

IMPLICATIONS OF INTERNAL CONTROL SYSTEMS FOR FRAUD PREVENTION IN THE PUBLIC SECTOR

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Abstract

Internal Control System is an important component in maintaining integrity, accountability, and transparency in the public sector. This system is designed to reduce the risk of fraud, such as corruption, data manipulation, and misuse of state assets, through a series of structured monitoring and control mechanisms. Internal Control System has several key elements, such as The following factors cooperate to stop fraud: Risk assessment, information and communication, control actions, monitoring, and the control environment. The creation of a robust internal control system within the public sector can identify potential fraud risks early on, tighten supervision of budget use, and ensure that every decision and action taken by government agencies is in accordance with applicable regulations. However, the challenges in implementing Internal Control System in the public sector are still quite large. By analyzing various case studies and related literature, it is hoped that this study can provide a clearer picture of how the One practical way to reduce the risk of fraud is to build an efficient internal control system. Furthermore, this study emphasizes how important it is to continuously evaluate and enhance the Internal Control System in order to maintain its effectiveness in facing dynamic challenges in the public sector.

Keywords: Implications, Internal Control System, Fraud prevention, Public Sector

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INTRODUCTION

Fraud in the public sector is a serious problem that can threaten public trust, hinder development, and cause significant financial losses. According to Taufik, T. (2019) fraud is defined as an action or behavior carried out with the intention of deceiving or hiding facts in order to gain an advantage or harm another party. In the public sector, fraud often occurs in various forms, such as corruption, budget misappropriation, manipulation of financial reports, and misuse of state assets. This phenomenon is not only detrimental in terms of material, but also affects the effectiveness and efficiency of public services that should be enjoyed by the wider community.

Along with the increasing awareness of the significance of openness and sound governance in the public sector, governments in various countries, including Indonesia, continue to strive to enhance the internal control system as a technique to prevent fraud. The internal control system's goal is to provide enough assurance that organizational goals are met. The trustworthiness of financial reports, the effectiveness and efficiency of operations, and adherence to pertinent rules and regulations are some of these goals. This system is an important element in maintaining the integrity and accountability of the government and ensuring that the resources managed can be used optimally for the public interest (Murti, A., & Kurniawan, 2020).

The various main elements of control are the control environment, risk assessment, control actions, communication and information, and monitoring the public sector's internal control system (Rashid, 2022). The organization's dedication to morality and honesty, as well as the leadership's stance in favor of putting in place efficient controls, make up the environment under control. The steps involved in risk assessment include identifying and assessing hazards, such as the possibility of fraud, that may obstruct the accomplishment of corporate objectives. Policies and procedures are examples of control actions implemented to reduce risks, such as division of tasks, transaction authorization, and a good documentation system. To make sure that the responsible parties can receive and comprehend all pertinent information, communication and information are required. In the meantime, monitoring is the act of assessing internal control effectiveness on a regular basis to make sure the system is operating as it should (WANGOMBE, 2017). Regarding the prevention of fraud in the public sector, an efficient internal control framework has a strategic role. This system not only aims to detect indications of fraud, but also to prevent deviant behavior through structured monitoring and control mechanisms (Chowdhury, A., & Shil, 2019). For example, with a clear separation

of duties, the risk of data manipulation or abuse of authority can be minimized. Likewise, the implementation of regular internal audits can identify weaknesses in the system and provide recommendations for improvements to prevent future fraud.

However, the effectiveness of the internal control system in preventing fraud in the public sector cannot always be achieved without challenges. One of the problems that is often faced is limited resources, both in terms of budget and human resource capacity. Many government agencies, especially at the regional level, experience budget constraints that hinder the optimal implementation of internal control. In addition, the lack of training and professional development for employees is also an obstacle that reduces the effectiveness of internal control (Musila, 2018). This is exacerbated by a work culture that is less transparent and a low commitment to ethics and integrity. In addition to internal constraints, external challenges also arise in the form of political pressure and influence from certain parties that can interfere with the independence of supervision and control. In several cases, Abei, Y. A. (2021) stated that fraud in the public sector occurs due to intervention from parties who have political or economic power, so that internal control that should function to prevent fraud becomes ineffective. Therefore, efforts are needed that are more than just implementing policies, namely by building a work culture based on integrity and strengthening the role of external supervision to ensure that the internal control system can run as expected. Given these challenges, it is clear that the implementation of an internal control system in the public sector requires strong support from various parties, including agency leaders, internal auditors, and the public as external supervisors.

Improving the competence and professionalism of employees, as well as increasing transparency in the process of managing state budgets and assets, are key elements in ensuring that the internal control system is able to prevent fraud effectively. Furthermore, there needs to be a continuous commitment from the government to continue evaluating and improving the internal control system to enable it to foresee potential changes and new hazards. This backdrop informs the study's analysis of the internal control system's effects on fraud prevention in the public sector. This study will discuss how internal control can be implemented effectively and identify factors that support and hinder the effectiveness of internal control in efforts to prevent fraud in the public sector.

