

PRIMARY RESEARCH

The influence of internal audit and internal control on fraud prevention in Bandung regency government

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Abstract. This research is conducted in Bandung regency government. The phenomenon that occurs is the case of internal control weaknesses, such as accounting and reporting control weaknesses, as well as cases of weakness of internal control structure. The existence of such fraud is non-compliant with the regulations resulting in a loss of area and the surrender value of assets or deposit cash into countries/regions. The research objectives are to determine how big the influence of internal audit is on fraud prevention and internal control on fraud prevention in District of Bandung Government. The methods used in this research are descriptive and verification method. Descriptive method is used to determine the variable picture of internal audit, internal control variables and variables of fraud prevention. To determine the effect of internal audit and internal control statistical tests were performed. The test statistic used is designing the structural model, designing a measurement model, construct the path diagram and test the model fit. Suitability test structural models and hypotheses were tested using software SmartPLS 2.0.M3. The result of this research reveals the coefficient of correlation between internal audit on fraud prevention is 0.422. The internal audit influence on fraud prevention in District of Bandung Government in percentage is 8.566%. The rest of it with a value of 91.434% is influenced by other factors unobserved in this research. The correlation coefficient between internal control on fraud prevention in District of Bandung Government is about 27.878%. The rest of it with a value of 72.122% is influenced by other factors unobserved in this research.

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INTRODUCTION

The occurring fraud cases in Indonesia recently have attracted the government attention and the community (Nisak & Kurniawan, 2013). According to Fitrawansyah, the fraud prevention is an activity to counter fraud with low cost because fraud prevention can be associated with disease which is better to prevent than to cure (Festi &

Natariasari, 2014). There are three kinds of frauds; first, the misuse and fraud of assets involving active entity theft; second, false statement on financial report or value neglect or deliberate statement with an intention to trick the financial report recipients; third, corruption and misuse of position in government sector for personal purposes (Tuanakotta, 2010). In Bandung Regency Government, there are 34 reported cases, with 14 internal control weakness cases, 16 defiance cases of rules and

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regulations resulting in regional losses, and 4 cases of assets value giving or regional/governmental cash deposit on findings which are in a process of investigation (Aziz, 2014). Internal audit plays an important role in observing and monitoring the activities and assures that anti-fraud control program is running effectively and internal audit activities could prevent as well as detect frauds (Amalia, 2013). With the presence of internal audit, frauds and errors and other disadvantaging efforts in an organization can be reduced and even prevented (Gusnardi, 2011). Internal audit in government agencies isn't running its jobs optimally (Didi, 2008). Islahudin contends that fraud cases occurring in Indonesian government are caused by the termination of internal audit and detection system, such as ineffective regional monitoring institution because it is staffed by misfits and staff who is about to retire (Robert, 2013). Internal Control System (ICS) in implementation must always consider norms of justice and obedience as well as considering size of complexity and nature of its duties and government agencies' functions (Mulyani & Suryawati 2013). In Bandung Regency Government, there are 14 reported cases of ICS with 9 accounting reporting and control weaknesses, 2 system weaknesses on income and expense cost control, and 3 internal control structure weaknesses (Aziz, 2014). ICS is a policy and procedure designed to provide significant trust to management as a proof of the fact that organization has accomplished its goal and targets (Agung, 2010).

Problem Identification

1. How significantly does the internal audit affect the fraud prevention in Bandung Regency Government?
2. How significant is the influence of internal control with respect to fraud prevention in Bandung Regency Government?

Research Purposes

The purpose of this research is to collect information on internal audit, internal control system, fraud prevention, empirical proof of internal audit, and internal control system that affects the fraud prevention in Bandung Regency Government. The purposes of this research are:

1. To acknowledge how significantly the internal audit affects the fraud prevention in Bandung Regency Government.
2. To know how significant the internal control is with respect to fraud prevention in Bandung Regency Government.

RESEARCH USABILITY

Practical Usability

The result of this research is meant to find solutions of problems within internal audit, internal control, and fraud prevention in Bandung Regency Government. The practical usability of this research is as follows:

For Inspectorates

As a medium of consideration, it is useful for inspectorates in order to find significant effects from internal audit and internal control system with respect to fraud prevention in Bandung Regency Government so they could do improvements.

For Internal Auditors

As information and inputs in doing their jobs and maximizing its functionalities so fraud prevention in Bandung Regency Government is effective.

