

THE ROLE OF INTERNAL CONTROL IN FRAUD PREVENTION AND DETECTION

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Abstract

An effective internal control system should be able to provide managers with increased accountability for their plans and reasonably ensure that the plans they guide reach the set goals. However, effective systems are not limited to digital systems but also systems that can prevent and detect fraudulent activities. The overall goal of this research is to analyze the impact of internal control systems on fraud detection and prevention. It is necessary to set an appropriate tone at the top, and top management should encourage ethical behaviour in a transparent manner. A risk assessment process needs to be set up, and the risk of fraud can be assessed by brainstorming to deceive the organization. It is necessary to create report and the investigation process. Thus, this work attempted to review and analyze 20 articles among different countries to reveal the importance of internal control system in preventing and detecting fraud in commercial companies. It is discovered that it has a significant role in fraud prevention.

Keywords: *Fraud, Internal Control System, Commercial Companies, Fraud Prevention.*

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1. Introduction

Financial crisis has brought enormous difficulties and challenges to the societies all around the countries. An individual cannot achieve his/her desires easily. Thus, people might easily involve in conducting financial crimes especially fraud (Noori & Rashid, 2017).

Fraud can be defined as one of the financial crimes that happen in an organization with the intention of achieving illegal advantages, either for personal or institutional benefits. This

is a crime that will be conducted by using deception or false suggestions (Herawaty, & Hernando, 2020).

Internal control is designed and effected process by those whom charged with governance, administration, and others to deliver reasonable assurance about company's objectives regarding to financial report reliability and compliance with applicable rules and regulations (Fernandhytia, & Muslichah, 2020).

There are many studies on internal control and fraud in various countries. Based on the current literature, successful management covers mainly four processes of planning, organizing, leading/motivating, and controlling (Malikhah, 2021; Poturak et al., 2020). Accordingly, every organization should follow those processes periodically to provide effective management. Further, controlling is one of the key functions of the management that give information about the performances of the staff. Based on the performance criteria companies survive and define future strategies (Mohammed et al., 2020; Budur et al., 2018). Subaida, & Mahbubah, (2020) indicated that internal control in NGOs plays a significant role in fraud prevention and detection and ensures that all transactions comply with the internal guidelines and manuals (Demir and Budur, 2019; Rashid, 2017; Rashid et al., 2020). The result of another study showed that internal control has a significant negative effect on accounting fraud tendency. In other words, an increase in Internal Control will decrease the tendency of accounting fraud in a company. Individual morality also has a significant negative effect on accounting fraud tendency (Taufik, 2019).

The purpose of the current study, therefore, is to review and investigate the articles that have been conducted on this issue. Accordingly, it discovered that the majority of the studies that have been completed conclude that internal control has significant effect on preventing fraud.

2. Literature Review

Internal Control

Internal controls and prevention of fraud have been examined in this paper by using both primary and secondary data. Internal control has been tested through primary data,

whereas prevention of fraud has been experienced by secondary data. The variables of this research have been divided into two aspects: primary variables and secondary variables. The first one refers to separation of duties, monitoring, and staff qualifications, while the last is for bank profit, regulation, technology and M2. For conducting both cases the techniques of regression are implemented. The outcomes demonstrate that internal control has an impact on fraud prevention but not all employees are committed to it. Although, the secondary data is quite supportive of the primary data but more exemplifying in that M2, staff qualifications and technology were significant throughout the various dependent variables (Budur et al., 2019; Kehinde, Felicia, & Joseph, 2016).

This paper argued the problem of financial statement fraud. Clearly, financial statement fraud will result in financial and non-financial losses. For instance, fall in reputation of the business and company's image; decreasing investment and customers' demands; damage in relationships with company's partners which can lead to negative effect on the company's activity. The result illustrated that one of the most effective techniques for managing and controlling company's activity is internal control. This paper described the financial statement falsification prevention method more precisely external and internal accounting compliance-control method (Kulikova, & Satdarova, 2016).

This paper discussed the influence of internal control and fraud awareness on preventing fraud in inter-governmental organization. In this study, two variables have been used, as an independent variable anti-fraud awareness and internal control. Whereas, as dependent variable fraud prevention have been used. Hence, for controlling data a convenience sampling have been utilized. Questionnaire has used as a sample of data collection which was distributed to Indonesian staff who have been contributed in the procurement process. The total respondents who have been collected in this questionnaire are 58 respondents. Moreover, means of multiple regressions has been used as a data analyzing method. Consequently, the result proved that significant influence on preventing fraud can be achieved through internal control and anti-fraud awareness. Furthermore, launching an effective internal control can prevent fraud effectively with increasing anti-fraud awareness among all the company's parties (Rozmita, 2017).

