

## **THE IMPACT OF INTERNAL CONTROL AND GOOD CORPORATE GOVERNANCE ON FRAUD PREVENTION**

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### **Abstract**

*This research aim to examine: (1) The Influence of Internal Control on Fraud Prevention (2) The Influence of Good Corporate Governance on Fraud Prevention. This study uses a quantitative approach and analysis method which used in this research is multiple regression method. The population of this research are banking companies in the Jakarta and Tangerang Selatan regions. The result of this study showed that the internal control have no effect on fraud prevention, good corporate governance have a positive effect on fraud prevention. In addition, the internal control and good corporate governance simultaneously influence the fraud prevention.*

Keywords: *Internal Control, Good Corporate Governance, Fraud Prevention*

### **1. INTRODUCTION**

Fraud (fraud) is an act intentionally done by one or more people to use resources from an organization improperly (acts against the law) and wrong in presenting facts (hiding facts) to gain personal gain (Noviani & Sambharakresna, 2014). The consequences that must be borne by a company from fraud cases are company collapse, large investment losses, and can cause significant litigation costs. Various modes of fraud and weak control systems in an organization or company cause fraud can not be stopped or eradicated until now. The occurrence of white collar crime in various countries which has increased has prompted various parties to take various preventive measures and increasingly increase

demands for the application of good governance in both the private and public sectors.

According to Ernst & Young (2014), as many as 59 countries involved in the survey conducted by E&Y agreed that the incidence of fraud did not decrease compared to previous years. In fact, new ways to commit fraud always emerge from regulators that the public considers inappropriate. (Association of Certified Fraud Examiners [ACFE]) 2016, states the estimated loss of fraud to the company is 5 percent of its revenue which could result in a global fraud loss of around \$6,3 billion. Based on survey data conducted by the Indonesian Association of Certified Fraud Examiners (ACFE), in collaboration with Ernst & Young in 2016, shows that:

**Table 1.** ACFE and EY Survey Results (2016)

<b>Type of Industry</b>	<b>Percentage</b>
Government	58.8%
Finance and Banking Industry	15.9%
Health Industry	9.3%
Manufacturing Industry	3.5%
Education Industry	3.1%
Transportation Industry	2.7%
Others	1,3%

From the survey results it can be seen that the financial and banking industry is the second most disadvantaged industry with a percentage of 15.9%. In banking operations, there are several activities that can be identified prone to fraud. In funding activities, usually in conducting financial transactions the bank and the customer enter into

an agreement between the bank and the customer. In the implementation of this agreement, it can trigger an act of fraud committed by both parties.

Based on information obtained by researchers from Okezone.com in January 2016 that in 2015, employees of PT Bank Permata Tbk as relation managers embezzled money of Rp 29

billion, the fund was funded by 17 customers with fictitious deposits while in 2016 also occurred The same thing was done by a person of PT Bank Tabungan Negara (Persero) Tbk where the loss of money amounting to Rp 420 million belonged to customers due to skimming.

Fraud in the banking sector can eliminate the public's trust as a customer which can harm the sustainability of the bank's operational activities. In order to prevent fraud in banks, Bank Indonesia issued circular No. 13/28 / DPNP to all commercial banks regarding the Implementation of Anti-Fraud Strategy for commercial banks. To strengthen the internal control system, banks are required to have an effective anti-fraud strategy. In developing and implementing an effective anti-fraud strategy, banks must pay attention to matters such as (1) internal and external environmental conditions, (2) complexity of business activities, (3) potential, type, and risk of fraud, and (4) adequacy of resources power needed.

In the case of fraud risk control, the role of internal control is needed to oversee the occurrence of fraud (fraud). Internal control functions as evaluating all applicable systems and procedures whether those procedures have been implemented properly and correctly through observation, observation and inspection through the implementation of tasks in each division of the company.

In addition to preventing fraud, the Financial Services Authority (OJK) stated in the Financial Services Authority Circular Letter No.13 / SEOJK.03 / 2017 regarding the Implementation of Governance for Commercial Banks that the application of Good Corporate Governance (GCG) is very necessary to improve bank performance protect the interests of the stakeholders, and improve the laws and regulations.

Implementation of Governance in the banking industry must be based on five basic principles of Good Governance, namely accountability which is the clarity of the implementation function and accountability of the Bank's organs so that management is effective, responsibility which is the conformity of bank management with related laws and regulations, independence which is a professional bank management without influence and pressure from any party, and fairness which is fairness in fulfilling the rights of stakeholders arising based on agreements and laws and regulations.

The implementation of GCG is part of the bank's control measures in dealing with widespread fraud problems. The bank's

management can control by implementing GCG and conduct overall supervision so that it can improve bank performance, protect the interests of stakeholders and meet the applicable laws and regulations in general banking industry.

