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TITLE: THE INFLUENCE OF INTERNAL CONTROL, ETHICAL CULTURE OF ORGANIZATION, AND LEADERSHIP STYLE ON FRAUD AT PRIVATE UNIVERSITY IN BANDAR LAMPUNG

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ABSTRACT

The purpose of this study was to obtain empirical evidence about the influence of internal control, ethical culture of organization, and leadership style on fraud. This research was conducted at Private University in Bandar Lampung with minimum accreditation of C. The sampling technique used is random sampling.

Types of data used in this study are primary and secondary data. Primary data were obtained by using field surveys using questionnaires distributed to respondents. Secondary data are collected from data collection agencies and published to the users of the data. In this study consists of three independent variables, namely internal control, organizational culture, and leadership style, and one dependent variable, namely fraud. Methods of data analysis using Structural Equation Model (SEM) with SmartPLS 3.2.6 data processing tool.

The results of this study indicate that internal control significantly negatively affect fraud. Leadership style consisting of Participative Style, Authoritarian Style, and Task Oriented Style significantly negatively affect fraud. While the ethical culture of organization has no effect on fraud. This may be influenced by a lack of employees' understanding of the ethical culture in their office. This results are expected to be useful to prevent the occurrence of fraud, especially at the Private University.

Keywords: internal control; ethical culture of organization; leadership style; and fraud

1. INTRODUCTION

A potential agency problem occurs when the share of a manager's ownership of a company's stock is less than one hundred percent (Masdupi, 2005). With the proportion of ownership that only

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part of the company makes managers tend to act for personal gain rather than maximizing the company. This is the basis for a person doing fraud in the company where he works.

Fraud is a latent danger that threatens the world. The results of the Association of Certified Fraud Examiners Global in the Association of Certified Fraud Examiners (2017) show that each year an average of 5% of the organization's income is the victim of fraud. Fraud is a growing problem nowadays. The perpetrators who perpetrate the fraud are not limited to the upper classes, but many have touched the lower layers of employees. ACFE in the Report to the Nations on Occupational Fraud and Abuse reported that fraud and abuse cases that occurred in 2016 reached 2,410 frauds in the workplace that occurred in 114 countries around the world.

According to Fritz Heider in Luthans (2005) as the originator of attribution theory, explains the process of how we determine the causes and motives of one's behavior. The use of attribution theory can be useful in finding out what factors affect the occurrence of fraud acts that occur within the company. Shelton (2014) explains that initially thought there were three different factors that contributed to a person's decision to commit fraud. All three factors are included in the fraud triangle. There are three elements of fraud triangle, among others: Pressure (pressure), Opportunity (opportunity), and Rationalization (rationalization).

According to Wolfe and Hermanson (2004) explained that the fraud diamond is a new view and concept of the phenomenon of fraud. The theory of diamond fraud is a form of refinement of the fraud triangle theory proposed by Cressey. If in fraud triangle there are three elements, then in fraud diamond plus one significant element to influence someone to do fraud, that is capability or capability. Wolfe and Hermanson (2004) explain that the fraud triangle can be increased to improve both fraud prevention and detection by considering the fourth element.

Fraud has gained much media attention as a phenomenon that can not be underestimated. The findings of the Supreme Audit Agency (BPK) and other educational corruption are ironic in the midst of Indonesia's efforts against corruption through education. Based on the monitoring of Indonesia Corruption Watch (ICW) quoted from Kompas.com site (2016) during the period 2003-2013 found 296 cases of educational corruption investigated by law enforcement and dragged 479 people as suspects. The state losses on all these cases amount to Rp 619.0 billion. Educational governance mainly related to the budget has not been complete. Almost all education programs, from the central level to the school and universities, lack public participation. Education policies and regulation still do not consider the importance of stakeholder participation in the preparation of programs and budgeting and management of education funds. The central government education program relies solely on the submission of needs submitted by the regional education office as well as statistical data issued by certain institutions such as BPS and the World Bank. This is a separate consideration for educational institutions to start paying attention to fraud actions that will harm these agencies.