Academic Usability

For Public Sector Accounting Developers

Could add knowledge and provide scientific research particularly to public sector accounting on the effect of internal audit and internal control with respect to fraud prevention by proving theoretically and through prior researches.

Writer

To increase or comprehend the knowledge and understandings, to find solutions found by writer on internal audit and intern control on fraud prevention. This research is also useful as a final project reference in order to obtain undergraduate degree at Faculty of Economy at Universitas Komputer Indonesia (UNIKOM), Bandung.

Other Researchers

This research is expected to provide deep knowledge and information or reference required by other researchers for further development in internal audit and internal control on fraud prevention.

LITERATURE REVIEW

Internal Audit

According to Sukrisno (cited by Hery, 2010:57) it is defined that internal audit is a checking done by entity of internal audit of financial reports and accounting notes entity and also for obedience of top level management

regulations, obedience of government issues and regulations related to profession. The government rules like tax, environment, banking, industries, investment, etc. According to Tugiman (2006:53) internal check process should have four stages:

1. Checking planning
2. Information evaluation and test
3. Checking result publication
4. Checking follow up

Internal Control

According to Rahayu & Suhayati (2010:221), internal control explains about the internal control within a process, influenced by board of commissioners, management, and other personnel within an entity, designed to provide trust in order to accomplish goals, such as rigid financial report, maintaining assets and organizational notes, obedience of rules and regulations, and operation effectivity and efficiency. According to Rahayu & Suhayati (2010:223) an internal control must consist of 5 components:

1. Environment Control
2. Risk Management Implementation
3. Activities Control
4. Accounting Information and Communication
5. Observation

Fraud Prevention

According to Amrizal (2004:5), fraud prevention is activity done by management to implement policies, system, and supporting procedures to ensure that required activities have been done by board of commissioners, management, and other personnel in a company to provide trust in accomplishing three goals; rigid financial report, effective and efficient operations, and obedience to rules and regulations. According to Amrizal (2004:5) fraud detection that might occur should be prevented by these following ways:

1. Establish a good internal control structure
2. To make effective use of activity control
3. Organizational culture improvement
4. To make effective use of internal audit function

Knowledge Framework

Internal Audit Effect on Fraud Prevention

According to survey by Widilestariningtyas (2012) the relation between internal audit and fraud prevention is

that internal audit affects significantly on fraud prevention simultaneously and partially.

Internal Control Effect on Fraud Prevention

The relation between internal control and fraud prevention exposed by (Sukrisno, 2012:212) is if internal control of an institution is weak, there will be a big chance of fraud and errors. On the contrary, if the internal control in an institution is strong, the chance of fraud and errors will be relatively small. The paradigms in this research are as follows:

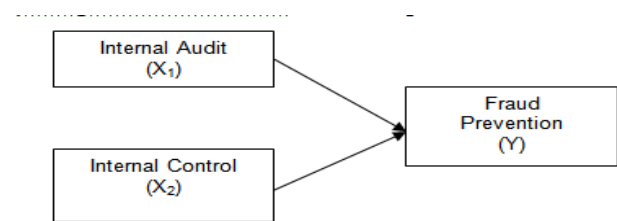


FIGURE 1. Research model

Hypothesis

- H1:** Internal audit affects the fraud prevention
H2: Internal Control affects fraud prevention

METHODOLOGY

The methods used for this research are descriptive and verificative. By these methods, the relation among observed variables can be obtained to produce conclusions.

Descriptive method is a way to make description or view systematically, factually, and accurately on facts and nature of observed phenomena. Verificative method is to test the theory and hypothesis offered by experts on internal audit and internal control on fraud prevention. The verificative method used in this research is done by using statistical test i.e. structural equation model (SEM) based on variance or known as partial least square (PLS).

