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ICOn-LBG 2016

**The Third International
Conference on Law,
Business and Governance**

PROCEEDINGS

Hosted by
Faculty of Law, Faculty of Economics and Faculty of Social Science
Bandar Lampung University (UBL)



Icon-LBG 2016

THE THIRD INTERNATIONAL CONFERENCE
ON LAW, BUSINESS AND GOVERNANCE 2016

20, 21 May 2016
Bandar Lampung University (UBL)
Lampung, Indonesia

PROCEEDINGS

Organized by:



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PREFACE

The Activities of the International Conference are in line and very appropriate with the vision and mission of Bandar Lampung University (UBL) to promote training and education as well as research in these areas.

On behalf of the Third International Conference on Law, Business and Governance (3th Icon-LBG 2016) organizing committee, we are very pleased with the very good response especially from the keynote speaker and from the participants. It is noteworthy to point out that about 46 technical papers were received for this conference.

The participants of the conference come from many well known universities, among others : International Islamic University Malaysia, Unika ATMA JAYA, Shinawatra University, Universitas Sebelas Maret, Universitas Timbul Nusantara, Universitas Pelita Harapan, Universitas Bandar Lampung, Universitas Lampung.

I would like to express my deepest gratitude to the International Advisory Board members, sponsor and also to all keynote speakers and all participants. I am also grateful to all organizing committee and all of the reviewers who contribute to the high standard of the conference. Also I would like to express my deepest gratitude to the Rector of Bandar Lampung University (UBL) who give us endless support to these activities, so that the conference can be administrated on time

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Table Of Content

Preface.....	ii
International Advisory Board	iii
Steering Committee	iv
Organizing Committee.....	vi
Table of Content	ix
Keynote Speakers :	
1. Capability of Public Organizationstructure After Regional Extention in Way Kanan Regency (A Study on Basic Service Organization) – Yadi Lustiadi	I-1
2. Criminalisation of Copyright Piracy And International Trade: A Marriage of Convenience? The Case With Transpacific Partnership Agreement – Ida Madieha bt. Abdul Ghani Azmi	I-8
3. Legislative Measures To Prevent And Combat Sexual Violence Against Child: National and International Perspective – Antonius PS Wibowo	I-15
4. The Impact of Economic Structure Change on The Local Own Source Revenue and Its Effect Towards The Regional Income Improvement – Iskandar Ali Alam	I-25
5. The Influence Of Audit Committee and Internal Auditor Toward The Prevention of Fraud (A Survey In SOEs of Indonesia) – Angrita Denziana	I-40
Paper Presenter :	
Law :	
1. Application of Islamic Economic Law of Murabahah Funding In Islamic Banking – Nunung Rodliyah	II-1
2. Consultative Board Role of Country (BPD) in Monitoring Implementation of Government in The Country by Act Number 6 Of 2014 Concerning The Country – Rifandy Ritonga & Indah Satria	II-6
3. Identifying Criminalitor Using Face Detection on Room Security System – Robby Yuli Endra, Ade Kurniawan & Ari Kurniawan Saputra	II-14
4. Juridical Studies Mastery Mine Concept in The Approach to History and Principles of IMS (<i>Internasional Minimum Standard Of Civilization</i>) – Recca Ayu Hapsari	II-19
5. Legal Protection of Bank Customers In Cyber Crime Connected With The Internet Bankinglaw Number 11 Of 2008 Concerning Information and Electronic Transactions – Risti Dwi Ramasari	II-24
6. Legal Standing of Financial Services Authority (FSA) as Supervision of Banks Institutions in Indonesia – Zulfi Diane Zaini & Tami Rusli	II-28
7. Outlook for Tapis Fabric as Traditional Crafts Lampung Society in The Indication Geography Legal Protection – Erlina B, Recca Ayu Hapsari & Risti Dwi Ramasari	II-35

8. Punishment System Policy in The Prevention Effort To Criminal Act of Murder (Case Study of Murder Under Drunkenness) – Bambang Hartono & Benny Karya Limantara II-38
9. The Policy of Criminal Law Against The Crime of People Trafficking – Intan Nurina Seftiniara II-45
10. Analysis Reject Measure in Testing Non Constitutional Law on The Constitution NRI 1945 – Baharudin and Tantolailam II-51

