 2017) Ineffective Monitoring has no effect on fraud, while Putri (2017) research results have an effect on fraudulent financial statements.

In a family company, the ownership of the company is dominated by several individuals who have family relationships. Arifin (2003) the majority of public companies in Indonesia are controlled by family ownership. Beuren et al (2015) in Dwiyanti and Astriena (2018) state that a company is said to have a family when one of the family members serves as CEO or board of directors in a company. And according to Arifin (2003) a company is said to be a family company if there is individual ownership of 5% or more of the number of outstanding shares. Ownership of shares by the family will increase oversight of management performance. Family companies tend to have a concentrated ownership structure so that family companies almost do not experience type 1 agency conflict (Cheng, 2014).

2. Literature Review

2.1. Agency Theory

Agency theory (Agency Theory) put forward by Jensen & Meckling (1976) defines agency relationship as a contract between two parties which contains the delegation of work and authority by the first party (as the principal) to the second party (as the agent). Where the second party performs work for the benefit of the first party. The interests of the first party generally conflict

with those of the second party, because the first party as an information user obtains asymmetric information from the second party as an information provider which creates uncertainty (Deegan, 2007).

Information asymmetry can be in the form of an unequal distribution of information between the agent and the principal, and it is not possible for the principal to directly monitor the business transactions carried out by the agent. This causes agents who are directly related to business transactions to tend to perform dysfunctional behavior, among others, by presenting profits according to the expectations of the principal, so that the profit prediction does not describe the actual condition of the company (Scott, 2009) .

2.2. Ineffective Monitoring

Ineffective monitoring is a situation where the company does not have a supervisory unit that effectively monitors the company's performance. Ineffective monitoring can occur because of the dominance of management by one person or small group, ineffective supervision of the board of directors and audit committee over the financial reporting process and internal control and the like (SAS No. 99). To be able to control the company's performance effectively, an independent commissioner is needed. With the presence of an independent commissioner, the supervisory activities will be more independent.

2.3. Family Company

Family companies are one of the foundations of the business community, the majority of companies worldwide are owned by families (Burkart et al., 2003). The existence of the owner of the company acting as well as management can provide incentives for management to carry out direct monitoring and use voting power that minimizes less productive business activities (Jiraporn & DaDalt, 2007). The results of research (Claessens , et al., 2000) on the structure of corporate ownership in nine Asian countries show that public companies in Asia have a concentrated ownership structure. As many as 54% of public companies, especially in Asia, are controlled by families.

Donnelley (2002), an organization is called a family company if there are at least two generations of involvement in the family and they influence company policy. Andres (2008) states that a company is categorized as a family company if it meets at least one of two criteria. First, the founder and/or his family members have more than 25% voting rights, secondly if the founding family has less than 25% then 1 of their voting rights must be represented either in the executive or supervisory board. Meanwhile, in Indonesia there are regulations regarding share ownership of a company, namely the decision of the directors of PT. Jakarta Stock Exchange No.Kep-305/BEJ/07-2004 which explains that a shareholder can be called a controlling shareholder if he owns 25% or more of the company's shares. Another opinion says a company can be categorized as a family company if the ownership structure of 20% or more is in the hands of people who have a significant level of kinship, voting rights or control . (Anderson & Reeb, 2003).

2.4. Effect of Ineffective Monitoring on Fraudulent Financial Reporting

The board of commissioners has full authority and responsibility in controlling, supervising and directing the management of company resources (Syakhroza, 2005) in (Pamungkas et al., 2018). Research by Oktarigusta (2015) and Abdillah and Susilawati (2014) states that independent

commissioners have a negative effect on financial statement fraud. Due to the increasing number of independent commissioners, the supervisory process carried out by this board is getting more qualified because more and more independent parties are demanding transparency in the company's financial reporting. Rahmanti (2013) states that the high level of fraud that occurs in Indonesia is one of the reasons for the low level of supervision that creates a gap for someone to commit fraud . Based on this description, the proposed hypothesis is:
H1a: The ineffectiveness of the Independent Commissioner's Supervision has a positive effect on Fraudulent Financial Reporting.

