Risk Culture: An Approach to Reduce Local Government Fraud

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Abstract. The research objective was to examine how the risk culture approach can reduce fraud in local government circles. The study population was top management and middle management in the North Sumatra Provincial Government's regional work units, Indonesia. We will sample the entire population. The dependent variable is the level of corruption, and the independent variable is organizational support. At the same time, the moderating variable is the risk culture. The tools used are the PLS applications. The results showed that organizational support positively reduced of fraud in local governments. The research results also show that risk culture is a moderating variable that strengthens the influence of organizational support on reducing fraud.

1. Introduction

State and regional financial fraud is a phenomenon that occurs continuously. Although some of the cheating perpetrators have received the punishment, it does not create a deterrent effect for others. Many cases of fraud that occur involve several state and regional officials. There have been many studies in Indonesia examining the factors that influence fraud. Their research concluded that the element of the internal auditors' inability to find fraud in local government causes the perpetrators of fraud to feel comfortable in committing fraud. Besides that, risk culture has not been implemented in local government organizations. Fraud in the form of bribery, corruption, and so on is one of the most complex and destructive issues in our lifetime. No matter how it is eradicated nationally & internationally, bribery and corruption remain widespread. The World Bank estimates that more than 1 Trillion USD is spent on bribes each year, with the impact of catastrophic disasters such as decreasing political stability, increasing

business operating costs, and causing poor communities. Globally, bribery is a significant barrier to international trade, while organizationally, it has a high-intensity negative impact on employee morale. Many countries have taken action to eradicate bribery through state law and the UN Convention against corruption. However, there are still many things that must be done accordingly. Institutional changes and an anti-bribery culture within the organization can significantly contribute to the fight against bribery and complement legal action nationally and internationally.

Based Table 1 about the research of about the Corruption Perception Index (CPI) for Medan City having the lowest score among the 12 cities with 37.4 level from a scale of 100 point. The 2015 CPI for Medan was ranked 5th out of 11 cities surveyed (index 57 out of a scale of 100), and in 2010 Medan was rated 8th out of 11 cities surveyed (index 4.17 from a scale of 10).

Table 1: Corruption Perception Index Score of Cities in Indonesia

No	Cities	2017		2015		2010	
		Score	*Rank*	Score	*Rank*	Score	*Rank*
1	Surabaya	61,4	8	65	2	3,94	10
2	North Jakarta	73,9	1	57	5	4,43	7
3	Semarang	58,9	9	60	3	5,00	5
4	Pontianak	66,5	2	58	4	4,52	6
5	Pekanbaru	65,5	3	42	9	3,61	11
6	Makassar	53,4	11	48	8	3,97	9
7	Medan	37,4	12	57	5	4,17	8
8	Balikpapan	64,3	4	-	-	-	-
9	Banjarmasin	63,7	5	68	1	5,20	2
10	Padang	63,1	6	50	7	5,07	3
11	Menado	62,8	7	55	6	5,35	1
12	Bandung	57,9	10	39	10	5,04	4

Sources : Corruption Perceptions Index 2020 (https://www.transparency.org/en/cpi/2020)

Based on this phenomenon in Tabke 1, we would like to research the factors that are thought to reduce the level of fraud in Indonesia. Based on the literature review results, several variables are thought to affect the reduction in fraud level. These factors include organizational support (Putri et al., 2018) risk culture (Locke et al., 1986), organizational commitment (Erlina and Muda, 2018)and risk management implementation (Putri et al., 2018).The study examine about organizational support, organizational commitment, and implementation of risk management can reduce the level of fraud, both fraud in the form of bribery and corruption. This study also wants to test whether a risk culture's existence will increase the influence of organizational support, organizational commitment, and the model of application of risk management on reducing the level of corruption.

Three theories underlie this research framework, namely: (1) Agency Theory; (2) Expectancy Theory; and (3) Goal Setting Theory. Agency theory explains the relationship between the principal and the agent that governs the contractual relationship between two or more persons, groups, organizations or institutions. The principal makes an implicit or explicit contract with the agent, with the hope that the agent will carry out the work as desired by the principal and this is a form of delegation of authority. Agency theory recognizes that self-interest causes a conflict between the principal and the contract to overcome information asymmetry and moral hazard. Expectancy theory states that individuals have different goals and can be motivated if they have certain expectations. This choice theory describes the process that a person goes through to make a choice. Motivation boils down to deciding how much effort to apply in a given task situation. Goal-setting theory (Locke et al., 1986)asserts that many human actions are goal-directed and that the individual's conscious goal is the direct and most direct regulator of many human activities. Goals are expressed closer to the point of action than general needs, values, and attitudes.

