



Analysis of the Effectiveness of Internal Control as Fraud Prevention in the Kupang City Government

Maria Kurnia Purnayuda¹, F.X. Kurniawan Tjakrawala²

^{1,2}Study Program of Accountant Profession (PPAk), Business & Economic Faculty, Tarumanagara University, Jakarta—Indonesia

ABSTRACT: This study aims to evaluate the effectiveness of the implementation of the Internal Control System (ICS) in financial management and Government Regulation (PP) No. 06 of 2008 as a fraud prevention measure. This study employs a qualitative descriptive approach. Primary data were gathered through questionnaire about internal control system, completed by relevant officials, which were supplemented by additional insights obtained from interviews.

Meanwhile, secondary data were sourced from the Summary of Audit Results (IHPD) for the East Nusa Tenggara Province. Given the paucity of research on internal control-based auditing in the government sector and the rising instances of corruption in public financial accountability and operations, it is critical to delve deeper into this issue to investigate the effectiveness of internal controls in preventing fraud within the government. This study identifies the causes of compliance findings in the Financial Statements of the Regional Government of Kupang City for the 2023 Fiscal Year, analyzed them in relation to the effectiveness of the Internal Control System (ICS). The findings reveal that ineffective implementation of internal control is a significant factor contributing to compliance violations of regulations, which result in state or regional losses that require recovery.

KEYWORDS: Accounting Fraud, Accounting Public Sector, COSO Framework, Fraud Prevention, Internal Control System (ICS).

INTRODUCTION

The effective management of public finances requires a system that is efficient, transparent, and accountable. To achieve these goals, an effective Internal Control System (ICS) is indispensable in government activities. Indonesian Government Regulation No. 60 of 2008 defines the ICS as a comprehensive and continuous process implemented by leaders and employees to provide reasonable assurance regarding the achievement of organizational objectives through effective and efficient operations, reliable financial reporting, safeguarding of state assets, and compliance with laws and regulations. Internal control serves as a cornerstone in guiding government operations, ensuring that activities are conducted within the legal framework established by such regulations.

According to Law No. 23 of 2014, regional leaders, including those in the Regional Government, such as Governors, Mayors, and Regents, are responsible for overseeing the implementation of internal control in local government institutions by as stipulated in. This law emphasizes the importance of clean and effective governance, which inherently includes the application of robust internal controls. The decentralization of financial management, as outlined in Law No. 22 of 1999 on Regional Government and Law No. 25 of 1999 on the Financial Balance between Central and Regional Governments, grants local governments the authority to manage their revenues and expenditures. This fiscal decentralization enables local governments to utilize their budgets in alignment with their priorities and needs, as determined through regional regulations on the annual budget (APBD).

Local governments are required to manage and report public finances as part of their accountability under Law No. 1 of 2004 on State Treasury. Local Government Financial Statements (LKPD) must adhere to Government Accounting Standards (SAP), as regulated by Government Regulation No. 71 of 2010. However, weaknesses in the implementation of internal controls create opportunities for fraud in budget management. These vulnerabilities can undermine the integrity of public financial management and erode trust in government institutions.

The Supreme Audit Agency (BPK), as an independent external auditor, plays a pivotal role in evaluating the financial management and accountability of public funds, as mandated by Law No. 15 of 2006. BPK audits ensure that public finances are managed transparently and in compliance with regulations while evaluating LKPD and providing opinions on their fairness. Based on the Summary of Semester Audit Results (IHPS) for the first semester of 2024, BPK reported that 493 out of 546 LKPD received



unqualified opinions (WTP) for the 2023 fiscal year. Nevertheless, the persistence of exceptions (WDP) and unfavorable opinions (TW) highlights the need for strengthening internal controls in local governments.

BPK's findings reveal two main categories of issues: deficiencies in internal control and non-compliance with regulations. The latter often leads to financial losses for the state. In IHPS Semester 1 of 2024, there were 7,845 cases of non-compliance, with 4,147 of which resulted in financial losses amounting to IDR 2.45 trillion. These issues are largely due to ineffective internal controls, manifesting as underreported project volumes, excessive spending, duplicate travel expenses, and overpayments, among other irregularities.