Statement of Auditing Standards (PSA) No. 70 states that the risk of fraud will increase if opportunities are opened because there are weak or inadequate internal controls. Institutional shareholders have an incentive to monitor management performance because they get great benefits and by voting greater power makes it easier for them to take corrective action, thereby reducing the possibility of fraudulent financial reporting. If the proportion of institutional ownership of more than 5% of outstanding shares increases, then there is a possibility that indications of fraud will also increase. Loebbecke and Willingham (1988) found that internal control and decentralization had an impact on the risk of financial misstatement. According to Abbott et al. (2002) by using the ratio of institutional ownership can determine the impact of internal control. Based on this description, the proposed hypothesis is:
H1b: The Ineffectiveness of Institutional Ownership Supervision has a positive effect on Fraudulent Financial Reporting

2.5. The Influence Of Family Share Ownership Strengthens The Relationship Between Ineffective Monitoring And Fraudulent Financial Reporting

Family controlling shareholders in Asian countries tend to take advantage of the flexibility and discretion in accounting choices to distort the truth of the company's earnings performance (Fan and Wong, 2002). Agency problems are often found in concentrated companies, where the principal is the controlling shareholder and the agent is the non-controlling shareholder. When shareholders have majority control of the company, shareholders have the opportunity to make decisions in their own favor. Thus, the role of the independent commissioner serves as a mediation between majority and minority shareholders in order to obtain appropriate rights, as well as reducing conflicts between majority and minority shareholders (Andersen & Reeb, 2004). Based on this description, the proposed hypothesis is
H2a: Family share ownership in the company strengthens the effect of the ineffective supervision of independent commissioners on Fraudulent Financial Reporting

The existence of the family as the majority shareholder which will cause differences in interests with the minority shareholders and the family can also take unprofessional actions to be logical. This can have an impact on the ineffectiveness of internal control as proxied by the percentage of institutional ownership in identifying possible fraudulent financial reporting. Based on this description, the proposed hypothesis is
H2b: Family share ownership in the company strengthens the effect of ineffective supervision of Institutional Ownership on Fraudulent Financial Reporting

2.6. The Influence of Family Members in the Composition of the Board of Directors strengthens the relationship between Ineffective Monitoring and Fraudulent Financial Reporting

Family companies with a concentrated ownership structure are generally dominated by the majority shareholder (controlling). The majority shareholder generally also appoints family members to be on the board of directors. This can have a negative impact on minority shareholders because majority shareholders can abuse substantial control to act in the interests of the family rather than the interests of shareholders as a whole (Young, et al., 2008). Monitoring carried out by the board of commissioners and shareholders is an important mechanism in aligning the interests of shareholders and management in order to minimize manipulation of financial statements. Based on this description, the proposed hypothesis is:
H3a : Family members in the composition of the board of directors strengthen the influence of the ineffective supervision of independent commissioners on Fraudulent Financial Reporting

Fraud can occur when there is an opportunity for someone to do so and can occur in companies that do not have sufficient oversight. Effective supervision can affect the size of the opportunity or opportunity to commit fraud. The ineffectiveness of institutional ownership in carrying out the supervisory function of the financial reporting process will create opportunities for misstatements to occur. Opportunities can also occur due to the appointment of family members who are actually less competent to run a business business, so that they have poor performance in using accounting policies, especially those related to reporting. Agency problems in family firms also lead to higher agency costs compared to non-family firms because of the family's reluctance to fire incompetent family members in the firm. Based on this description, the proposed hypothesis is:
H3b : Family members in the composition of the board of directors strengthen the effect of ineffective institutional ownership supervision on Fraudulent Financial Reporting

3. Research Methodology

This study uses a quantitative approach, testing the relationship between the variables that became the hypothesis of this study. The following is the sampling obtained after the selection according to the criteria that have been set:

