

Influence of the Quality of Implementation of Islamic Corporate Governance and Complexity on the Frequency of Fraud in Sharia Banking in Indonesia

Suharto¹, Priyarsono DS², Trias Andati³

^{1,2,3}Management & Business Study Program, Institut Pertanian Bogor, Indonesia
suharto2003@gmail.com, Priyarsono@yahoo.com, Trias_andati@yahoo.com

Abstract

The purpose of this study is to explore the quality of Islamic Corporate Governance in sharia banking in Indonesia and analyze the effect of the quality of Islamic Corporate Governance implementation and bank complexity on the frequency of fraud in sharia banking in Indonesia from 2011 through 2020. This study uses a descriptive method with a quantitative approach. The population in this study were all Indonesian sharia commercial banks based on banking statistics issued by the Financial Services Authority (OJK) in December 2020, which were 14 sharia commercial banking, then selected by the purposive sampling method using sharia commercial banking criteria that reported a complete self-assessment report during 2011 – 2020, which is as many as 10 sharia commercial banking. The type of data used is secondary data whose data collection is carried out by online data search methods through website searches. The data analysis method used panel data regression. The results of the study showed that the quality of Islamic Corporate Governance implementation at sharia commercial banking during 2011 - 2020 on average had a "good" predicate, minimum value (best implementation quality "very good", and maximum value (lowest implementation quality "good enough". The implementation of Islamic Corporate Governance in sharia commercial banking BUKU III is better than sharia commercial banking BUKU II and BUKU I. The results also show that the quality of Islamic Corporate Governance implementation has a significant effect on fraud with an estimated coefficient of 1.3251, meaning that if the composite ICG value increases (the quality of ICG implementation decreases) by 1 unit, then fraud will increase by 1.3251 units. Then, the complexity has no effect on the frequency of fraud with a probability value of $0.1651 > 0.05$ ($\alpha=5\%$), meaning that the complexity of banks is reflected in the category of BUKU I banks has the same level of fraud as BUKU II and III banks.

Keywords

complexity; fraud, Islamic corporate governance; sharia banking



I. Introduction

During the last 10 years, Islamic banking has experienced significant development, as can be seen from the increase in the number of banks, the number of offices, total assets, disbursed financing, and third-party funds collected. This development is a consequence of the increasing complexity of the types of businesses, products, and operational activities carried out by Islamic banking. Sharia banking which initially only had the type of business to collect and distribute funds in rupiah currency then developed to be more complex by adding business types, products, and operational activities to the distribution of funds in foreign currencies, money changers, trade finance, and equity participation according to the

Commercial Bank category. Business Activities (BUKU). BUKU is a category of business type, product, and bank operational activities determined by the financial services authority (OJK) based on the core capital owned.

The business development and increasing complexity also add to the risks that must be managed, including the risk of fraud. Perpetrators of fraud are carried out starting from lower-level employees, managers to top management as well as by owners. One of the efforts to prevent fraud is to implement Good Corporate Governance (GCG) based on sharia principles or Islamic legal principles, called Islamic Corporate Governance (ICG) properly in accordance with Bank Indonesia Regulation No.11/33/PBI/ 2009 concerning the implementation of good corporate governance for Islamic commercial banks and Sharia business units.

Based on the above thought, the research question formulated is how the quality of the implementation of Islamic corporate governance and complexity affects the frequency of fraud in Islamic banking in Indonesia.

Based on the background and formulation of the problem above, the objectives of this study are as follows:

1. Exploring descriptively the quality of the implementation of Islamic corporate governance in Islamic banking in Indonesia.
2. Does the quality of the implementation of Islamic corporate governance affect the frequency of fraud in Islamic banking in Indonesia?
3. Does the operational complexity of Islamic banks affect the frequency of fraud in Islamic banking in Indonesia?
4. Formulate recommendations to minimize the frequency of fraud events through the implementation of Islamic corporate governance by considering the operational complexity factor in Islamic banking in Indonesia.