This paper examined the role of internal control in declining the intention to conduct fraud. Internal control has become a good variable for moderating the relationship between company's culture, irregularity information and law enforcement with those persons who have

intention to commit fraud. This study has been conducted in Sorong West Papua, an area which located in Eastern Indonesia. The respondents are from governmental organizations and taken with convenience sampling method. The results reveal that the greater the irregularity information the higher the intention to conduct fraud. Hence, regulation and law enforcement can decrease the intention of fraud. Conversely, this paper could not prove the effect of company's culture on fraud. Furthermore, the role of internal control in fraud intention reduction had not been proved in this research. Moreover, a practical contribution can be seen in this paper, in which the law enforcement becomes the most significant issue in fraud intention reduction (Hasnawati, & Muhammad, 2020).

This paper attempted to understand the consequence of accounting information system on fraud detection. Jordanian banks have been used to analyze data which is collected among 225 employees in banks. The data analyzed with PLS 3, and thus the outcomes reveal that there is a necessary role of control link between AIS and fraud detection within the observed banks. Hence, there is an absolute and considerable correlation between fraud detection and AIS. The results which have been achieved in this study added value to the literature regarding to the factors affecting fraud detection in all countries in the world, more precisely Jordan and its relating geographical region. This paper recommends further research and justification for examining AIS and internal control effectiveness (Audeh, & Bani, 2019).

In latest years, the cases of corruption at the level of village have been concerned. Almost 154 cases of corruption at the level of village have been evidenced involving village heads and village officials. Consequently, the state experienced a loss of 47.56 billion rupiah during 2015 – 2017 due to these corruption cases. There are various modes which can support carrying out these kinds of corruption cases. For instance, practicing budget manipulation, fictional reports, fictional activities or projects, and budget bubbles. Ineffective internal control system resulted in all these corruption cases which lead to provide good opportunity to occur. Thus, boosting personal interests as manager rather than community's interests as principals is their main objectives. The existence of irregular information is the main cause of this behavior. Irregular information provides conditions to obtain information that is not associated between village head as manager and community as principal. Thus, the purpose of the current study is to reveal the influence of internal control system on fraud through using village funds in agency conflict conditions by using adverse selection. The laboratory experiment method has been used with being the subject of accounting students at Pattimura University Ambon. ANOVA

with a 2x2 factorial experimental design has been used as a technic to analyze data. Subsequently, the result indicated that the relationship between internal control system and use of village funds by fraudulent will be affected by adverse selection. Effective internal control system will lead to not affecting fraudulent use village funds by adverse selection conditions. In the case of not existing adverse selection, an effective internal control system can minimize fraudulent use of village funds, if it is compared to ineffective internal control system (Theresia, 2019).

This paper examined the major challenges to the business into the entire world which is fraud. Its destructive effect is manifested in performance degradation the bank is also in an economic slowdown. Thus, the major concern from management staff and internal control is to fraud in the banking sector. Therefore, the purpose of the current study is to target empirical evidence about the auditors' responsibility regarding to fraud prevention and detection in the banking system. To do so, a number of materials such as: books, reports, articles have been examined about fraud and auditors' duty. The data has been collected through interviews, information obtained in the bank's website, department of internal control in order to examine the role of auditors to detect fraud in the bank. These data that has been obtained in this study was qualitatively analyzed. This study revealed that internal control system in the current bank is generally effective, but in some points there is an indicator to confirm the fail of internal control system. Thus, regarding to the study's findings, the seminars about antifraud is recommended to be holding on a regular basis. Hence, senior officers and auditors are responsible for planning job rotations inside the bank. The reason is to ensure that employees responsibilities have been divided regarding to financial transactions. Consequently, internal control required to be reviewed regularly in order to minimize the fraud occurrences (Adeoye, 2017).

Voters in Rossllyn, New York unintentionally funded the \$11 million school district tax fund embezzled over the years. Disguised due to excellent school rankings and backed by a strong tax base, this is the largest misappropriation of funds by American school districts. The head of the school and his accomplice found preliminary evidence of cash fraud two years before the formal investigation. However, a series of cover-ups and substandard audits carried out by members of the Education Committee allowed the embezzlement to continue. In response to the crisis, state regulatory agencies passed a series of fiscal reform legislation aimed at improving school district internal control by changing school district governance,

independent procurement audits, and state agency oversight. The case explored the motivations, rationalizations and opportunities for conducting and concealing Roslin's fraud, as well as the overall impact of the state's fiscal reform legislation on the New York independent audit market and the quality of reports. This situation applies to auditing, government and non-profit courses (Randal and & Alfred, 2017).