### Research Question

This research is focused on the study of internal control and the application of good corporate governance in the banking industry. From the explanation above, there are three questions as follows:

1. Does the application of internal control affect fraud prevention?
2. Does the effect of implementing good corporate governance influence fraud prevention?
3. Does the application of internal control and good corporate governance can jointly influence fraud prevention?

This research is expected to produce several benefits including the following:

1. For Banking Companies, this research is expected to contribute to the thought of internal control, the application of good corporate governance and its influence on fraud prevention.
2. This research is expected to be useful and be an additional literature for other parties conducting research on the application of internal control and the application of good corporate governance to fraud prevention.

## 2. LITERATURE REVIEW

### Agency Theory

According to the Institute of Chartered Accountants in England & Wales (2005) Agency theory is a theory of economic accountability, which helps explain audit developments. Agency relationships arise when one or more actors (eg owners) involve others as their agents (or stewards) to perform services on their behalf. This service performance results in the delegation of some decision making authority to the agent. Delegation of responsibility by principals and the resulting division of labor is very helpful in promoting an efficient and productive economy. *Fraud*

The Association of Certified Fraud Examiners (ACFE) (2006) in Rukmawati (2011), defines fraud as intentional unlawful acts committed for a specific purpose, carried out by people from within or outside the organization to gain personal or group benefits. directly or indirectly harming other parties. Fraud can be defined as a deliberate action taken to deceive others into obtaining benefits where the recipient is declared not given legal power to own or have the

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right to own (Deepa et al, 2017). Fraud involves recording transactions without the essence or omission of recording transactions or documents, intentional errors in applying accounting policies and deliberately mistakenly recording entity disclosures (Olatunji, 2009).

### Internal control

According to government regulation No. 60/2008 concerning the Internal Control System is an activity carried out continuously by the leadership and all employees to provide adequate confidence in the achievement of organizational goals through effective and efficient activities so as to detect and minimize the occurrence of actions that can harm the country. Meanwhile, according to the AICPA (American Institute of Certified Public Accountants) in Bambang Hartadi (2000: 3) the internal control system includes the organizational structure, all the coordinated methods and conditions adopted by the company to protect assets, examine accuracy, and to what extent the data trustworthy accounting, improve business efficiency and encourage compliance with established company policies.

### Good Corporate Governance

According to the Forum for Corporate Governance in Indonesia (FCGI), Good Governance is a set of rules that establish the relationship between shareholders, management, creditors, the government, employees and other internal and external stakeholders with respect to their rights and obligations, or can be said as a system that directs and controls a company (Sari et al, 2015). Bank Indonesia explained that Good Corporate Governance is bank governance through the application of several principles, namely:

a. Transparency, which is the principle that upholds openness in disclosing all material

information that is adequate, timely and accurate as well as company openness in decision making.

- b. Accountability, which is a principle that requires a clear function or separation of duties and the implementation of the responsibilities of each section in the company so that the company can be managed properly.
- c. Responsibility (Responsibility), namely the principle that requires that the management of the company in accordance with and compliant with the principles of a healthy corporation and in accordance with applicable laws and regulations.
- d. Independency, which is a principle that requires professional management of the company without conflict of interest or pressure from any party.
- e. Fairness, which is a principle that demands the fair and equal fulfilment of shareholder rights in accordance with agreed agreements and in accordance with applicable laws and regulations.

### Hypothesis

Referring to the research objective, which is to examine the effect of internal control and good corporate governance on fraud prevention, the research hypotheses proposed are as follows:

H1 = Internal control influences fraud prevention.

H2 = Good Corporate Governance affects fraud prevention.

H3 = Internal control and good corporate governance together affect the prevention of fraud.

### Conceptual Framework

The conceptual framework of this research is as follow:

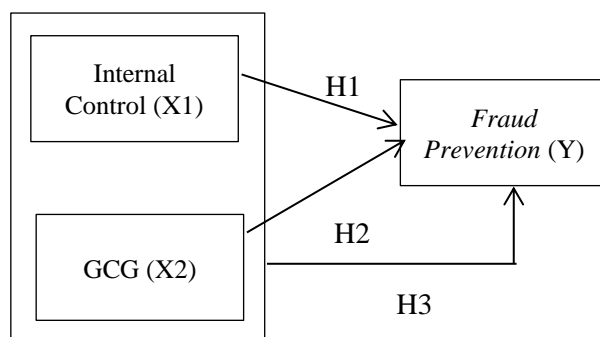


Figure 1. Conceptual Framework

From the framework of research thought above, it shows that this research is to find out how the influence of internal control and GCG on fraud prevention.

## 3. DATA AND RESEARCH TECHNIQUE ANALISYS

### Population and Samples

The population of this research are banking companies in the Jakarta and Tangerang Selatan

regions. The sampling method used was purposive sampling, which is sampling based on the following criteria:

1. Employees working in the banking sector.
2. Employees who have a relationship with recording, financial reporting and evaluation and supervision so that there is a big enough opportunity to commit fraud.