Based on Law no. 21 of 2008 concerning Islamic Banking, it is stated that Islamic banking is everything related to Islamic banks and sharia business units. Furthermore, it is stated that Islamic banks consist of Islamic commercial banks (BUS) and Islamic Rural Banks (BPRS). This study is limited to the effect of the quality of corporate governance implementation and complexity on the frequency of fraud in Islamic Commercial Banks (BUS) in Indonesia.

II. Research Methods

The research was conducted in Bogor and carried out from May 2019 to September 2021. Using the online data search method, namely data obtained through searching the websites of each Islamic commercial bank, Bank Indonesia, and the Financial Services Authority, in the form of reports on GCG implementation and liability reports minimum capital adequacy (KPM) in 2011 – 2020.

The population in this study were Islamic commercial banks registered with the Financial Services Authority (OJK) in December 2020. While the sample selection was based on purposive sampling with the following criteria:

- 1) Sharia commercial banks that are registered with the financial services authority and publish reports on the implementation of GCG and KPM reports on their respective websites for the period 2011 – 2020.

2) Disclosing data related to research variables and fully available.

The measurement of variables and operational definitions in this study is described in table 1 below by showing the research variables, operational definitions, indicators used in measurement, and the measurement scale.

Table 1. Research Variables and Operational Definitions

Research Variables	Operational definition	Indicator	Scale
<i>Islamic Corporate Governance</i> (X1)	<i>Islamic Corporate Governance</i> is <i>Good Corporate Governance</i> based on sharia principles, namely the principles of Islamic law in the field of sharia banking as stated in the DSN-MUI fatwa	The composite value of the GCG implementation <i>self-assessment</i> results in the GCG implementation report that is reported to the OJK.	Ratio
Bank Complexity (X2)	Bank complexity is the diversity of types of sharia bank business according to the category of commercial bank business activities (BUKU) regulated in POJK No. 6/POJK. 03/2016 concerning Business Activities and Office Networks based on core capital	Using a <i>dummy</i> variable, namely BUS category BUKU 1 is rated = 0, and BUS other than category BUKU I is rated = 1	Nominal
<i>Fraud</i> (Y)	Acts of irregularities or omissions that are intentionally carried out to deceive, deceive, or manipulate banks, customers, or other parties that occur within the bank and/or use bank facilities to cause banks, customers, or other parties to suffer losses and/or <i>fraud</i> perpetrators gain profits. finance either directly or indirectly.	The number of internal <i>fraud</i> incidents disclosed in the GCG <i>self-assessment</i> report of Islamic commercial banks reported to OJK	Nominal

Descriptive analysis was conducted on the characteristics of Islamic Corporate Governance (X1), complexity (X2), and fraud (Y) variables. Then the data on these variables are entered and analyzed in a regression model using the panel data method, including pooling least squares (common effect model), fixed-effect model, and random effect model. To choose the best model, the Chow test, Hausman test, and Lagrange multiplier test were carried out. Previously, for the analysis results to meet the BLUE (Best, Linear, Unbiased, estimator) rules, the classical assumption test was first performed, including normality test, multicollinearity test, heteroscedasticity test, and autocorrelation test.

Based on the results of selecting the best model to estimate the regression model, then a significance test is carried out, including:

a. Coefficient of Determination Test (R Squared)

The test aims to measure the model's ability to explain the diversity of the dependent variable. The value of the coefficient of determination is between zero and one.

b. F Uji test

The F statistic test shows whether all the independent variables included in the model have a simultaneous effect on the dependent variable.

c. t-test

The t-statistical test shows how far one independent variable individually or partially can explain the diversity of the dependent variable.