The purpose of this study is to analyze the application of internal control systems in preventing pharmaceutical factories from purchasing drugs fraudulently. This study is a qualitative case study. Data and information obtained through in-depth interviews and discussions. Collect data through document review and field observation, and use descriptive analysis for data analysis. The results showed that because there is no internal audit in RSUD X, the internal control system cannot operate effectively performed by the person in charge of the drug installation department. RSUD X Pharmacy Hospital has no division of functions and division of responsibilities for each function. The conclusions drawn from the research results indicate that the internal drug control process of RSUD X Pharmacy Hospital is still not optimal, so it is possible that fraud is still vulnerable (Subaida, & Istiyanatul, 2020).

The study attempts to study the impact of internal control measures on the following aspects: Fraud prevention in selected deposit banks in Borno, Maiduguri Nigeria. The research population includes five auditors Nigeria's currency bank drew a sample size of 101 Fifty-two (152) senior employees used Yamane's formula. 152 (152) 141 copies of the questionnaire were distributed (141) has been filled and retrieved. The collected data are listed in the table and Use analysis of variance (ANOVA) for analysis to test hypotheses With SPSS 20.0. It turns out that the effect of internal control is significant Measures (separation of duties, CCTV and password protection) Fraud prevention in Maiduguri Metropolitan Select Deposit Bank Borno State, Nigeria. Research suggests that banks should have effectively separate responsibilities, especially when it comes to salary, they should take advantage of the installation of effective CCTV in the bank Environment to improve efficiency and smooth operation, and provide Effective password protection can protect employees' activities Bank (Garba, & Ejiro, 2020; Rashid, 2019).

Fraud

This study examined the failure cause of break down the internal control of fraud detection in trading information system of the bank regarding to spread of fraud in a mid-level

of derivatives trader. The revealed events at Société Générale, a large French bank, in January 2008 have been evaluated in this study. The question has been raised here, whether the fraudulent activities of an individual trader result in obvious breakdown in internal control, or as long as the trader in the bank is making a profit, these kinds of activities are occurring with the bank hierarchy. The result indicated that the internal controls of the bank trading information systems have been overrides by the bank management, during risky periods of practicing trades which lead to making profits in the bank. However, this management acted quickly regarding to correct this internal control overrides when loses caused by trading practices. Therefore, it is crucial for the top of internal control environment to be re-emphasizing. Further research can be conducted at Société Générale regarding to fraud prevention (Richard, Bruno, & Nancy, 2017).

The purpose of this paper is to discover empirical evidence from Bengkalis District on the impact of the implementation of internal control system in fraud prevention by recognizing good governance. Clearly, 34 Regional Apparatus Organization (RAO) was participated in this research with gathering 93 respondents. Partial Least Square (PLS) method with warp PLS 3.0 software has been used in this paper as a technique for data analysis. The results revealed that the implementation of internal control system and good governance have an effect on fraud prevention with P-value of $0.01 < 0.05$.

The purpose of this paper is to reveal the influence of individual ethics, internal control and moral value on accounting fraud tendency in start-up businesses. The participations of this study are 188 participants. Clearly, the result exposed that accounting fraud tendency affected negatively by internal control. Hence, accounting fraud tendency in a company can be controlled by internal control, in which the increase in internal control will lead to decline in accounting fraud tendency. Likewise, it is affected negatively by individual ethics, which means an increase in individual ethics can be achieved through implementing the good ethics in regular activity, and this will detect the fraudulent behavior actions. Moreover, accounting fraud tendency influenced adversely by moral value. This value can be enhanced by proper profession moral codes in an individual's professionalism which will lead to decline the fraudulent behavior action (Fernanda, & Muslichah, 2020).

The purpose of this article is to study the role of internal auditing in detecting and preventing fraud. First, this chapter will determine the concept and types of fraud on the one hand, and on the other hand the fraud triangle faced by the company and those that internal

auditors are trying to detect and resolve. Second, it will provide a description of the concept of internal audit and the particularity of the company's core functions. The procedures for internal control and the basic principles leading to the effectiveness of internal control will be determined. In this regard, the author analyzes the image of internal auditors. Therefore, an internal audit function with supervisors will produce a good internal control system and maintain the ability of internal audit to detect fraud. Finally, it analyzes the role of internal auditors in preventing fraud from the following three aspects: The first aspect is preemptive strike. The second aspect is society and morality. The third dimension is the actual dimension (Safa, 2020).