Fraud is an act against the law to get personal or group gain, directly or indirectly harming other parties. Fraud is a deliberate act for employees, governance and third parties that involve deception to gain an advantage unfairly or violate the law. The fraud tree has three main namely:

1. Corruption. Yates (2011) defines corrupt as depraved, debased, morally degenerate, spoiled and tainted,. The break down Corruption schemes into four classifications: (1) illegal gratuity, (2) conflict of interest, (3) economic extortion and (4) bribery.s
2. Asset Misappropriation. Asset misappropriation can divide into two categories, namely: (1) cash misappropriation, which can be done in the form of skimming, larceny, or fraudulent disbursement, and (2) non-cash misappropriation, which can be done in the form of skimming, larceny, or fraudulent disbursement..
3. Fraudulent Financial Statement. Fraudulent financial statements can be carried out in several ways, namely by (1) recording fictitious revenues, (2) recording revenue and expenses in inappropriate periods (3) deliberately omit information or include wrong information from notes on financial statements (improper disclosure), or (4) improper asset valuation.

Khani and Sakeni (2020) state that the three conditions generally cause fraud to occur, namely: (1) there is an incentive or pressure that becomes a motivation for fraudsters to commit fraud. (fraud), (2) the existence of opportunities or opportunities (opportunities) that support the perpetrator to commit fraud (fraud), and (3) the existence of rationalization (rationalization), namely justification for behavior to commit fraud by the parties who commit the fraudulent act.

Risk culture is a set discussions, behaviors, decisions, and attitudes for taking and managing risk within an institution. The risk culture and organizational performance has attracted issue post the Global Financial Crisis in 2008 (Saedi et al., 2021). Extant studies about risk culture and organizational performance show that risk culture affects organizational performance. Unfortunately, these studies are few and concentrated in developed countries. A generic Risk Culture Framework was developed to facilitate the development of influential risk culture in all organizations (Kpodo and Agyekum, 2015)

In a company, risk culture can be seen in the policies and culture that are applied to the company. This culture will influence and set strategies and goals in business. Culture starts from the behavior and nature of governance (the board of directors), which will set concrete management actions. Risk culture has a significant impact on a company's business processes. Lack of competence in leadership, communication, and culture often results in major industrial events and disasters. This disaster can be in the form of a large amount of loss (can even lead to bankruptcy) or an environmental disaster that affects the wider community, such as the collapse of a shopping mall, which killed many people. In short, a strong risk culture can help risk management to minimize risk and loss and be able to create opportunities that can provide a competitive advantage in business.

Perception as a value their contribution and care about their welfare (Krishnan and Mery, 2012 and Caesens, 2017). Perceptions of organizational support represent employees' beliefs in the extent to which the organization can meet their socio-emotional needs and how the organization responds to their increased effort at work (Sun, 2015). Organizational Support Theory is a fundamental theory of perceived corporate support (Krishnan and Mary, 2012). Employees try to determine the organization's willingness to reward their efforts and meet their needs by making inferences about the organizational support level they feel(Krishnan and Mary, 2012). According to this theory, employees develop several perceived organizational support levels based on the treatment that the organization gives them. Good or bad, the organization's treatment of employees will make the employee attribute why the organization treats them in this way. The agreement and active involvement of the management must be secured in a climate that encourages the independent evaluation of the effectiveness of control, risk management, and governance (Putri et al., 2018).

The author states that there are certain phases in building commitment. To understand the importance of management commitment through employee performance studies. Managers make better use of their employees' creativity and imagination, prevailing at RBA implementation. Employees want to work for a company they can be proud of, that exhibits values and viewpoints similar to their own, and is concerned about long-term goals. These include the scientific stage where management motivates workers using the carrot and stick method, the human relations phase in which companies treat employees fairly and well and the principle-emphasized phase.