Data Collection Techniques

Data collecting techniques used in this research are done in two ways, field research and literature review. Primary data collecting and secondary data collecting:

1. Field research
 - a. Interview
 - b. Questionnaires
 - c. Documentations
2. Literature review

TABLE 1. Operational variables

Variable	Variable Concept	Indicator	Scale	Questionnaire No.
Internal Audit (X ₁)	Internal Audit is an independent judgement value in an organization to test and evaluate organization activities (Tugiman 2006:1)	1. Checking Planning		1 - 2
		2. Testing and Evaluating	O R	3 - 4
		3. Checking Result Publicatoin	D I N	5 - 6
		4. Checking Follow Up (Tugiman, 2006)	A L	7
Internal Control (X ₂)	Internal control is a process, influenced by board of commissioners, management, and other personnel entity designed to provide trust in order to achieve goals such as rigid financial report, asset and organization notes, obedience of rules and regulations, and effective and efficient operations. (Rahayu & Suhayati 2010:221)	1. Environment Control		8 - 9
		2. Management Risk Statement		10 - 11
		3. Control activities	O R D	12 - 14
		4. Accounting Information and Communication	I N A L	15 - 16
		5. Observation (Rahayu & Suhayati 2010:223)		17
Fraud Prevention (Y)	Fraud prevention is activity done by management to implement policy, system and procedures to ensure that actions are done by board of commissioners, management, and other personnel in a company to provide trust to achieve three main points, rigid financial report, effective and efficient operations and obedience of rules and regulations. (Amrizal 2004:5)	1. Good Internal Control System Structure		18
		2. To make effective use of control activity	O R D I N A L	19
		3. Organization culture improvement		20
		4. To make effective use of internal audit function(Amrizal 2004:5)		21

Analysis Unit

Analysis unit in this research is auditor and P2UPD in inspectorate which audits regional government work union (SKPD) Bandung district of 33 SKPD.

RESEARCH RESULTS

Descriptive Analysis Results

Internal audit descriptive analysis: In overall response from respondents, it is known that the score of internal audit variable is 85.90%. This value if referred to criteria by Narimawati (2008:85) is categorized as very good within the interval of 84.01% - 100%, so it is concluded that the value is scored as very good.

Internal Control Descriptive Analysis

In overall response from respondents, it is known that the percentage value obtained for internal control variable is 74.06%. This value if referred to criteria by Narimawati (2008:85) is categorized as good within 68.01% - 84% interval, so it is concluded that internal control overall is scored as good.

Fraud Prevention Descriptive Analysis

In overall response from respondents, it is known that the percentage value for fraud is 71.67%. This value if referred to criteria by Narimawati (2008:85) is categorized as good within 68.01% - 84% interval, so it is concluded that the overall score is good.

Verificative Analysis

Internal Audit on Fraud Detection Verificative Analysis Result

Based on data analysis using Smart PLS 2.0 software, the verificative internal audit result can be explained as below:

1. Correlated coefficient value for internal audit (X1) with fraud prevention (Y) is about 0.422 and categorized as intermediate/sufficient within 0.40 - 0.70 interval. This means internal audit has a positive effect on fraud prevention. Where if internal audit runs well, fraud prevention will also be better. On the contrary, if internal audit performance is reduced then fraud prevention will also be reduced.

2. Determination coefficient (partial) of internal audit (X1) gives an effect for 8.566% on fraud prevention (Y) and categorized as very low > 0.40. While the remaining 91.434% is a factor unobserved in this research.

3. Determination coefficient value (overall) of internal audit (X1) and internal control (X2) altogether give contribution for 36.44% (intermediate/sufficient) on

fraud prevention (Y). While the remaining 64.56% is other factor unobserved in this research.

Verificative Analysis Result of Internal Control on Fraud Prevention

Based on data analysis using Smart PLS 2.0, the verificative analysis result of internal audit on fraud prevention can be explained as below:

1. Correlation Coefficient value obtained between internal control (X2) with fraud prevention (Y) is 0.576 and categorized as intermediate/sufficient within 0.40 - 0.70 interval. This means the internal control has a positive effect on fraud prevention. If the internal control is better, then fraud prevention will also be better. On the contrary, if internal control is reduced so fraud prevention will also be reduced.

2. Determination coefficient (partial) of internal control (X2) provides a good effect of 27.878% on fraud prevention (Y) and categorized as intermediate/sufficient within 0.16 - 0.49 interval. While the remaining 72.122% is factor unobserved in this research.

3. The determination coefficient (overall) of internal audit (X1) and internal control (X2) altogether provide contribution factor of 36.44% and categorized as intermediate/sufficient on fraud prevention (Y), while the remaining 63.56% is factor unobserved in this research.