According to Tunggal (2010) fraud prevention can be done through the implementation of internal control system. This is in line with the statement of Arens (2008) that management has a responsibility to evaluate the risk of fraud. Management needs to implement corporate governance and control procedures to minimize fraud risk through a combination of preventive, protection and detection measures. According to Robbins, *et al.* (2013) culture serves as a shaper and control mechanism that provides guidance and forms of behavior and attitudes of employees. When there are new employees in the company, they are not immediately able to run all the rules that exist within the company, but the employee will see the habits or culture that exist within the company. So when the ethical culture of the organization is good, then this will encourage employees to avoid fraud actions that will indirectly facilitate internal control. The ethical culture of this organization is usually influenced also by the leadership style of the organization's top brass. Yulk (2005) states that leadership style is a behavioral norm used by a person when the person tries to influence others as he or she wants In this effort to align perceptions among people who will influence behavior with people whose behavior will be influenced to be very important position.

There are some previous studies that deal with fraud issues. The result of Ansori, *et al.* (2018) in this study concludes that there is negative and significant effect of variable good university governance and effectiveness internal controlling system on the tendency of accounting fraud. This result proves the advantage of governance reinforcement to prevent fraud behavior in PTKIN-BLU. Meanwhile, variable obedience of accounting regulation does not affect the tendency of accounting fraud. Therefore, the obedience of accounting regulation in PTKIN-BLU does not affect the tendency of accounting fraud. Donelson, *et al.* (2017) find a statistically and economically significant association between internal control weaknesses and the future revelation of fraud. This association is driven entirely by instances where the internal control issue reflects a general opportunity to commit fraud (as captured by entity-level material weaknesses) rather than account- or process-specific control deficiencies. Joseph, *et al.* (2015) find that there was a statistically significant and positive relationship between the adequacy of internal control systems and fraud prevention and detection in district treasuries in Kakamega County.

Fraud can occur in any company whether in the private sector or in the government sector. Private companies are even more family-owned prone to fraud. This is due to the lack of oversight from external parties, making it easier for fraud perpetrators to take actions that harm the company. Therefore, the authors are interested to conduct research on the Private University in Bandar Lampung. This research aims to :

1. Analyze the effect of internal control on fraud.
2. Analyze the influence of organizational ethical culture on fraud.
3. Analyze the influence of leadership style on fraud.

2. LITERATURE REVIEW

2.1. Agency theory

Jensen and Meckling (1976) explain:

“Agency relationship as a contract under which one or more person (the principals) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent.”

The agency relationship is a contract in which the principal authorizes the agent to perform a service on behalf of the principal and make the best decision for the principal. If both parties have the same objective to maximize the value of the company, it is believed the agent will act in a manner consistent with the principal's interests. A potential agency problem occurs when the share of a manager's ownership of a company's stock is less than one hundred percent (Masdupi, 2005). With the proportion of ownership that only part of the company makes managers tend to act for personal gain rather than maximizing the company. This is what will lead to agency costs. Jensen and Meckling (1976) define agency cost as the sum of the principal's costs of controlling agents.

2.2 Theory of Attribution

According to Fritz Heider in Luthans (2005) as the originator of attribution theory, attribution theory is a theory that explains about one's behavior. Attribution theory explains the process of how we determine the causes and motives of one's behavior. Attribution theory explains the understanding of one's reaction to events around them, knowing their reasons for the event. Attribution theory explains that there are behaviors associated with attitudes and characteristics of individuals, it can be said that just look at the behavior will be known attitudes or characteristics of the person and can also predict the behavior of a person in the face of certain situations.

2.3. Fraud

Fraud is a common term among accountants, auditors, investors, and people engaged in accounting economics. Fraud itself has a wide range of understanding. The Association of Certified Fraud Examiners (2000) mentions fraud as unlawful acts committed intentionally (manipulation or

misrepresentation of other parties) perpetrated by persons from within or outside the organization for personal gain or groups that directly or indirectly harm others. Based on the Professional Standards of Public Accountant, section 316 Indonesian Institute of Accountants (2001) there are five instruments that can be used to measure fraud: manipulation, falsification of documents, omission of information, embezzlement of assets, and violations of accounting principles.

2.4. The effect of internal control on fraud

Arens (2008) states that management has a responsibility to evaluate the risk of fraud. Management needs to implement corporate governance and control procedures to minimize fraud risk through a combination of preventive, protection and detection measures. Management can prevent fraud by narrowing down opportunities, with fraud detection and punishment for fraud perpetrators. Agustina and Riharjo (2016) explained that one of the factors of the occurrence of fraud is because of opportunities. Fraud that occurs due to opportunities is a fraud arising from the weak and ineffective internal control system. This is in line with previous research conducted by Pristiyanti (2012), Pramudita (2013), and Zulkarnain (2013) where the results show that internal control negatively affects fraud trends. This shows that the tendency of employees to fraud can be reduced by internal control. The better the internal control, the less the level of fraud that occurs within an organization or company.