III. Discussion

3.1 Descriptive Analysis of Population and Research Sample

The research population includes the number of BUS in Indonesia based on banking statistical data from the OJK in the position of December 2020, which is 14 BUS. Then, selected by *purposive sampling method* using certain criteria, obtained a sample of 10 BUS within a period of 10 years (2011 - 2020), so that 100 observational data were obtained. Then the BUS which became the research sample were grouped based on the category of commercial bank business activities (BOOK). The development of Islamic economy that is increasingly prevalent is a reflection and longing for Muslims (Rahmati, 2018). According to POJK No. 6/POJK.03/2016 Regarding Business Activities and Office Networks based on core capital, it is stated that the BUKU category is a grouping of banks based on the diversity of types of businesses, products, and activities following their core capital, namely BUKU I, II, III and IV, such as shown in Table 2.

Table 2. List of BUS that became the Research Sample

No	Sharia Commercial Banks (BUS)	BOOK
1	Bank Mandiri Syariah	III
2	Bank Muamalat Indonesia	II
3	BNI Syariah Bank	III
4	BRI Syariah Bank	III
5	Bank BJB Syariah	I
6	Victoria Sharia Bank	I
7	Bank Mega Syariah	II
8	Panin Syariah Bank	II
9	Bank BCA Syariah	II
10	Bukopin Islamic Bank	I

Source: Banking Statistics Data, processed 2020.

Descriptive statistics of research data are used to determine the characteristics of each variable, namely *fraud*, ICG, and complex variables.

a. Fraud Variable

The *fraud* variable obtained an average value of 7.74, a minimum value of 0, and a maximum value of 82 with a standard deviation of 13.20. The lowest frequency of *fraud* is 0, occurring in Bukopin Syariah (2012,2013,2015,2016,2018), BJB Syariah (2011, 2012, 2019, 2020), BCA Syariah (2019, 2020), BRI Syariah (2011) and Victoria Sharia (2020). Meanwhile, the highest frequency of *fraud* occurred at Bank Muamalat (2016). If the frequency of *fraud* is seen from the BOOK category, it can be seen in table 3.

Table 3. Incidents of BUS *Fraud* Based on BOOK categories

BKU type	mean	StdDev	Max.	Min.
BOOK I Bank	5	12	69	0
BOOK II Bank	9	14	82	0
BOOK III Bank	14	7	25	7

Source: review processing results, 2021

Table 3 shows the highest average *fraud value* occurred in BUS BUKU III. However, the highest maximum *fraud value* occurred in BUKU II, followed by BUKU 1 and BUKU 3. Based on the data above, it can be concluded that the frequency of *fraud* in Islamic commercial banks during 2011 – 2020 has heterogeneous data. This can be seen from the high standard deviation value.

In addition, *fraud* that occurred in Islamic commercial banks based on information obtained from the mass media mostly occurred in the act of providing fictitious financing and embezzlement of customer funds by Islamic bank employees in collaboration with external parties. Meanwhile, the cause is due to management pressure to get appreciation, the *moral hazard of the perpetrators*, such as greed, weak morals, and faith. In addition, the causes of fraud that occur in Islamic banks are also due to the non-implementation of the existing *standard operating procedures* (SOP), weaknesses in the *internal control system*, lack of supervision from superiors, non-optimal monitoring, and ineffective supervisory functions.

b. ICG Variables

The ICG variable obtained an average value of 1.82 ("good" category), a minimum value of 1 ("very good" category), and a maximum of 3 ("good enough" category) with a standard deviation of 0.59. Excellent quality of ICG implementation (1) carried out by BCA Syariah (2014 – 2020) and Bank Mandiri Syariah (2016, 2018 - 2020). While the lowest (good enough = 3) are Muamalat bank (2014, 2015, 2017 - 2020), BJB Syariah (2018 - 2020), Panin Syariah (2017), Bukopin Syariah (2020), and Victoria Syariah (2015). When viewed from the BOOK category, it can be seen in table 4.

Table 4. Composite Value of ICG BUS BOOK Category

BOOK bank	ICG Composite Value
BOOK I Bank	1.96
BOOK II Bank	1.78
BOOK III Bank	1.18

Source: review processing results, 2021

Table 4 shows that the average composite ICG value in BUS BUKU III is smaller than BUS BUKU II and BUKU I, meaning that the quality of ICG implementation in BUS BUKU III is better than BUS BUKU II and BUKU I. Based on these data, it can be stated that the quality of the implementation of ICG in a BUS with a variety of complex types of operational activities is better than the implementation of ICG in a BUS with a diversity of types of operational activities that are less complex.