Business:

1. An Analysis of Business Strategy To Increase Sustainable Competitiveness in Street Vendors (Studies in Mang Udin Ice Business in Bandar Lampung) – Sapmaya Wulan & Mahmudi III-1
2. Analysis of Economic Growth And Inflation Rate of Unemployment in Lampung Province – Achmad Subing III-10
3. Critical Success Factors and Risks Management in Applying Extensible Business Reporting Language – Idris Asmuni III-19
4. Differences Stock Return Between Company Which Has High Accounting Conservatism Level and Low Accounting Level to Company Registered at Stock Exchange of Indonesia Period 2010-2014 – Haninun, Angrita Denziana, Hepiana Patmarina & Theresia Aprilliani III-24
5. The Influence of Human Resources, Commitment Leader, The Use of Information Technology, and System Internal Control on The Quality of Local Government Financial Report Pringsewu – Chairul Anwar & Devi Meliana Mukadarul III-30
6. Foreign Debt Management Analysis And Impact On Economic Growth – Habiburrahman II-39
7. Influence of Motivation And Performance Work The Performance of Employees in Train Indonesia Company Tanjung Karang Bandar Lampung (A Case Study in The Commercial Employees) – Endang Siswati Prihastuti III-45
8. Influence of Work Motivation And Work Discipline on The Performance of Employees in Regional General Hospital in The District Demang Sepulau Raya Central Lampung – M.Oktaviannur & Adhetya Pratama III-52
9. Leverage Ratio Analysis Comparison Before and After Fixed Assets Revaluation in Jakarta Stock Exchange Impact on Investment Decisions Studies on The Company's Manufacturing IES Which Went Public on The Jakarta Stock Exchange – Ardansyah & Jant Kennedy Junior III-59
10. Market Regime and Relative Risk Between Sectors - Defrizal III-68
11. Moderating Effect of Switching Cost on Relationship Between Perceived Value, Satisfaction, Trust on Loyalty of Young-Age Customer In Tokopedia – Margaretha Pink Berlianto III-74
12. Marketing Mix Effect on Sales Volume of Banana Chips in Joint Business Group (KUB) "Telo Rezeki" in Bandar Lampung – Olivia Tjioener III-86
13. The Effect of Intellectual Capital and Corporate Governance on Bank's Financial Performance in Indonesia – Tia Rizna Pratiwi III-98

14. The Effect of Number Of Customers and Fund of Third Parties (DPK) on The Provision of Cash In Bni Sharia Yogyakarta Branch Period 2008-2010 – Revita Sari	III-107
15. The Effect of Services Quality on Satisfaction of Visitors Tourism in Recreation Park Mutun Beach Lampung – Selfia Alke Mega	III-113
16. The Effect of The Implementation of Good Corporate Governance on The Company Financial Performance – Nurdiawansyah & Aminah	III-121
17. The Influence of Leadership Style and Work Motivation Toward Employee Performance at Department of Communication and Information in Bandar Lampung City – Tri Lestira Putri Warganegara	III-129
18. The Influence of Quality Products and Quality of Customer Loyalty in Cigarette Class Mild in PT.Niaga Nusa Abadi Bandar Lampung) – Farida Efriyanti & FerdyRahman	III-136
19. The Influence of Transparency and Accountability Local Government Financial Report on The Level of Corruption Local Government of Sumatera Area – Khairudin, Rosmiati Tarmizi, Herry Goenawan Soedarsa & Rina Erlanda	III-146
Governance:	
1. Analysis of Implementation Program Village Funds in Supporting Regional Revenue - Ida Farida	IV-1
2. Development of A Public Service Model Through E-Government in Lampung Province - Malik & Noning Verawati	IV-6
3. Implementation of The Policy Program Bina Lingkungan The Government of Bandar Lampung City (A Studies on Vocational High School 2 Bandar Lampung) – Asrudi, Ferdiansyah & Sundari Saputri	IV-12
4. Motivation and Creativity Influence Toward Students Academic – Azima Dimiyati & Agus Purnomo	IV-15
5. Political Marketing and Communication Strategy To Win Legislative Nominee’s Competition Within Golkar Party in General Election 2014 – Pujono	IV-20
6. Sustainable Development Offuture Firmreputation - Vienda A Kuntjoro	IV-31
7. The Influenced of Good Corporate Governance to Corporate Sustainability – Vienda A Kuntjoro	IV-39
8. The Village People Empowerment to Increase Social Welfare - Wahyu Edi Purnomo, Desi Wahyuni & Widia Paramita	IV-45
9. The Dominant of Characteristic of Company at The Disclosure of Intellectual Capital (Study In Banking Company Registered In BEI Period 2010-2012) – Soewito, Suwandi & Hotma Margaretha Rumapea	IV-50
10. IT Bussiness : At A Glance Cloud Learning System in EF Bandarlampung – Arnes Yuli Vandika, Ruri Koesliandana & Dina Ika Wahyuningsih	IV-61