2.5. The effect of an organizational ethical culture on fraud

According to Schein (1992) states that organizational culture is a basic pattern accepted by the organization to act and solve problems, forming employees who are able to adapt to the environment, and unify the members of the organization. The ethical culture of an organization is an unwritten, unwritten or perceptual pattern that is shared and embraced by members of the organization in order to be obeyed by all involved, and contains the moral values or principles of the organization. Robbins, *et al.* (2013) state the ethical organizational culture in which organizational culture tends to form high ethical standards among its members. If a culture is strong and supports high ethical standards, it will have a very powerful and positive effect on the behavior of its employees. This is supported by research conducted Pramudita (2013) and Pristiyanti (2012) in which the results of his research indicate that organizational culture a negative influence on fraud The better understanding of the employees of the organization's ethical culture, then reduce the propensity of fraud.

2.6. The effect of leadership style has an effect on fraud

Yulk (2005) states that leadership style is a behavioral norm used by a person when the person is trying to influence others as he or she wants. Leadership style is a characteristic of core managers in achieving company goals or in other words more point to the behavior patterns of top executives and senior management team. According to Rae and Subramaniam (2008), the ethical environment of an organization includes aspects of the top management style in achieving organizational goals, their values and management or leadership styles, it is argued that in a more ethical environment employees will tend to follow the rules companies and regulations will be morally acceptable behavior so it can be said that in an ethical environment formed by a good leadership style, will affect the tendency of cheating by employees. Research Pramudita (2013), Faisal (2103), and Zulkarnain (2013) showed that leadership style negatively affect the tendency of fraud.

2.7. Hypothesis

Based on the theoretical basis above, it can be derived hypothesis as follows:

- H1: Internal control is negatively affecting fraud.
- H2: Organizational ethical culture negatively affects fraud.
- H3: Leadership style negatively affects fraud.

3. METHODS

The population in this study is the Private University in Bandar Lampung that is accredited at least C. For the selection of samples is done by random sampling method which is the technique of sampling without certain criteria. From 14 private universities in Bandar Lampung, five Private University samples were selected in Bandar Lampung. The universities used in this study were Saburai University, Teknokrat University, Bandar Lampung University, Mitra University, and Malahayati University.

Respondents in this study are employees consisting of Staff, Sub-head, Head, and Lecturer working at the University. Each University will be sampled as many as 20 people. The survey method was conducted by spreading 4 sets of questionnaires to the employees of the Private University in Bandar Lampung. Measurement Scale questionnaires using 5 Likert scales, where the answer of each instrument item has a gradient ranging from Strongly Agree (SA), Agree (A), Less Agree (LA), Disagree (D), and Strongly Disagree (SD).

Dependent variable in this research is Fraud, where dependent variable or dependent variable is variable influenced by independent variable. In order to measure the dependent variable, required indicators as a test instrument in the study. The instrument used to measure fraud consists of 5 items of questions developed from the Professional Standards of Public Accountant, section 316 of the Indonesian Institute of Accountants (2001) namely manipulation, falsification of documents, omission of information, embezzlement of assets, and violation of accounting principles.

The independent variable is a variable that influences or becomes the cause of change or the incidence of the dependent variable (bound). The independent variables in this study are Internal Control, Organizational Ethical Culture, and Leadership Style. Internal control as an independent variable according to Government Regulation Number 60 of 2008, which is an integral process on actions and activities conducted repeatedly by the leadership and all employees to provide reasonable assurance on the achievement of organizational goals through effective and efficient activities, reliability of financial reporting, security of State assets, and compliance with laws and regulations. Indicators in this variable are developed and modified from the Komitee of Sponsoring Organization (2013), namely: control environment, risk assessment, control standards, information and communication, and monitoring.

This variable is one of the proxies of Fraud Diamond Theory, namely Rationalization, in the form of normative rules and employee code of ethics set that contains the rules of values and moral principles that become the reference in carrying out its duties. The indicators used to measure the organizational ethical culture were developed by Robbins, *et al.* (2013), namely: visible role model, communication of ethical expectations, ethical training, punishment for ethical action, and ethical protection mechanisms.