4. Methods

This research population is from the lower level management to the upper-level management in the regional work units of North Sumatera Provincial. This study uses a Documentation Study Technique and a Questionnaire. Documentation studies are data collection by studying scientific journals and books and searching the internet related to the researched problem. The questionnaire is a data collection technique that gives a set of questions or written statements to the respondent. Based on the previous explanation, the research framework can be considered in Figure 1 below.
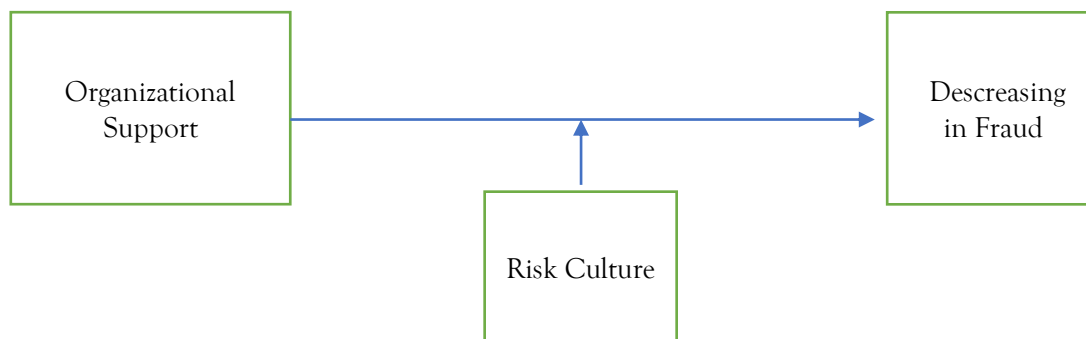
Figure 1. The Research Framework

3. Findings and Discussions
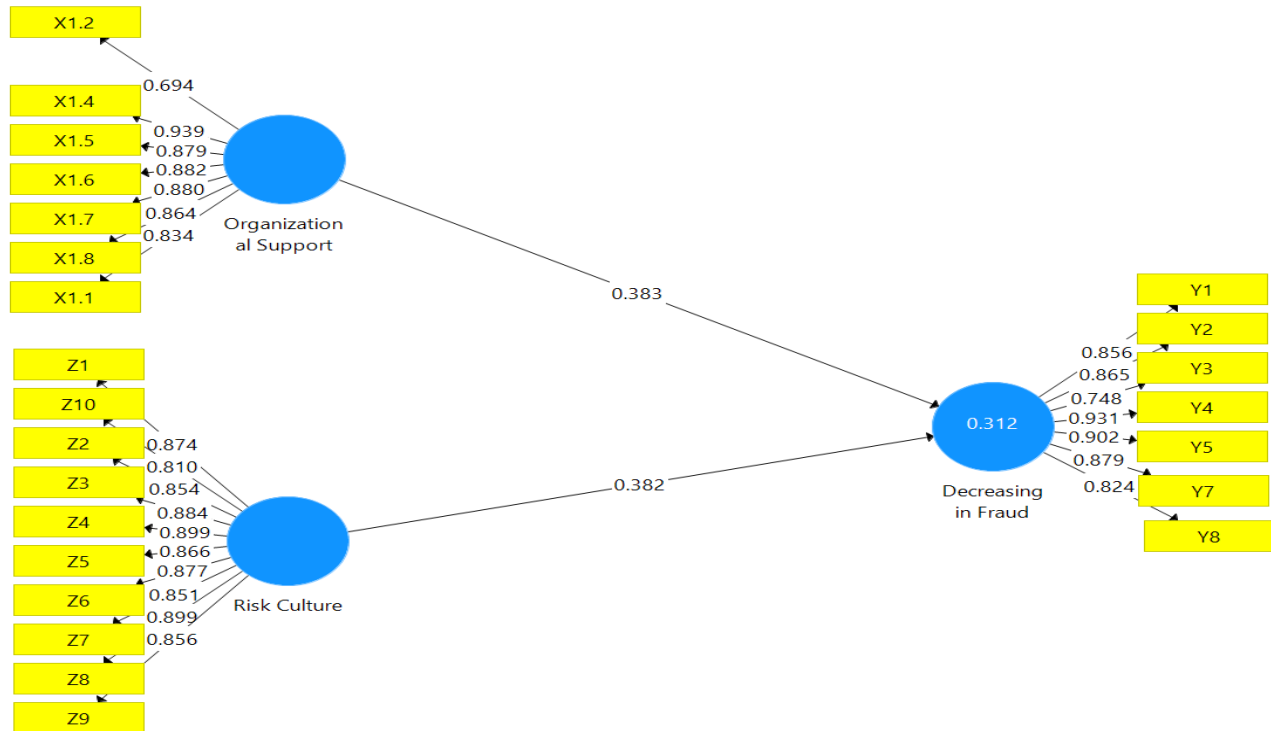
3.1. Findings

Testing consists of testing the quality of the measurement model (PLS Algorithm) and hypothesis testing (Bootstrapping). The inference of measurement quality refers to the following rule of Tumb show in Table 1.