RESEARCH METHOD

The literature review approach was the research strategy employed in this investigation. Various relevant material, including books, scientific journals, audit reports, and policy documents about internal control systems and fraud prevention in the public sector, are gathered, reviewed, and analyzed as part of this process. These sources are selected based on their credibility and relevance to understand how internal control systems can affect fraud prevention efforts. By employing this methodology, the study seeks to uncover the results and conclusions generated by earlier research and investigate theoretical ideas that serve as a foundation for comprehending the connection between fraud prevention and internal control. The systematic approach to this literature evaluation involves categorizing the material according to its three primary subjects: fraud, internal control, and the public sector. Each literature is analyzed to find patterns, themes, or factors that influence the effectiveness of internal control in preventing fraud. In addition, this study also includes studies that discuss the challenges in implementing internal control systems in the public sector, both at the local and national levels. By using this method, this study attempts to provide a complete and in-depth grasp of the implications of internal control systems on fraud prevention, as well as to identify areas that require improvement or further attention in the public sector.

RESULT AND DISCUSSION

Analysis of Internal Control System Effectiveness

Internal control systems in the public sector are designed to provide reasonable assurance in achieving organizational goals, including fraud prevention, efficient resource management, and regulatory compliance (Channar et al., 2015). The degree to which an internal control system's essential elements are executed and observed determines how effective the system will be. The present analysis will focus on several critical aspects that influence the effectiveness of internal control, including the control environment, risk assessment, control actions, information and communication, and monitoring. First, the control environment is the internal control system that needs to be managed, which is built upon the organization's commitment, ethics, and values (Mahadeen et al., 2016). The establishment of a robust and integrity-driven control environment can foster a work culture that facilitates the efficient execution of internal control. In the public sector, the dedication of leaders and upper management has a big impact on how well the control environment works. When government agency leaders demonstrate

exemplary compliance with policies and regulations, this will have a positive impact on the behavior of other employees. However, if the control environment is weak or leaders do not demonstrate a strong commitment to ethics and integrity, the internal control system tends to be less effective in preventing fraud. Several cases of corruption in the public sector indicate that control failures often start from the weak commitment of leaders in enforcing regulations and ensuring transparency in the decision-making process (Aramide, S. F., & Bashir, 2015).

Second, risk assessment is an important element in determining areas with high potential for fraud or other irregularities. In the public sector, the risk of fraud often arises in the procurement of goods and services, budget management, and supervision of state assets. An effective risk assessment allows organizations to identify areas with high risk and design appropriate control measures to minimize these risks. Unfortunately, many government agencies still face difficulties in conducting comprehensive risk assessments. This is often due to limited resources, both in terms of budget and employee capacity. Without adequate risk assessments, organizations cannot allocate control efforts appropriately, increasing the opportunity for fraud (Sudirman et al., 2021).

Furthermore, Control measures including document review, transaction authorization, and job segregation are crucial for guaranteeing that operational procedures are followed in compliance with relevant rules. Good control measures will reduce the chance that staff members may misuse or manipulate their position of authority. Employee ignorance of the significance of these protocols frequently makes it difficult for control actions to be implemented in the public sector. For example, although there are standard procedures for budget management, many agencies do not implement them consistently due to external pressure or the indifference of leaders to the importance of implementing control. In addition, the lack of a reliable and transparent information technology system is also a factor that affects the efficiency of public sector control initiatives.

The next component according to Vu, H. T. (2016) is information and communication, which ensures that relevant information related to control and risk is delivered in a timely manner to the parties in need. In an effective internal control system, information regarding policies, procedures, and monitoring results must be distributed clearly and transparently to all employees. In the public sector, challenges in communication often arise due to complex and long bureaucratic hierarchies, which slow down the flow of information. In addition,

an organizational culture that tends to be closed can also hinder access to important information, thereby reducing the effectiveness of the internal control system. Finally, monitoring is a component that functions to ensure that all elements of internal control are running as expected. Monitoring carried out periodically, either through internal audits or independent evaluations, is very important to identify weaknesses and provide recommendations for improvement. In the public sector, the effectiveness of monitoring is greatly influenced by the independence and professionalism of internal auditors. If auditors have high integrity and are free from political intervention, then they will be able to carry out their supervisory function effectively. However, in reality, some internal auditors in the public sector often face external pressures that interfere with their independence. This has an impact on the quality of the audit and the recommendations produced, which ultimately affects the overall effectiveness of internal control. Drawing from the aforementioned study, it can be inferred that the efficacy of the internal control system within the public sector is significantly impacted by the level of dedication exhibited by the leadership, the ability of employees, and the provision of sufficient resources. Although the internal control system has great potential in preventing fraud, its implementation still faces various challenges that need to be overcome. Therefore, continuous efforts are needed to strengthen the control environment, improve employee competence, and ensure transparency and accountability in all operational processes in the public sector.