Table 1 Research Sample

Sample Criteria	Amount
Banking companies listed on the Indonesia Stock Exchange	158
The company does not publish its financial statements	(5)
Financial statements are not stated in Rp	(30)
The company conducts an IPO/ delisting during the year of observation	(18)
Total Company Sample	**105**
Research Period	3
Total research sample	**315**
Outliers	(5)
Total sample used	**310**

The dependent variable in this study is fraudulent financial reporting which is proxied by one of the fraud score models (F-Score Model) developed by (Dechow, et al. 2010). Measurement of the F-Score Model consists of two components, namely, accrual quality which is proxied by RSST and the second component is financial performance which is proxied by changes in accounts receivable, changes in inventory accounts, changes in cash sales accounts and changes in income before interest and taxes. The following describes the F-Score calculation model:

FFR = Accrual Quality + Financial Performance

The proxies for each variable in this study are as follows:

Table 2 Variable Operation

Variable	Proxy	Variable Proxy Definition	Calculation
Fraudulent Financial Reporting (Dependent)	FFR	Deliberate actions or actions to produce a material misstatement in the financial statements that are the subject of the audit. (Dechow, et al. 2010)	Accrual Quality + Financial Performance
Ineffective Monitoring (Independent)	BDOUT	The ratio of commissioners who come from outside the company to all members of the board of commissioners (Skousen, 2009)	$\frac{komisaris\ independen}{dewan\ komisaris}$
	BLOCK	Percentage of shareholders owned by institutional owners (>5%) (Skousen, 2009)	The dummy variable is code 1 for companies that have institutional ownership, and code 0 is for companies that are categorized as having no institutional ownership
Family Company (Modation)	Family shareholding (FO)	Ownership structure of 20% or more in the hands of persons with significant kinship, voting rights or control (Anderson & Reeb, 2003)	The dummy variable is code 1 for companies categorized as family firms , and code 0 is for companies categorized as non-family firms.
	Family members on board of directors (FM)	The ratio of family members in the composition of the board of directors and commissioners (Hu, Wang, & Zhang, 2007)	$\frac{Anggota\ keluarga\ dalam\ susunan\ direksi\ dan\ komisaris}{Total\ jumlah\ anggota\ direksi\ dan\ komisaris}$

The statistical analysis technique in this study uses multiple linear regression (multiple linear regression) . In the multiple linear regression analysis, descriptive statistical tests and classical assumption tests were carried out first. Classical assumption test is used to find out whether the data meet the assumptions basic assumptions. The tests carried out in this study were the normality test, the multicollinearity test, and the heteroscedasticity test.

The regression equation model used in this study is assumed to be linear and tested with a significance level of 5%. The first hypothesis was tested using multiple linear regression analysis with the following equation:

$$F\ FR_{it} = ®_0 + ®_1\ BDOUT + ®_2\ BLOCK + \varepsilon \quad (1)$$

The second and third hypotheses use *moderated regression analysis* (MRA), which is a special application of multiple linear regression in which the regression equation contains interaction variables.

$$FFR_{it} = ®_0 + ®_1\ BDOUT + ®_2\ BLOCK + ®_3\ FO + ®_4\ BDOUT*FO + ®5BLOCK*FO + \varepsilon \quad (2)$$

$$FFR_{it} = ®_0 + ®_1\ BDOUT + ®_2\ BLOCK + ®_3\ FM + ®_4\ BDOUT*FM + ®5BLOCK*FM + \varepsilon \quad (3)$$

4. Results

4.1. Descriptive Analysis Results

Descriptive statistical analysis in this study was used to provide information about the characteristics of the variables in the study, including minimum, maximum, average, and standard deviation. Based on a sample of 310 companies, the lowest value of the FFR variable is -0.995 owned by PT. Tiga Pilar Sejahtera Food Tbk for the 2019 financial year, while the highest score of 2,367 was at PT. Trisula International Tbk for the fiscal year 2019. The variable ineffective monitoring (BDOUT) has the lowest 0.2 owned by PT. Kimia Farma Tbk for the 2018 financial year, while the highest value of 0.833 is owned by PT. Unilever Tbk for fiscal year 2020. Highest score family firm (FM) is 0.714 by PT. Saranacentral Bajatama Tbk during the year of observation.