3.2 Complexity Variables

For the complexity variable, because it is a *dummy variable*, it has values of 0 and 1. For BUS BUKU 1 as a comparison, it has a value of 0, while BUS BUKU other than BUKU 1, namely BUKU 2 and BUKU 3 has a value of 1.

3.3 Analysis of Panel Data Regression Estimation Results

For the results of the analysis to meet the BLUE (Best, *Linear, Unbiased, estimator*) rules, the classical assumption test is first performed, including normality test, multicollinearity test, heteroscedasticity test, and autocorrelation test. From the classical assumption test, the research data is normally distributed and meets the normality assumption, there is no heteroscedasticity in the model, there is no strong correlation between the variables because the correlation value between the independent variables is < 0.80 , and from the output results obtained the Durbin-Watson value of 1.3915 has approached 2, meaning that it can be concluded that there is no autocorrelation in the model.

Based on the *Chow test* and the *Hausman test*, the results show that the best model for estimating panel data regression is the *Fixed Effect Model* (FEM). The results are shown in the estimation in Table 5.

Table 5. FEM. Estimation Results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
ICG	1.325145	0.205146	6.459533	0.0000
Complexity	0.195281	0.139502	1.399845	0.1651
C	0.631174	0.147903	4.267471	0.0000
R-squared	0.710414	Mean dependent var		1.595288
Adjusted R-squared	0.674216	SD dependent var		1.049204
SE of regression	0.725993	Sum squared resid		46.38177
F-statistics	19.62565	Durbin-Watson stat		1.391585
Prob(F-statistic)	0.000000			

Source: Eview processing results, 2021

Table 5, shows the following:

a. Coefficient of Determination (R Squared)

Obtained an R-Squared value of 71.04%, meaning that 71.04% of the diversity of *Fraud* variables can be explained by the ICG and Complexity variables. While the remaining 28.96% is explained by other factors outside the model.

b. F Uji test

The value of Prob (F- *statistics*) is $0.000 < 0.01$, meaning that the model is feasible at the 1% level of significance. It can be concluded that there is a significant effect between ICG and Complexity on *Fraud*

c. t-test

The ICG factor has a significant effect on *fraud* as indicated by a probability value of $0.0000 < 0.05$ ($\alpha=5\%$), with an estimated coefficient of 1.325.1 or the equation is:

$$Fraud = 0.631174 + 1.325145 \text{ ICG} + 0.195281 \text{ Complexity} + \text{eit.}$$

This means that if the composite ICG value increases by 1 unit, the *Fraud* frequency will increase by 1.3251 units. While the complexity factor has no effect on *fraud* with a probability value of $0.1651 > 0.05$ ($\alpha=5\%$), meaning that the complexity of the bank reflected in the BUS BUKU 1 category has the same level of *fraud* as BUS BUKU II and III.

3.4 Hypothesis Test

a. The Quality of the Implementation of Islamic Corporate Governance Affects the Frequency of *Fraud*

The hypothesis is proven that the quality of ICG implementation has a significant effect on the frequency of *Fraud*, namely based on the t-test, the probability value is $0.000 > 0.05$ with an estimated coefficient of 1.3251, meaning that if the composite ICG value increases by 1 unit (the quality of ICG implementation decreases), then *fraud* will increase by 1.3251 units.

The results of this study are in line with the ICG theory, which states that ICG is GCG that is carried out with Islamic principles in Muamalah, namely *Siddiq* (honest), *Amanah* (trust), *Tabligh* (public education to do good), and *Fatonah* (professional). , so that if the ICG principles are implemented consistently with excellent quality, *fraud* can be prevented or minimized because *stakeholders* will consistently prioritize the principles of honesty, maintain trust, invite kindness and work professionally according to their functions. In addition, ICG also has 8 functions, including supervisory function, managerial function, compliance function, internal audit function, legal and financial advisory function, external audit function, and monitoring function. If these functions are carried out simultaneously well, it can prevent *fraud* because the existence of these functions reflects important responsibilities in three areas, namely managerial, supervisory, and monitoring fields.