**Data Analysis Method**

On this occasion the authors used the method of multiple linear regression analysis. This model was chosen because this study was designed to examine the effect of independent variables on the dependent variable. The multiple linear regression equation model used is as follows:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + (X_2 * X_1) e$$

Information:

Y : Fraud Prevention

- A : Constant
- X1 : Internal Control
- X2 : Good Corporate Governance
- $\beta_1$  : Regression coefficient of internal control variable
- $\beta_2$  : Regression coefficient of Good Corporate Governance variables
- e : Standard Error

**4. RESULTS AND DISCUSSION**

**t Statistical Test (partial test)**

According to Ghazali (2016) a t test was performed to compare the variance explained by regression to the residue and the results tell whether the relationship is partially of statistical significance or not.

**Table 3. t-Test Result**

Model	B	Std. Error	t	Sig.
1 (Constant)	17,297	5,043	3,430	,001
PI	,067	,088	,759	,452
GCG	,339	,099	3,439	,001

Based on table 3, the resulting internal control regression coefficient is 0.067, it can be said that every 1 (one) increase in internal control will increase fraud prevention by 0.067. Hypothesis testing results have a t count of 0.759 smaller than t table (0.759 < 1.681) and obtained a significance of 0.452 greater than the significance level of 0.05 (0.452 > 0.05) then the test shows that H1 is not accepted which means that internal control has no effect on fraud prevention Bank employees.

In table 3, a good corporate governance regression coefficient is generated for 0.339, it can be said that every 1 (one) increase in motivation will increase fraud prevention by 0.339. Hypothesis testing results have a t-count of 3,439 is greater than t table (3,439 > 1,681) and obtained a significance

of 0.001 smaller than the significance level of 0.05 (0.001 < 0.05), the test shows that H2 is accepted, which means good corporate governance has a significant effect on fraud prevention.

**Statistical Test F (simultaneous test)**

F test (simultaneous) aims to determine whether there is a simultaneous influence of independent variables on the dependent variable. according to Ghazali (2016: 99), where to determine the F value of the table,  $\alpha$  used is 0.05 with the degree of freedom for numerator = k - 1 = 3 - 1 = 2 and denominator = n - k = 45 - 3 = 42, so the F table value of 3.22 is obtained.

**Table 4. F Test Result**

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	28,794	2	14,397	5,928	,005 <sup>b</sup>
Residual	102,006	42	2,429		
Total	130,800	44			

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The table above shows that the Anova or F test results were 5,928 with a probability of 0.005 <0.05. Thus, H3 is accepted. In addition, based on the F table value of 3.22, then  $F_{\text{arithmetical}} > F_{\text{table}}$  (5.928 > 3.22), it can be concluded that the regression model of internal control variables and good corporate governance together (simultaneously) affect the prevention of bank employee fraud.

### Determination Coefficient Test

The determinant coefficient test is used to measure how far the model's ability to explain the variation of the dependent variable. A small adjusted R2 value means that the ability of the independent variables to explain the variation of the dependent variable is very limited (Ghozali, 2016). The following table presents the results of the determination coefficient test using the IBM SPSS Statistics 20 program.

Table 5. Determinant Test Result

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	,469 <sup>a</sup>	,220	,183	1,558

Based on the table above, the value of R Square is 0.220. This shows that 22% of fraud prevention conducted by bank employees can be explained by internal control variables and good corporate governance, the remaining 78% fraud prevention of bank employees is influenced by other factors outside this research such as internal audit and job satisfaction.

Based on table 5 can also indicate whether the predictor of the dependent variable is correct. According to Sarwono (2017), if the value of Std. The error of the Estimate is smaller than the Std value. Deviation, then the predictor for the dependent variable is correct.

## 5. CONCLUSION

This study aims to examine the effect of Internal Control and Good Corporate Governance on Fraud Prevention. Respondents in this study were 45 employees in the banking sector in Jakarta and South Tangerang. Based on the data analysis and discussion described, the overall conclusions from this study can be obtained as follows:

1. This study shows that internal control has no effect on fraud prevention. This is due to the fact that internal control has not been able to encourage fraud prevention activities, this happens because the majority of respondents in this study have a working period of less than five years so it is suspected that the majority of

- respondents do not understand the internal controls even though they work.
2. This study shows that good corporate governance has a significant effect on fraud prevention. This is due to good corporate governance bank employees can encourage fraud prevention activities. The encouragement can come from various parties, both superiors and colleagues, that can create good corporate governance within the respondent environment that can encourage fraud prevention activities.
3. This research shows that internal control and good corporate governance together (simultaneously) affect the prevention of fraud. This reflects that by increasing good corporate governance and increasing the effectiveness of internal control, it can increase fraud prevention.

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