In descriptive statistical measurements for the dummy variable based on 310 companies in the ineffective monitoring variable (BLOCK) proxied by the percentage of shareholders owned by institutional owners at the time of the study were coded 1 as many as 67 companies or 22% of the total sample of companies. Meanwhile, the percentage of shareholders who are not owned by institutional owners is coded 0. There are 243 companies or 78% of the total sample of companies. highest variable family Firms (FO) as proxied by the share ownership structure by families are coded 1 as many as 188 companies or 61% of the total sample of companies. Meanwhile, share ownership that is not owned by the family of the company's founders is coded 0. There are 122 companies or 39% of the total sample.

4.2. Hypothesis test

The following are the results of hypothesis testing which are described in the table below:

Table 3 Hypothesis Testing Results

	Regression			**Simultaneous Effect**		**Coefficient of Determination**	
	®	**T**	**Sig**	**F**	**Sig.**	**R2 -**	**Adjusted R ^{2}**
BDOUT □FFR (H $_{1a}$)	0.221	0.765	0.445	3,960	0.020	0.025	0.019
BLOCK □FFR (H $_{1b}$)	-0.217	-2,714	0.007				
BDOUT*FO □FFR (H $_{2a}$)	-0.467	-1,725	0.086	3,428	0.005	0.053	0.038
BLOCK*FO □FFR (H $_{2b}$)	0.435	**2,836**	**0.005**				
BDOUT*FM □FFR (H $_{3a}$)	-4,778	-5,333	0.000	11,449	0.000	0.158	0.145
BLOCK*FM □FFR (H $_{3b}$)	1,199	**3,791**	**0.000**				

Based on the table above, it can be concluded that this model test is feasible to be used in research, so that the regression equations (1), (2) and (3) that are formed are feasible or good to be used as estimation tools and can be continued to the next test.

5. Discussion

5.1. Effect of Ineffective Monitoring on Fraudulent Financial Reporting

H1a test shows that the effect of the ineffective monitoring variable to fraudulent financial reporting obtained a significance value of 0.445 > □(5%) and the t- count value is 0.765 while the t - table value is 1, 96 . The results of this hypothesis test show that ineffective monitoring has no and no significant effect on fraudulent financial reporting. This means that H1a is rejected . The results of this study are in line with (Kurnia & Anis, 2017) and (Skousen, 2004) showing that ineffective monitoring of independent commissioners has no effect on fraudulent financial reporting.

H1b test proves that the effect of the ineffective monitoring variable proxied by the percentage of institutional ownership (BLOCK) on the probability of a company committing fraudulent financial reporting is obtained a significance value of 0.007 < 〈(5%) and the t-count value is -2.714 while the t-table value is 1,96 . The results of this hypothesis test show that ineffective monitoring is proxied by the percentage of institutional ownership (BLOCK). take effect negative and significant to fraudulent financial reporting . This means that H1b is rejected . This is in accordance with the research of Abbott, et al . (2002) who found that institutional ownership has a negative effect on the possibility of fraudulent financial reporting.

5.2. The Effect of Family Stock Ownership strengthens the relationship between Ineffective Monitoring and Fraudulent Financial Reporting

H 2a . test show that influence the variable of family share ownership (FO) in moderating the ineffective monitoring variable proxied by the ratio of independent commissioners (BDOUT) to probability something company To do action fraudulent financial reporting obtained score significance 0.086 > 〈 (5%) and score t-count is -1,725 while the value of t-table of 1,96 . Results test hypothesis this show The interaction variable of family share ownership (FO) is not able to moderate the effect of ineffective monitoring on fraudulent financial reporting . This thing means that H 2a rejected.