**THE INFLUENCE OF AUDIT COMMITTEE AND INTERNAL AUDITOR TOWARD THE
PREVENTION OF FRAUD
(A SURVEY IN SOES OF INDONESIA)**

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Abstract

The weakness of corporate governance is often called as the cause of some frauds and accounting scandals that were uncovered recently. It requires information quality, and free from distortion. Some cases both nationally and internationally indicate the occurrence of irregularities in financial reporting due to the weakness of the company's internal control system, and the audit committee has not functioned optimally. The audit committee has the responsibility to supervise matters that potentially contain risks in the internal controlling system and to monitor the supervision process conducted by internal auditor, to conduct examination and assessment on sufficiency and effectiveness of internal controlling system. The results show that audit committee optimization must have experience as auditor in public accountant office and the internal auditor must be improved through quality of internal auditor responsibility in prevention of fraud.

Keywords: Audit committee, internal auditor, and prevention of fraud

1. INTRODUCTION

The cause of the fraud and financial scandal which recently have been revealed is regarding with the weak corporate governance (Cohen et al. 2004). Fraud is an intentional deceiving act set by superiors in order to show better report than the actual report (Albrecht 2003: 97). This report which usually functions as a guidance sometimes misguides the investors in their decision (Verdi, 2006). Fraud can give bias and misleading information (Belkaoui, 2004:53-54)

This fraud cases has recently happened because the internal audit function is still not effective yet (Anwar Nasution, 2009). The modus of financial crime is not only about fraud but also about the weak system of audit (Josh Luhukay, 2011). It is also supported by the research, which reveals that 1) the financial report audit for external and internal is still not effective. 2) The function of internal audit or the risk assessment function is not effective while in fact this function is really needed by companies in order that the internal audit can run smoothly.

Bahr et al (2010) also proves that the involvement of chief executive officer as chief financial officer which triggers the fraud from 1997-2007 increases for about 6% or from 294 cases up to 347 cases and the most common fraud is about income claim. Income claim by managements using fraud technique such as asset misappropriation and corruption. Other research by ACFE (2010) reveals that American companies suffer from 6 % lost which is caused by fraud, this lost has not changed yet since 1996, the most common fraud has happened is asset misappropriation (85%) and corruption (15%) gives the most significant lost for about \$ 4.25 million (COSO, 2007).

Audit by Indonesia Audit Board (BPK) within 2005-2011 explains that there are 24 suspected corrupt SOEs, these frauds happen because of some factors, and the most factor is the weak system in internal control and accountant control. The general director of PT. Waskita Karya, TBK (M. Choliq, 2011) found an excess of report of 4 billion Rupiah which is made by previous director in doing fraud report within 2004-2008 by claiming the next prospective income as a certain period income. Moreover, an investigation by BPK towards bank century also reveals some important things such as: 1) \$ 18 billion corruption of valas finance and 247 negotiable certificate of deposits with prospective of 2 million rupiah; 2) there are some frauds done by bank officers, wealth holders and other related people which suffers Bank Century (Hadi Purnomo, 2011).

The reveals of some cases in India also shows the fraud reporting, like Satyam Computer Services, Ltd which reported the finance of about Rp. 50,4 billion or \$1.04 which is actually a fictive report. While the Lehman Brothers in USA 2008 was caused by materially misleading accounting gimmick or window dressing, that is an effort which is done in order to camouflage the real ugly truth.