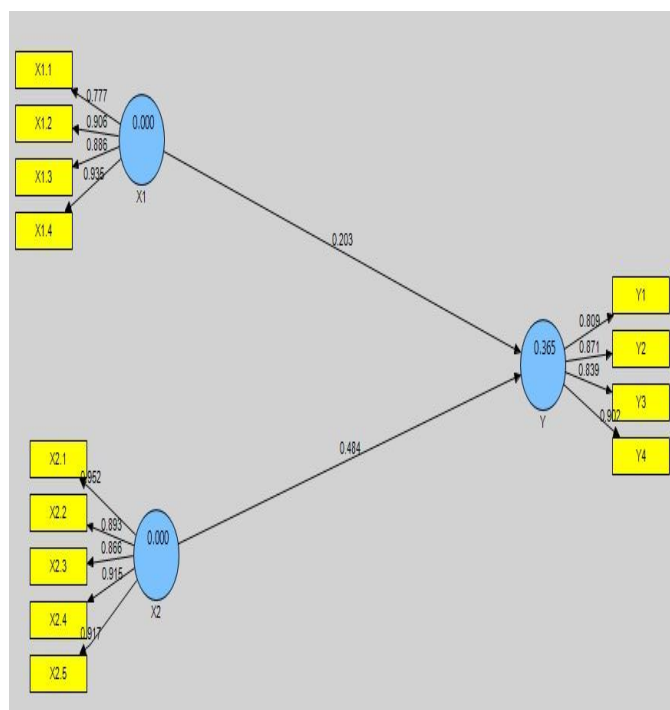


FIGURE 2. Relationship between internal audit and fraud prevention

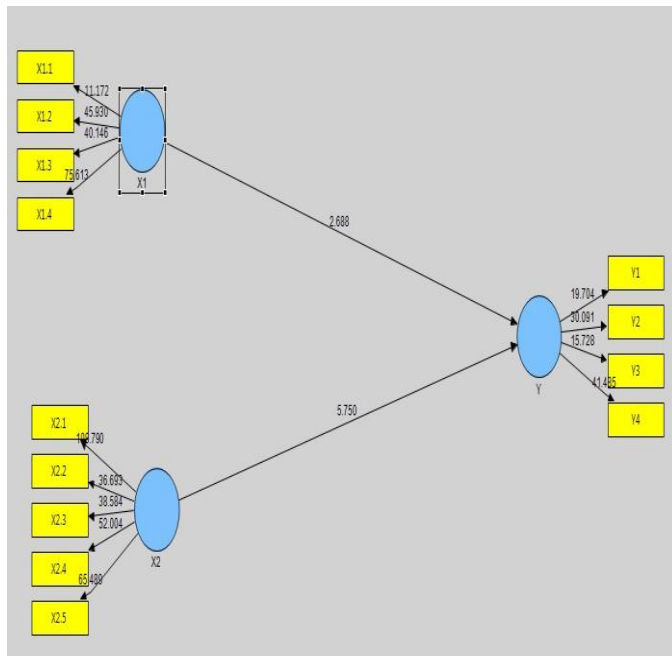


FIGURE 3. Relationship between internal control and fraud prevention

R Square

	R Square
X1	
X2	
Y	0.364665

[Table of contents](#)

Cross Loadings

	X1	X2	Y
X1.1	0.776778	0.355581	0.289752
X1.2	0.906298	0.509199	0.344743
X1.3	0.886204	0.346405	0.371522
X1.4	0.935001	0.395121	0.451736
X2.1	0.452444	0.951549	0.475255
X2.2	0.465830	0.893471	0.428249
X2.3	0.391457	0.865718	0.616875
X2.4	0.398986	0.914501	0.581690
X2.5	0.363113	0.916648	0.456337
Y1	0.410862	0.399666	0.808535
Y2	0.336180	0.586013	0.870746
Y3	0.339680	0.456858	0.838599
Y4	0.369955	0.508362	0.901949

Redundancy

	redundancy
X1	
X2	
Y	0.095942

[Table of contents](#)

Cronbachs Alpha

	Cronbachs Alpha
X1	0.899964
X2	0.947524
Y	0.877819

[Table of contents](#)