Yulk (2005) states that leadership style is a behavioral norm used by a person when the person is trying to influence others as he or she wants. Leadership style is a characteristic of core managers in achieving company goals or in other words more point to the behavior patterns of top executives and senior management team. In this study, the dimension of leadership style refers to the dimension developed by Mas'ud (2004), which consists of: Participative Style, Nurturant Style, Authoritarian Style, Bureaucratic Style, and Task Oriented Style.

In this research, data analysis using partial least squar (PLS) approach is a SEM structure equation model based on component or variance. PLS is a full power analysis method because it is not based on many assumptions. Data do not have to be multivariate normal distribution (indicators by category scale, ordinal, interval, until the ratios can be used on the same model) and the sample should not be large (Hair, *et al.*, 2010). In addition can be used to confirm the theory of PLS can also be used to explain the presence or absence of relationships between latent variables, PLS can simultaneously analyze constructs formed with reflexive and formative indicators.

4. FINDINGS AND ARGUMENT

4.1. Validity test

The discriminant validity test can be seen from the average variant or Average Variance Extracted (AVE) model. From the result of SmartPLS 3.2.6 estimation obtained AVE curve as follows:

Table 4.1. Average Variance Extracted (AVE)

	Average Variance Extracted (AVE)
Organizational Ethical Culture	0.698
Fraud	0.805
Leadership Style	0.650
Internal Control	0.718

Source: SmartPLS processed data (2018)

The results of the estimated AVE values obtained for X1, X2, X3, and Y are 0.718; 0.698; 0.650; and 0.805. Henseler, *et al.* (2009) states that the construct is said to have a good validity value if AVE has a value greater than 0.5 ($AVE > 0.5$). This value indicates that one latent variable has been able to explain more than half the variants of its indicators in the mean. Thus the construct of this research has good convergent validation value.

4.2. Test of Reability

The test was conducted to evaluate the outer model by looking at the reliability of the latent variable construct measured by two criteria: cronbach alpha and composite alpha $> 0,700$ and composite reliability value $> 0,700$ showing accuracy, accuracy, consistency of a measuring instrument in performing a measurement (Neuman, 2006). The following output results from SmartPLS 3.2.6. in Table 4.6.

Table 4.2. Quality Criteria (Cronbach Alpha and Composite Alpha)

	Cronbach's Alpha	Standard Reliable	Composite Reliability	Standard Reliable	Description
Organizational Ethical Culture	0,854	0,700	0,902	0,700	Reliable
Fraud	0,939	0,700	0,954	0,700	Reliable
Leadership Style	0,732	0,700	0,848	0,700	Reliable
Internal Control	0,799	0,700	0,884	0,700	Reliable

Source: SmartPLS processed data (2018)

The table above shows the overall cronbach alpha value of all constructs having values above 0.700 as well as for the composite reliability values of all constructs having values above 0.700. Thus it can be concluded that all constructs have high reliability so that the construct is said to be accurate and the respondent is quite consistent in answering the item statement on the given questionnaire.

4.3. Hypothesis testing

The hypothesis developed in this study is based on the existing theoretical considerations and the results of previous studies. Hypothesis testing is done by looking at probability value and t-statistic value. With probability values at $\alpha = 5\%$, the t-table value for $\alpha = 5\%$ is 1.96. So the proposed hypothesis is accepted and significant if $\rho \leq 0.05$ and $t\text{-statistics} > 1.96$ (Gujarati, 2010). Based on the

estimation of SEM path analysis through SmartPLS 3.2.6 application, Path Coefficients result in each relation with estimated value as follows:

Table 4.3. *Path Coefficients (Mean, STDEV,T-Values)*

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (O/STDEV)	P Values	Description	Conclusion
X1 → Y	-0,411	-0,386	0,102	4,045	0,000	Significant	Supported
X2 → Y	0,126	0,130	0,187	0,674	0,501	Not significant	Not Supported
X3 → Y	-0,650	-0,672	0,192	3,378	0,001	Significant	Supported

Source: SmartPLS processed data (2018)

Based on Table 4.8 it is known that the effect of internal control on fraud has t-statistics of $4,045 > 1,96$ and p -value of $0,000 < 0,05$ with coefficient value of $-0,411$ indicates that internal control variable significantly negative effect to fraud variable so H1 is supported .

Based on Table 4.8 it is known that the effect of organizational ethical culture toward fraud has t-statistics of $0,674 < 1,96$ and p -value of $0,501 > 0,05$ with the coefficient value of $0,126$ indicates that the organizational ethical culture variable has no significant effect on the fraud variable so H2 is not supported.