The results of this study are also in line with *agency theory* which states that *agency problems* will arise in agency relationships, namely information asymmetry and *conflict of interest*, which have the potential to cause *fraud*. To overcome this, it is necessary to implement GCG along with its principles and mechanisms to ensure that the rights and obligations of the parties are guaranteed, so that if GCG or ICG is implemented with excellent quality, *agency problems* can be avoided.

The results of this study support research conducted by Anugerah (2014); Chaoul (2016); Nadia (2018); Sadique (2016); In'airat (2015) which shows that the implementation of ICG has a significant positive effect on the occurrence of *fraud*.

However, the results of this study are not in line with research conducted by Astuti (2019), Rahmayani and Rahmawaty (2017), Najib and Rini (2016) which showed that the implementation of ICG did not have a significant effect on the occurrence of *fraud*. The implementation of ICG may not affect the frequency of *fraud* in Islamic commercial banks due to differences in population, as in Astuti's (2019) study, using a population of 13 BUS and 21 UUS in a 5 (five) period, namely 2012-2016, so the time is 5 (five) five years is not long enough to explain the ICG variable and the frequency variable for *fraud*. As for the research, Rahmayani and Rahmawaty (2017) conducted a study for 5 years, namely during 2011-2015. In addition, the research conducted is not on the ICG composite value, but only on 3 ICG factors, namely the DPS, Directors, and Internal control factors. While the research conducted by Najib and Rini (2016) the population was all BUS in the 2010-2014 time period, which was the initial period when ICG reporting obligations were imposed for BUS so that BUS was still in the adjustment and development stage.

b. Complexity Affects the Frequency of *Fraud*

The hypothesis is not proven, because based on the t-test, the probability value is $0.1651 > 0.05$ ($\alpha=5\%$), so that complexity does not affect the frequency of *fraud*. This means that the more complex types of business and operational activities carried out by the BUS do not increase the frequency of *fraud*. The results of this study are not in line with *agency theory* which states that the larger the size of the company will increase *agency* costs due to the increasing need for monitoring and control mechanisms

(Fama and Jensen, 1983). The larger the size of the company, the more transactions will be carried out. From this transaction the opportunity for *fraud* to occur. In addition, the more complex the operations of a company, the greater the opportunity for *fraud* to occur, considering that a complex company is a company that has an extensive operational network, complex technology systems, and a lot of management. However, in the new theory, it is stated that the occurrence of *fraud* is only an opportunity or possibility, or risk. If the opportunity, possibility, or risk of *fraud* can be mitigated, then the opportunity for *fraud* can be avoided. This is following OJK Circular Letter no. 27/SEOJK.03/2016 Regarding Commercial Bank Business Activities based on core capital, it is stated that in issuing products and/or carrying out activities, Banks need to implement adequate risk management to mitigate the risks posed by these products and/or activities. Banks must identify, measure, monitor and control the risks inherent in new products and/or activities, one of which is the risk of *fraud*. So in this case the risk of *fraud* on Islamic banks BOOK III and II types of business and operational activities are more complex than Islamic banks BOOK 1 has been mitigated, because each additional type of business, activity, or new product will be carried out an *assessment* by the FSA on the adequacy of managing risks in mitigating the risks arising from the added complexity, including the risk of *fraud*.

The results of this study support research conducted by Centhyawati (2017), Bambang & Kinanti (2017), Josey Barus et al (2011), which states that the complexity or size of the bank has no significant effect on *fraud*,

The results of this study are not in line with the research conducted by Besari (2009) and Indriatuti M, Luluk M (2011), which states that complexity has a positive and significant effect on *fraud*. In this study, the measure of complexity is the number of branch offices, namely BUS, which has a large number of office networks, which are considered to be more complex. Meanwhile, in this study, the complexity measure is the BOOK category.