Implications of Internal Control Systems for Fraud Prevention

Internal Control System is a mechanism designed by an organization the maintenance of legal and regulatory compliance, the accuracy of financial records, and the effectiveness and efficiency of operations. Fraud is significantly impacted by internal control systems prevention in organizations. The following discussion will outline how Internal Control System plays a role in preventing fraud and its impact on the organization (Nyakarimi et al., 2020).

1. Introduction to Internal Control System

An internal control system is a set of guidelines, practices, and regulations intended to safeguard company resources, guarantee data accuracy, and guarantee adherence to management directives. An internal control system covers a variety of subjects, including information and communication, risk assessment, control actions, monitoring, and the control environment. The internal control system's objective is to reduce the possibility of mistakes and fraud and to enhance the effectiveness of organizational operations.

Fraud is an unauthorized act carried out by an individual or group with the aim of obtaining personal gain or benefiting certain parties illegally. Fraud can harm the organization both financially and non-financially, and therefore, its prevention is a crucial aspect of risk management (Agyemang, 2016). Internal Control System is the main tool in fraud prevention by providing structure and control that reduces the opportunity and motivation to commit fraud.

2. Implications of Internal Control System in Fraud Prevention

The implications of Internal Control System in fraud prevention can be seen through several main elements according to Lyinomen, O. D., & Nkechi, O. T. (2016), namely:

a. Control Environment

The control environment is the foundation of the internal control system, which includes the values, ethics, and culture applied in the organization. A strong control environment will encourage ethical behavior and strengthen the commitment to integrity and honesty. Top management that demonstrates a commitment to ethics and internal control will create a culture where fraud is difficult to occur. It also creates an atmosphere where employees feel supervised and motivated to maintain high standards of behavior.

b. Risk Assessment

The process of locating and evaluating hazards that could impede the accomplishment of corporate objectives is known as risk assessment, including the risk of fraud. By conducting regular risk assessments, organizations can identify potential areas that are vulnerable to fraud and implement appropriate preventive measures. A good Internal Control System will include mitigation measures tailored to the level of risk identified, such as additional supervision, periodic inspections, or controlling access to certain assets.

c. Control Activities

Control activities comprise policies and processes aimed to guarantee that fraud prevention measures are executed properly. Authorization and task segregation are two instances of control actions of transactions, independent verification, and reconciliation of financial records. With good control activities, organizations can minimize the opportunity for individuals to commit fraud because each transaction or activity is reviewed and authorized by more than one party.

Segregation of duties, for example, is an arrangement in which responsibilities are divided among several individuals to ensure that no one individual has complete control over all aspects of a transaction. This can reduce the risk of abuse of authority and reduce the possibility of fraud.

d. Information and Communication

Effective communication is a critical element of the Internal Control System. A reliable information system allows management and stakeholders to receive accurate and timely data, so they can quickly identify and respond to potential fraud. The communication process also includes reporting potential violations or suspicious activity through secure and anonymous channels such as a fraud hotline. With a good information system, organizations can monitor activities that occur and detect unusual or suspicious patterns. In addition, anonymous fraud reporting provides an opportunity for employees to report fraud without worrying about repercussions, so aiding in the prevention of fraud.

e. Monitoring

Effective monitoring of the Internal Control System ensures that all control elements are running according to plan and functioning effectively. This monitoring can be done through Regular reviews of the current control policies and processes are conducted in addition to internal and external audits. Any flaws or holes in the control system can be found and fixed with close supervision, preventing would-be fraudsters from taking advantage of them.

3. Impact of Internal Control System Implementation on Fraud Prevention

The implementation of an effective Internal Control System has a positive impact on preventing fraud. With strict controls and a clear organizational structure, the Internal Control System can reduce the opportunity for individuals to commit fraud, even if there is motivation or pressure to do so. Organizations that have a good Internal Control System can also lower the possibility of financial loss from fraud and safeguard the organization's reputation from negative impacts (Mirinaviciene, 2014). In addition, an effective Internal Control System also increases employee awareness of the importance of maintaining integrity and ethics at work. Employees will be more aware that every activity is monitored and that there are consequences for actions that violate the law or organizational policies.

Challenges in Implementing Internal Control in the Public Sector

Implementation of Internal Control System in the public sector is an important effort to ensure transparency, accountability, and efficiency in the use of state resources (Ujkani, S., & Vokshi, 2019). However, the challenges in implementing Internal Control System in this sector are quite complex and require special attention. The following discussion will outline a few one of the main challenges facing internal control system implementation in the public sector, as well as its impact on governance.