Based on Table 4.8 it is known that the effect of leadership style on fraud has t-statistics of $3,378 > 1,96$ and p -value of $0,001 < 0,05$ with the coefficient value of $-0,650$ indicates that the leadership style variables significantly negatively affect the fraud variable so that H3 is supported.

5. CONCLUSIONS

This study aims to examine the influence of internal control, organizational culture, and leadership style to fraud. Based on the results of the research as described in the previous chapters, it can be drawn some conclusions, namely:

- Internal Control has a negative and significant effect on Fraud. This can be interpreted that the better the internal control system conducted by the Private University in Bandar Lampung will reduce the level of fraud tendency that will happen. The results of this study support Arens (2008) states that management has a responsibility to evaluate the risk of fraud. Management needs to implement corporate governance and control procedures to minimize fraud risk through a combination of preventive, protection and detection measures. Management can prevent fraud by narrowing down opportunities, with fraud detection and punishment for fraud perpetrators. This is in line with previous research conducted by Pristiyantri (2012), Pramudita (2013), and Zulkarnain (2013) where the results show that internal control negatively affects fraud trends. The results of research conducted Agustina and Riharjo (2016) explains that one of the factors of the occurrence of fraud is due to the opportunity. Fraud that occurs due to opportunities is a fraud arising from the weak and ineffective internal control system. This shows that the tendency of employees to fraud can be reduced by internal control. The better the internal control, the less the level of fraud that occurs within an organization or company.
- Ethical Culture Organization has no significant effect on Fraud. . This can be interpreted that good or not understanding of employees to ethical culture of organization that exist at Private University in Bandar Lampung do not affect the level of fraud tendency that happened in that

agency. This may be due to a lack of employee understanding of the ethics-related seminars or training given by the University so that existing ethics training is less likely to impact the propensity for fraud. Unclear organizational ethical codes related to the basic principles of the organization resulting in employee misunderstanding may also be the cause of the unsupported hypothesis. Besides the lack of strict punishment and the absence of means to do the reporting if there is an act of fraud committed by one employee is also biased to be the cause. This is certainly not in line with Robbins, *et al.* (2013) statement about the ethical organizational culture in which organizational culture tends to form high ethical standards among its members. The results of this study are also not in line with previous research Pramudita (2013) and Pristiyanti (2012) in which the results showed that organizational culture has a negative effect on fraud. However, the results of this study are in line with previous studies conducted by Rachmanta and Ikhsan (2014), Zulkarnain (2013), and Faisal (2013) where there is no influence between the ethical culture of the organization and fraud .

- Leadership style has a negative and significant effect on Fraud. Based on Figure 4.2 can be seen that the indicator of leadership style that affect the fraud is Participative Style, Authoritarian Style, and Task Oriented Style. While Bureaucratic Style is difficult to apply because every Private University has its own rules so that its leadership style is more authoritarian. Likewise with Nurturant Style, Private University tends to prioritize family members or close relatives to be promoted so that the development of employees less attention. This can be interpreted that the leadership style of a boss at the Private University in Bandar Lampung can reduce the level of fraud tendency that will happen. This result is in line with Rae and Subramaniam (2008) which states that the ethical environment of an organization includes aspects of the top management style in achieving organizational goals, their values and management or leadership styles, it is argued that in a more ethical environment, employees will tend to follow company regulations and these rules will be morally acceptable behavior so that it can be said that leadership style will affect the fraud tendency of employees. The result of this research is in line with Pramudita (2013), Zulkarnain (2013), and Faisal (2103) where there is a significant negative influence on leadership style variable to fraud.

Based on the results obtained in this study, further advice can be given to each stakeholder, namely:

- The results of this study provide practical implications in the education sector how to reduce the occurrence of fraud in instansinya respectively. It is expected that the education sector can improve internal control system and good leadership style so that it can reduce the tendency of fraud occurrence.
- Organizational ethical culture variables still result in inconsistencies of research results with previous theories and research. Therefore, it is expected that further research can develop new dimensions and indicators that can be more accurate.
- Further research is expected to use different samples and locations so that the results of the study can be compared with previous research. In addition, further research is also expected to use larger samples so as to provide better results and better research picture and can be generalized.
- Further research is expected to develop a questionnaire that is used to explore respondent's perception, so that the questionnaire used can be better in capturing respondent's perception more accurately.

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