The Auditors Klynveld, Peat, Marwick, Goerdeler (KPMG) in 2010 did a survey about fraud in any industrial segment in India with the managing director/Chairman, CFO, Head of Internal Audit and Compliance, Fraud Risk Manager and Senior management as respondent, and it was known that some factors initiating the fraud are: weak internal control (63%) the decrease of etiquite value (48%) and the fault in any action (40%). The reason of doing fraud is for management override control (66%), reaching market expectation (63%) and for remuneration based on work ethic (61%). fraud detection is mostly done by internal control system (47%). Detected fraud from mobile cellular is (38%) and from wistle blower is (26%).

Based on the data of fraud action by Certified Fraud Examiners (CFEs), The fraud done by top management and superiors contributes the biggest lost. The fraud prevention and detection is done by accounting standard board (FASB, 2008) and American Institute of Certified Public Accountants (AICPA, 2005), which is done by issuing standards and rules, which may prevent the fraud action.

The director of micro Mandiri Bank, Budi Gunadi Sadikin stated that the fraud is not only happening through physical action but also through electronic, which can be shown from fraud cases through credit card. This statement is supported by the data of Bank Indonesia as per April 2010 that the total fraud cases notified is 2.829 cases and the lost is about Rp. 16,72 billion, the volume of credit card transaction reaches 62,9 million which is equal to Rp. 49,85 triliun and the number of credit cards is 12,61 million cards. The money laundry case of Citibank costumer reaches Rp 17 billion also indicates the weak system of internal control. That is also the same to the money laundry effort in Indonesian State Bank (BNI), which ups to 4 billion, which has been reported recently.

The governor deputy of Bank Indonesiain Banking Efficiency Award discussion 2011 stated that the happening of many fraud cases is caused by the control toward top managements is not sustainable, the unoptimal internal control, the weakness in the policy and procedural implementation, and Human resource department does not really implement know your employee (Halim Alamsyah, 2011).

The preventive action of fraud has been done by the regulators like Bank Indonesia through regulation of Bank Indonesia No: 5/8/PBI/2003 which explains that fraud risk management must have the active control of hour of comisariat and direction, sufficient policy, procedure and limit sufficient identification, measurement, controlling and risk control, also management information sytem and thoroughly internal control by introducing risk prevention with "No fraud Tolerance" through optimalization of Principle based-regulation through optimalization of obedient direction function, internal control, and risk management which operates independently (KNKG, 2006). Audit committee can helps comisariat in: 1) improve the quality of report, 2) setting up the environment which can prevent the fraud action, 3) increasing the activity of internal audit, and 4) identifying things which need comisariat concern in company management.

The Telkom, Tbk case in 2002 indicates the weakness of audit committee, especially in terms of auditor recruitment, which did not confirm the qualification. This weakness of audit committee and the weakness of internal control also happened to Kimia Farma, Tbk which related to total benefit mark-up of Kimia Farma, Tbk in 2001 for about Rp. 32,668 billion (which was actually Rp. 99,594 billion but written as Rp. 132 billion). Some colleagues also stated that the cause of fraud action is also mainly about the decreasing of internal audit quality like in case of Enron, and Tyco (O' Keefe, 2003). This thing can help in rethinking that the improvement of audit committee quality must be done for preventing fraud. (Beasley et al, 2000 and Chtourou et al, 2001).

The audit committee is responsible in controlling things which have potential in the internal control system and monitoring the control process which is done by internal auditor (FCGI, 2006). Standards for the Profesional Practice of Internal Auditing (SPPIA) alo stated that the internal auditors must be able to use their position in doing internal control carefully, payin attention to any possibility of fraud, errors, manipulation, in-efficiency, non-effectiveness an conflict of interest and condition and activities which might cause irregularity (IIA, 2003).

Internal auditor also helps management in designing and sustaining the intern control sufficiency it is also responsible to control the sufficiency and effectiveness of respective control system (Hermanson et

al. 2008). According to Rezaee and Riley (2010), internal Auditor also has important roles in preventing and detecting the existence of fraud, also in evaluating the implementation of corporate governance.

Based on the background above, the researcher is interested in finding the clarity and empirical evidence about “The Influence of Audit Committee and Internal Auditor Toward the Prevention of Fraud” in SOEs Indonesia. The objective of the research is to analyze: 1) the influence of audit committee toward the prevention of fraud; and 2) the influence of internal auditor toward the prevention of fraud.