Family firms have strong corporate governance, so that on average, firms with family ownership are associated with higher earnings quality. Therefore, family companies do not need to practice fraudulent financial reporting. According to (KNKG, 2006) that one part of the company's organ that is important in GCG is the board of commissioners. The role of independent commissioners also serves as a mediation between majority and minority shareholders in order to obtain appropriate rights, as well as reducing conflicts between majority and minority shareholders (Andersen & Reeb, 2004).

H 2b . test show that influence the variable of family share ownership (FO) in moderating the ineffective monitoring variable to probability something company To do action fraudulent financial reporting obtained score significance 0.005 < 〈 (5%) and score t-count is 2,836 while the value of t-table of 1,96 . Results test hypothesis this show The interaction variable of family share ownership (FO) strengthens the effect of ineffective monitoring on fraudulent financial reporting . This thing means that H 2b accepted.

Indications that there are institutional ownership or ownership of institutional shares in the company will be a pressure on its own for the company because the management has a greater responsibility because the responsibility is carried out not only to an individual, but to the institution. The greater the share ownership owned by the institution, the greater the possibility of the company feeling pressured, causing fraudulent financial reporting. In addition, the existence

of the family as the majority shareholder will cause differences in interests that lead to unprofessional actions namely for personal benefits (private benefits) .

5.3. The Influence of Family Members in the Composition of the Board of Directors strengthens the relationship between Ineffective Monitoring and Fraudulent Financial Reporting

H 3a. test show that influence variable of family members in the composition of the board of directors (FM) in moderating the ineffective monitoring variable to probability something company To do action fraudulent financial reporting obtained score significance 0, 000 < 〈(5%) and score t-count is -5,333 while the value of t-table of 1,96. Results test hypothesis this show The interaction variable of family share ownership (FO) weakens the effect of ineffective monitoring on fraudulent financial reporting. This thing means that H 3a rejected.
Family companies can reduce or even eliminate agency problems, there is no conflict between management and company owners, because decision making and control are carried out by the same agent, namely the family.

H 3b. test show that influence variable of family members in the composition of the board of directors (FM) in moderating the ineffective monitoring variable proxied by the percentage of institutional ownership (BLOCK) to probability something company To do action fraudulent financial reporting obtained score significance 0, 000 < 〈 (5%) and score t-count is 3,791 while the value of t-table of 1,96. Results test hypothesis this show The interaction variable of family share ownership (FO) strengthens the effect of ineffective monitoring on fraudulent financial reporting. This thing means that H 3b accepted.

Companies that have a concentrated ownership structure in the family will usually have a merger between the management and control functions in the company. so that non-optimal investment decisions can occur namely when appointing family members who may actually be less competent to run a business venture. Investment decisions that are not optimal will only benefit the family, but harm the minority shareholders because of differences in interests between the two types of shareholders. (Fama and Jensen, 1983). Type your paragraphs here. For all formatting structure refer to previous guidelines

6. Conclusion

Ineffective Monitoring Test on Fraudulent Financial Reporting, shows the results have no effect and are not significant.

Testing the variable of family share ownership in moderating the ineffective monitoring variable proxied by the ratio of independent commissioners to the probability of obtaining a value of not being able to moderate the effect of ineffective monitoring on fraudulent financial reporting. And the effect of the variable of family share ownership in moderating the variable ineffective monitoring strengthens the effect of ineffective monitoring on fraudulent financial reporting.

Testing of family members on the Board of Directors strengthens the relationship between Ineffective Monitoring and Fraudulent Financial Reporting. The significance value shows that the interaction variable of family share ownership weakens the effect of ineffective monitoring on fraudulent financial reporting.

It is recommended for further research to expand the sample used. By using other industries and longer periods to produce more accurate conclusions.

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