3.5 Managerial Implications

Considering that the quality of ICG implementation has a significant effect on reducing the frequency of fraud, BUS management must create supporting programs that can improve the quality of ICG implementation, including:

1. Create a program that can create a common understanding of all BUS stakeholders regarding the importance of good quality ICG implementation for BUS, to reduce the frequency of fraud, as well as for a larger purpose, namely improving performance.
2. Creating a program that creates a joint commitment from all stakeholders related to each ICG factor, to carry out its functions with the best quality consistently.
3. Periodically monitoring the quality of the implementation of each ICG factor. If there are conditions that can cause the quality of the implementation of one of the ICG factors to decline, improvement initiatives are immediately carried out.

IV. Conclusion

4.1 Conclusion

The results of the research that have been carried out and the theoretical reviews in the previous chapters, as well as the discussion, suggest the following conclusions:

1. During 2011-2020 the quality of the implementation of Islamic Corporate Governance (ICG) at Islamic commercial banks in Indonesia averaged "good" (composite value "1.8"), with a minimum value of "1" (very good), and a maximum of " 3" (good enough). When viewed in the BUKU category, the quality of ICG implementation in

the BUS BUKU III category is better than BUS BUKU II and BUKU I, and the quality of ICG implementation in BUS BUKU II is better than BUS BUKU I.

2. The quality of ICG implementation and the complexity of the BUS together have a significant effect on reducing the frequency of fraud with an explanation rate of 71.04% of fraud, so that the remaining 28.96% is influenced by other factors not examined.
3. The quality of ICG implementation has a significant effect on fraud with an estimated coefficient of 1.3251. This means that if the ICG composite value increases (the quality of ICG implementation decreases) by 1 unit, then the frequency of fraud will increase by 1.3251 units.
4. BUS complexity has no effect on fraud because the probability value is $0.1651 > 0.05$ ($\alpha=5\%$). This means that the frequency of fraud in BUS BUKU I which has a low level of complexity has a level of fraud that is relatively the same as BUS BUKU II and BUS BUKU III which have higher complexity.

4.2 Suggestion

The suggestions that can be given based on the results of this study as an effort to improve the quality of ICG implementation to minimize the frequency of fraud are as follows:

1. The management of Islamic commercial banks consistently implements all ICG factors with the best quality.
2. Given that the diversity of fraud can only be explained by the ICG factor and the complexity of 71.04%, the remaining 28.96% is influenced by other factors not examined. Then, given that the fraud that occurs in Islamic commercial banks is partly due to moral hazard, weaknesses in the internal control system, lack of supervision from superiors, non-optimal monitoring, and less effective supervisory functions, the management of Islamic commercial banks should take other comprehensive initiatives. and integrated into minimizing the frequency of fraud other than ICG. In the banking industry, an effective initiative to reduce or minimize the frequency of fraud is to implement the Anti-Fraud Strategy as regulated in Circular Letter No. 13/28/DPNP dated December 9, 2011, which has been updated with POJK No. 39/POJK. 3/2019 concerning the Implementation of Anti- Fraud Strategy for Commercial Banks. Anti-fraud strategy is the Bank's strategy in controlling fraud which is designed about the process of fraud by taking into account the characteristics and range of potential fraud which is comprehensively integrated and implemented in the form of a fraud control system. The implementation of an anti-fraud strategy is part of the implementation of risk management, especially those related to aspects of the internal control system. The anti-fraud strategy includes the prevention stage, detection stage, investment stage, and reporting stage.
3. Considering that the composite ICG value and the number of fraud frequencies were obtained based on the results of the self-assessment conducted by the BUS, the result is that the composite ICG value data and the fraud frequency data have the potential for overstatement or understatement. In this regard, the regulator, in this case, the OJK, is to improve the implementation of verification of the implementation of the self-assessment of the quality of the ICG implementation reported by the BUS, both through the surveillance system and on-site when carrying out the inspection or supervision of the BUS.

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