2. METHOD

The object of this research is audit committee, internal auditor, and the prevention of fraud in SOEs Indonesia. The method of the research in this research is (explanatory research), which explains the cause-effect relationship among variables (Cooper and Schindler, 2006:154).

The population of this research is 141 SOEs in Indonesia. This research uses the probability sampling technique and proportioned stratified random sampling because the population has heterogenous members and in proportional level (Sugiyono, 2009). The minimum number of sample in this research is 58 SOEs in Indonesia. The analysis device which is going to be used in this research is multiple linear regression, due to the limitation which is caused by number of sample, the model must be based on theory and indeterminacy (Ghozali, 2008). The measurement model in this research will be convergent validity and discriminant validity. Inner model will be evaluated by seeing three quantities by using R-square for dependent construct, Stone-Geisser Q-square test, t value and significance from structural parameter coefficient (Ghozali, 2008).

3. RESULT AND DISCUSSION

A. TEST OF THE FIRST HYPOTHESIS: THE INFLUENCE OF AUDIT COMMITTEE TOWARD THE PREVENTION OF FRAUD

Through coefficient value the exogenous variable influence can be measured (audit committee) toward the prevention of fraud, the result is:

Tabel 1
 The Influence of Audit Committee(AC) Toward The Prevention of Fraud (PF)

Variable	Coefficient	Direct Influence	Indirect Influence		Total
			AC	IA	
AC	0,468	21,8%		12,0%	33,8%
Total					33,8%

Based on the above result it can be seen that t value of variable AC (2,586) is higher than t critical (1,96), with the degree of freedom 5% it can be concluded that AC has positive influence and significance towards PF and SOEs in Indonesia. Automatically, audit committee contributes influence of 21,8% toward the prevention of fraud. Unintentionally, because the correlation with audit committee is 12,0% so the total influence of audit committee toward the fraud in SOEs in Indonesia is 33,8%.

B THE SECOND HYPOTHESIS TEST: THE INFLUENCE OF INTERNAL AUDITOR TOWARD THE PREVENTION OF FRAUD

Through coefficient value it can be measured that the influence of respective independent variables is internal auditor (IA) toward the prevention of fraud(PF).

Table 2
 The Influence of Internal Auditor (IA) Toward The Prevention of Fraud (PF)

Variable	Coefficient	Direct Influence	Indirect Influence		Total
			AC	IA	
IA	0,325	10,6%	12,0%		22,6%
Total					22,6%

Based on the above measurement it can be seen that t value of variable IA (2,738) is higher than t critical (1,96), based on the degree of freedom 5% it can be concluded that IA has positive and significant

influence toward PF in SOEs Indonesia. Directly, IA give contribution 10,6% toward PF, indirectly because of its correlation with AC is 12,0% so the total influence toward PF in SOEs Indonesia is 22,6%.

4. CONCLUSION AND SUGGESTION

A. CONCLUSION

- a) There is influence of audit committee toward the prevention of fraud. The function of audit committee in preventing the fraud is not optimal and is caused by the weak control function and internal control by audit committee. It is because of the lack of knowledge and experience of audit committee in financial accountancy; lack of training and coaching in accountancy, finance, and auditing which is held by professional organization; and the decreasing of ethical value.
- b) There is internal auditor influence toward the prevention of fraud. The internal control and the controlling function are not yet optimal because not all internal auditors have sufficient ability in detecting the existence of symptoms and red flags; to identify the possibility of fraud which is done by management; the finding which is still influenced by independency; lack of commitment by top management and doing the control function and internal controlling to prevent the fraud.

B. SUGGESTION

- a) Audit committee optimization must be improved through the standard recruitment process, like having experience as auditor in public accountant office and obeying the fixed standardization, the recruitment is handed to professionals in order to be free from any intervention from companies. Besides, audit committee activity as member in professional organization must be improved in order to enhance knowledge and experience in recent accountancy and finance, so it can ease the implementation of controlling function and internal control.
- b) Internal auditor must be improved through quality improvement of internal auditor responsibility by placing experienced internal auditor in terms of business process and the certified auditor is more preferable (QIA/CIA), in order to be easier in doing analysis for prevention of fraudulent financial reporting.

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