This study aims to analyze whether internal control has an impact on fraud prevention and good corporate governance, and analyze whether good corporate governance has an impact on fraud prevention, and analyze that internal control governance for good corporate fraud prevention is an intervention variable (Zhanbei City Local government research). The research method used raw data to distribute the questionnaire to all SKPDs of the Jambi City Government. A total of 49 respondents used a purposeful sampling survey and 47 questionnaires were returned. A method of data analysis using SEM-PLS analysis (Structural Equation Model-Partial Least Squares). The research results show that internal control will not affect fraud prevention, internal control will not affect good corporate governance, and good corporate governance will not affect fraud prevention (Netty, & Risk, 2020).

This study aims to analyze the impact of reporting systems and internal controls on fraud prevention on Indonesian state-owned enterprises (SOE). This study uses reporting system and internal control as independent variables and fraud prevention as dependent variables. Researchers were hired as internal auditors, whistleblowers and other departments related to fraud in Indonesian state-owned enterprises. The researchers used Solvin's method of determining sample size. 62 respondents were drawn from 122 people. In addition, the data was analyzed using multiple regressions. The results show that in Indonesian state-owned enterprises, the reporting system, internal control and fraud prevention applications fall into quite good categories. The reporting system and internal control play an important role in preventing fraud. It shows that fraud can be prevented by establishing reliable internal controls and adding a reporting system for all parties in the organization (Dwi, & Sonia, 2020).

The purpose of this study is to determine the extent to which the internal control of Cimahi City Bank's "One Belt One Road" initiative affects fraud prevention. Internal control

is a series of interrelated activities performed by the board of directors, management and other personnel. It is designed to provide confidence in achieving certain goals within the organization. By formulating policies, procedures, organization, control technology and employee participation, fraud prevention is a preventive measure (Rahadiyan and Bunga, 2020).

Using the annual observation results of 465 companies on public litigation companies in the United States from 2000 to 2018, the study found that the stock price drop on the announcement day of securities fraud litigation is for public litigation companies that accept substantial defects in the internal control of US SOX 404 more serious (ICMW) opinions. In addition, the decline in the stock price of public litigation companies with entity-level ICMW was more prominent than those of public litigation companies with account-level ICMW. The above findings indicate that ICMW's views have predictive value for public investors and capital market participants (Yu-Cheng and Hua-Wei, 2020).

This article analyzes the relationship between the implementation of internal controls and the mitigation of fraud between the Association of Savings and Credit Cooperatives of Kenya (Saccos). In order to achieve this goal, specific variables have been formulated according to the five components of the internal control model. In particular, research focuses on the impact of control environment, control activities, surveillance, information and communications, and risk assessment on fraud mitigation. Collect data through the use of structured questionnaires. Use ordinary least squares regression for analysis. Data analysis found that all the variables mentioned have greatly affected the mitigation of fraud between the Sacos Islands in Kenya. The analysis emphasized that it is necessary for Saccos to work hard and implement an internal control system to a greater extent in order to solve the persistent fraud problem it solves. The analysis also suggested that Saccos should establish appropriate mechanisms to conduct appropriate checks during recruitment, install appropriate security, provide valuable information access regulations, and should also regularly monitor third-party links with personnel to reduce fraud (David, & Kevin 2020).

The study determined the impact of internal control on the fraud prevention of Nigerian currency deposit banks. The collected data is analyzed by using a simple percentage with a significance level of 5% and regression (social science statistical software package). The results show that among the three (3) independent variables tested in the course of this research, the constant coefficient gives a positive value of 0.046, which means that if all independent

variables remain constant, it represents the ratio of internal control and efficiency. Performance will increase by 0.046 units. It was found that the risk assessment agency is the most important for fraud prevention among deposit banks in Nigeria because it has the highest beta, followed by information and communications, and surveillance has the lowest beta. The study concluded that if Nigeria's deposit banks can also regularly review human resource management functions, it will greatly reduce the vulnerability of Nigeria's deposit bank employees to fraudulent activities (OLULADE, ILUGBUSI and AWONIYI, 2019).

3. Conclusion

This work reviewed 20 articles among different countries about the role of internal control in preventing and detecting financial crimes more particularly fraud. Most of them recommend that internal control can play a significant role in preventing fraud in governmental and non-governmental organizations. Although, with existing internal control, still this kind of crime is happening in the organizations. Thus, external auditors can provide help to prevent this particular financial crime through offering guidelines and professional bodies.

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