Table 1. Rule of Tumb

Testing	Parameter Test	The Rule of Tumb
The Convergent Validity	The Outer Loading	>0,7
	The AVE	>0,5
	Communality	>0,5
The Discriminant of Validity	√AVE and Latent Correlation	√AVE more than The Discriminant Validity
	The Cross loading	>0,7
The Reliability Test	The Cronbach Alpha Point	>0,6
	The Composite Reliability Test	>0,6

Outer loading testing is carried out in 2 stages. In the first stage, the outer loading values of some constructs are still below 0.7. In the second stage, constructs that do not meet the rule of Tumb are not included in the test. The results of testing the quality of the stage 2 measurement model can be seen in Figure 1 below.

Sources :Statistic Result Test (2021)

Figure 1. The Result

Outer loading testing is 2 stages. The outer loading values of some constructs are still below 0.7. In the second stage, constructs that do not meet the rule not included in the test. Based on the results of testing the quality of the stage 2 measurement model, it can be seen in Figure 1 below.

Table 2. The Quality of Stage Model

	Cronbach's Value	The rho value	Reliability Test	AVE Value
Decreasing in Fraud	0,942	0,968	0,952	0,739
Organizational Support	0,941	0,965	0,950	0,733
Risk Culture	0,963	0,970	0,968	0,752
Decision	Reliable		Reliable	Valid

*Sources :*Smart PLS (2021)

The measurement model for convergent validity testing has met the requirements because the outer loading more than 0.7 and the Average Variance value more than 0.5. This model is also reliable; this can be seen the Cronbach's Alpha value and composite reliability is more than 0.6 its show in Table 3.

Table 3. The first Hypotheses Testing

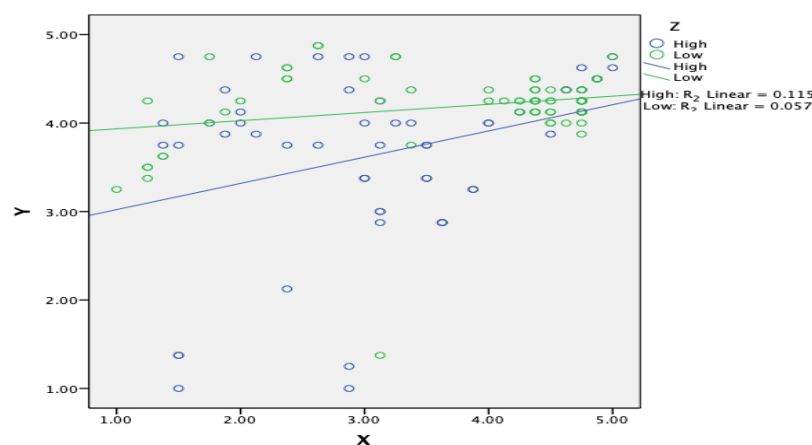|	Original	Stdev	T count	P Values
Organizational Support -> Decreasing in Fraud	0,383	0,060	6,386	0,000

*Sources :*Smart PLS (2021).

Both support organizations and risk culture have significant effect on reducing the corruption level. The adjusted R2 value is 0.301. This study also examined the role of risk culture as a moderating variable that influences the relationship between organizational support and reducing corruption. Moderating variables have three roles: strengthening, weakening, and reversing the independent variable's influence on the dependent variable. Table 4 shows that risk culture acts as a moderating variable. But Table 4 cannot conclude whether risk culture can weaken, strengthen or reverse.

Table 4. The second Hypotheses Testing

	Original	Stdev	T count	P Values
The Moderating Effect 1 -> Decreasing in Fraud	-0,174	0,081	2,153	0,032
Organizational Support -> Decreasing in Fraud	0,401	0,064	6,227	0,000
Risk Culture -> Decreasing in Fraud	0,368	0,050	7,406	0,000

*Sources :*Smart PLS (2021).