1. Complexity of Organizational Structure and Bureaucracy

The public sector generally has a complex organizational structure and long bureaucracy. This is one of the main challenges in implementing Internal Control System. Multi-layered structure and long bureaucracy often slow down decision making and policy implementation. In this condition, the internal control implementation process becomes inefficient and prone to ineffectiveness.

The complexity of this structure also hinders effective monitoring and evaluation of Internal Control System. When an organization has many levels and departments, it is difficult for internal auditors and management to ensure that all elements of Internal Control System are functioning as planned (Motubatse et al., 2015). This increases the risk of errors or non-compliance in the implementation of established policies.

2. Limited Human Resources

Human resources who have competence in the field of internal control are very much needed to ensure that the Internal Control System can function effectively. In the public sector, the limited number of skilled and experienced human resources in this field is often a challenge. Many government agencies lack professional staff with specific skills in internal audit, risk management, and control (Abdulkadir, 2014).

In addition, the problem of low levels of training and development of human resources also worsens the situation. Employees who do not have adequate training on Internal Control Systems may have difficulty understanding and implementing complex procedures, thus hindering the effective implementation of the Internal Control System. To overcome this problem, the public sector needs to invest more in the development and capacity building of human resources that focus on internal audit and control.

3. Resistance to Change

Resistance to change is a typical difficulty experienced in many organizations, including the public sector. Implementation of the Internal

Control System often requires changes to existing procedures, policies, and work culture. In the public sector, where most employees tend to be accustomed to existing ways of working and are reluctant to adopt new procedures, this resistance can be a major obstacle (Veledar, B., & Leticia, 2020).

The work culture in the public sector is often more static and less flexible than in the private sector. Employees may feel that new procedures in the Internal Control System are more burdensome or add administrative tasks, making them less enthusiastic about following and supporting change. Management needs to overcome this resistance by educating employees about the importance of the Internal Control System and its long-term benefits to the efficiency and accountability of the organization.

4. Budget and Technology Limitations

Effective implementation of the Internal Control System requires adequate technology and budget support. In the public sector, budget constraints are a significant obstacle. Limited budgets often make it difficult for government agencies to adopt new technologies that can support the control system, such as risk management systems and integrated accounting information systems.

In addition, without adequate technology support, the implementation of monitoring and reporting of the Internal Control System becomes less efficient. The data needed to monitor performance and compliance in the implementation of the Internal Control System may not be available in real time, thus hampering rapid response to emerging issues. Therefore, the public sector needs to allocate sufficient budget for investment in technology and infrastructure that supports the optimal implementation of the Internal Control System.

5. Lack of Commitment from the Leaders

Commitment from the leaders or top management is a key factor in the successful implementation of the Internal Control System. In the public sector, lack of commitment from the leaders is often a challenge. Leaders who do not provide adequate attention and support to the Internal Control System tend to make this system ineffective. When leaders do not show commitment, employees at lower levels also tend to ignore the importance of the Internal Control System.

Conversely, when leaders are committed and play an active role in ensuring that the implementation of the Internal Control System runs smoothly, employees will be more motivated to follow the established procedures and

policies. Therefore, increasing commitment and strong leadership in the public sector is very much needed to support the implementation of an effective Internal Control System.

6. Compliance and Ethics Issues

Compliance with the rules and ethics in the implementation of the Internal Control System is often a problem in the public sector. Violations of internal control policies or manipulation of data for personal gain are still serious challenges in governance. This problem is related to the low culture of ethics and accountability in several government agencies.

To address this issue, it is necessary to raise awareness of the importance of ethics and compliance through training, strict supervision, and the application of strict sanctions for violations. By building a strong culture of compliance, the public sector can ensure that the Internal Control System is implemented effectively and reduce the risk of fraud and other irregularities.

CONCLUSION

Internal Control System plays an important role in preventing fraud in the public sector. With an effective Internal Control System, government agencies can reduce the risk of misappropriation and abuse of authority. The Internal Control System helps ensure that every transaction and operational activity is carried out in accordance with applicable procedures and regulations, thereby minimizing the chances of fraud.

In addition, the Internal Control System also provides strict supervision and control over public assets and resources, so that it can detect and prevent deviations as early as possible. However, the implementation of an ineffective or inconsistent Internal Control System can open up opportunities for fraud. In the public sector, a weak Internal Control System or one that does not run according to standards can result in inadequate supervision, increasing the risk of fraud, such as corruption and data manipulation. Therefore, it is important for government agencies to strengthen and continuously monitor the implementation of the Internal Control System periodically and ensure transparency and accountability in every process, in order to create a work environment free from fraud.

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