Latent Variable Correlations

	X1	X2	Y
X1	1.000000		
X2	0.454384	1.000000	
Y	0.422686	0.576247	1.000000

FIGURE 4. Correlation and regression results

Analysis

Analysis Result on Fraud Prevention

Based on field research, internal audit effect percentage is 8.566% on fraud prevention with a correlation value of 0.422 which means internal audit provides an intermediate/sufficient value towards a positive effect on fraud prevention in District of Bandung Government. The positive internal control value with fraud prevention shows that a better internal audit will be followed by better fraud prevention as well. This research reveals that internal audit provides 8.566% effect on fraud prevention, while the remaining 91.434% is influenced by other unobserved factors. From the descriptive analysis result, it is revealed that internal audit has a respondent percentage of 85.90% and categorized as very good which means that internal audit is very good. This is proven by good respondent indicator with a value of 87.87%, next the indicator of checking planning with a value of 86.975%, the indicator of checking follow up with a value of 85.45% and the lowest value is testing and evaluating with a value

of 71.67% and categorized as good which means fraud prevention is good. This is proven by the highest indicator from respondents which are internal control structure with a value of 76.97%. Indicator to make effective use of internal audit function is 71.52%, next an indicator to make effective use of control activity has value of 70.30%, and the lowest indicator to improve organizational culture with a value of 67.8% but at this present time there is a gap with a value of 28.33%. So in order to improve internal audit, we can look at loading factor, done by increasing checking planning (0.777), testing and evaluating (0.906), checking result publication (0.886), and checking follow up (0.935). Besides we can do fraud prevention by building good internal control (0.809), to make effective use of control activity (0.871), improving organizational culture (0.839), and to make effective use of internal audit functions (0.902).

The research result proves empirically that internal audit affects fraud prevention, where good internal audit will improve fraud prevention in District of Bandung Government. The research result is supported by theory stating that inappropriate internal audit will increase the opportunity of administrative fraud (Amin Widjaja Tunggal (2012:134). The research has also supported that better internal audit will cause higher prevention effort (Festi & Natariasari, 2014).

Internal Control Influence on Fraud Prevention

Based on field research, internal control has a big effect with a value of 27.878% on fraud prevention with a correlation value of 0.576 which means internal control system provides intermediate/sufficient value in a positive way on fraud prevention in District of Bandung Government. Internal control with fraud prevention shows that good internal control will be followed by good fraud prevention. From this result it is known that internal control gives an effect with a value of 27.878% on fraud prevention, while the remaining 72.122% is affected by unobserved factors. From the descriptive analysis result it is proven that internal control has a respondent respond with a value of 74.06 and categorized as good which means internal control is better. This is proven by the highest response with an indicator of risk management of 83.64%, next the environment control factor of 75.45%, accounting information and communication with a value of 67.27%. There is a gap with a value of 32.73% which means the problems are within the internal control. Next one is fraud indicator to build good internal control with a value of 76.97%, next to make effective use of internal audit control

with a value of 71.52%, next the indicator to make effective use of cultural organization with a value of 67.88% but there is still a gap with a value of 28.33%. Prevention has the respondent with a value of 71.67% and categorized as good which means fraud prevention is good to counter existing problem in internal control can be seen on loading factor, can be done by improving environment control (0.952), risk management (0.893), control activity (0.866) by adding human resource in accounting so we could separate functions between recording, admitting, expense, and money keeping, accounting information system and communication (0.915), adding accounting information system or upgrading accounting information system and observation (0.917). Besides it can be done by improving internal control (0.809), to make effective use of control activity (0.871) increasing organization culture (0.839), and to make effective use of internal audit function (0.902). The research result proves empirically that internal control system affects fraud prevention, where good internal control will increase the fraud prevention in District of Bandung Government. The research result is supported by theory stating that if internal control within an institution is weak, there will be a bigger chance of fraud. On the contrary, if internal control is strong, there will be a bigger chance to prevent fraud (Sukrisno, 2012:212). The research result is also supported by previous researches stating that the better the internal control the stronger the effort to prevent fraud (Arfah, 2011).

CONCLUSION AND RECOMMENDATIONS

Based on data analysis and description of this research, we can conclude several things as follows:

1. Internal audit affects the fraud prevention in District of Bandung Government, means the better the internal audit the better the effort of fraud prevention.
2. Internal control affects fraud prevention in District of Bandung Government, means the better the internal control the better the fraud prevention. But in practice it is still not optimal because there are several problems:
 - a. Activity control on SKPD which is adequate on respondent is caused by inoptimal function splitting; record, admission, and expense
 - b. Accounting information and communication system in SKPD are still lacking, which causes accounting information system scored by respondents as still relevant.

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— This article does not have any appendix. —