The role of risk culture as contingency variable we used a graphical test was performed with the SPSS application. The test results show in the following Figure2 :

*Sources :*SmartPLS (2021)

Figure 2. Influenced of risk culture as Moderating Variable

From Figure 2, it can be concluded that if the risk culture is high, then the effect of organizational support on reducing fraud will also be higher. It shows that the risk culture can strengthen the influence of organizational support on reducing the level of fraud. High organizational support will be constructive for all parties to work according to the rules. If all employees from both the highest and lowest levels have

agreed to work properly and honestly, then the level of cheating will be smaller. If organizational support is high and the application of high-risk culture, then the influence of organizational support will be greater. but if the application of low risk culture, then the effect of organizational support on reducing fraud is low

Perceived organizational is contribute for the organization values and cares for their welfare (Rhoades and Eisenberger, 2002, Krishnan and Mary, 2012). Perceptions of organizational support represent employees' beliefs in the extent to which the organization can meet their socio-emotional needs and how the organization responds to their increased effort in the workplace (Eisenberger et al., 1986). Organizational support will affect the performance of an employee. If organizational support is high, employees will show higher performance. The study results concluded that with high organizational support, employees feel treated humanely compared to conditions of low organizational support.

Internal auditors' performance will increase if they can fully support the organization. With the increase in internal auditors' performance, their ability to detect fraud will also increase so that the internal auditors can provide suggestions for improvements earlier and give warnings to those who commit fraud. Internal auditors who feel valued by the organization will show that they are motivated and try to do their job well. Eisenberger & Stinglhamber, (2011) explained by social exchange theory, where internal auditors who feel supported by the organization will try to reciprocate the positive support (). Social exchange theory states that employees and organizations must carry out a reciprocal relationship to maximize their benefits (Gouldner, 1960). Perceptions of organizational support can be understood as organizational resources that meet the social-emotional needs of internal auditors, such as positive self-esteem, approval, and affiliation (Armeli et al., 1989).In other words, organizational support is essential to maintain a positive attitude of internal auditors. Organizational support can lead to feelings of appreciation if internal auditors can do their job well (Eisenberger et al., 1986). Besides that, organizational support can provide emotional support, generate positive self-esteem in internal auditors and approval, and affiliation (Lee, J., & Peccei, 2007), all of which are related to work engagement (Zacher, H., & Winter, 2011).

This research found that if the risk culture is high, then the effect of organizational support on reducing fraud will also be higher. This shows that the risk culture can strengthen the influence of organizational support on reducing the level of fraud. Risk culture is the "set of encouraged and acceptable behaviors, discussions, decisions and attitudes toward taking and managing risk within an institution. Developed de Araújo Lima (2020) conducted all organizations together because it reflects the practices into an organization's decision-making processes and risk management whether risk/reward trade-offs really matter.

In a company, risk culture can be seen in the policies and culture that are applied to the company. This culture will influence and set strategies and goals in business. Culture starts from the behavior and nature of governance (the board of directors), which will set concrete management actions. Risk culture has a significant impact on a company's business processes. Lack of competence in leadership, communication, and culture often results in major industrial events and disasters. This disaster can be in the form of a large amount of loss (can even lead to bankruptcy) or an environmental disaster that affects the wider community, such as the collapse of a shopping mall, which killed many people. In short, a strong risk culture can help risk management to minimize risk and loss because of fraud and be able to create opportunities that can provide a

competitive advantage in business.

5. CONCLUSION

This study concluded that organizational support has a impact on reducing of corruption. It shows that if all the people involved in the organization, from the top leadership to the lowest employee level, have the same goal: to work honestly and responsibly, then the level of corruption can be minimized. This study also concluded that the application of risk culture has a positive and significant effect on reducing the level of fraud. The role of risk culture as a moderating variable. The results concluded that organizational support on reducing the fraud will be strong if the organization applies a risk culture.

Further research is needed to see other factors that are thought to affect the reduction in the level of fraud, such as the internal auditor's ability to detect fraud. The effect of organizational support and risk culture on the reduction in the level of fraud only has an adjusted R^2 value of 0.301.

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