Fraud within local government poses significant risks to the integrity of public financial management and the efficacy of service delivery. The lack of internal control makes public funds vulnerable to misuse, thereby reducing public trust in government institutions. Notable corruption cases in East Nusa Tenggara (NTT) Province, such as the mismanagement of COVID-19 funds in Sikka Regency (AntaraneWS, 2021), corruption in the construction of Pratama Hospital in TTS Regency in 2017 (Detik, 2023), and fraud in the procurement of medical equipment at Kefamenanu Hospital in 2015 (Detik, 2022), underscore the critical need for robust internal controls.

In light of these challenges, this study examines the effectiveness of internal control implementation in the City of Kupang, NTT Province. The research aims to understand how internal controls are applied in preventing fraud and to identify barriers to their effectiveness. Through interviews with key stakeholders in Kupang's local government, this study seeks to provide a comprehensive understanding of internal control practices and propose strategies for enhancing their efficacy.

The results of this research are expected to contribute to the broader discourse on public sector governance and accountability. The results will not only inform local policymakers but also serve as a reference for other regions looking to strengthen internal controls, safeguard public finances, and enhance trust in government institutions.

RESEARCH REVIEW

Fraud: Definitions, Classifications, and Implications

Fraud, defined as an intentional act of deception for personal or organizational benefit, is a critical issue in both the public and private sectors. According to the Association of Certified Fraud Examiners (ACFE), fraud is categorized into three main types: corruption, asset misappropriation, and fraudulent financial reporting. Within the context of government, fraud can manifest in various forms, such as budget misappropriation, bribery, embezzlement, and procurement manipulation. In accounting and financial contexts, fraud often involves falsifying records, concealing assets, or abusing authority for illicit gain.

Fraud in government institutions has far-reaching consequences, including financial losses, erosion of public trust, impeded development, and damage to national reputation. Studies highlight that effective internal control mechanisms are vital for mitigating these risks. The "Fraud Triangle" theory, introduced by Cressey (1973), attributes the occurrence of fraud to three factors: pressure, opportunity, and rationalization. Pressure may arise from financial strain, lifestyle demands, or management-imposed performance targets. Opportunities for fraud emerge from weak internal controls, inadequate understanding of regulations, or system loopholes. Finally, rationalization occurs when perpetrators justify their actions morally or ethically, often based on perceived inequities or a sense of entitlement.

Internal Control Systems and Their Framework

The Indonesian Government's Internal Control System (SPIP) is modeled after the COSO (Committee of Sponsoring Organizations of the Treadway Commission) framework, which outlines five key components for effective control, as outlined below:

1. Control Environment:

The control environment underpins ethical behavior and organizational integrity. Government institutions are required to establish a culture of integrity, enforce ethical conduct, and align their leadership and organizational structures with performance management principles. Research underscores the importance of strong leadership in fostering accountability and promoting an ethical workplace culture.



2. Risk Assessment:

Periodic risk assessments are essential to identifying and addressing vulnerabilities in government systems. Risk analysis involves determining the potential impact of identified risks and implementing precautionary measures to mitigate them. Studies suggest that comprehensive risk management frameworks enhance institutional resilience and reduce fraud risks.

3. Control Activities:

Control activities include rules, processes, and practices designed to ensure compliance with regulations and organizational objectives. These measures should be tailored to the institution's scale and complexity. Research highlights the importance of clearly established protocols and regular assessments to sustain the effectiveness of control actions.

4. Information and Communication:

Effective communication channels are essential for disseminating relevant information to stakeholders. Recent studies emphasize the role of advanced information systems in enhancing transparency and facilitating timely decision-making.

5. Monitoring:

Monitoring involves continuous and periodic evaluations of internal controls to identify weaknesses and take corrective actions. Empirical evidence suggests that regular audits and follow-up actions improve compliance and accountability in public institutions.

The COSO framework, which is widely adopted on a global scale, serves as a fundamental guide for developing and evaluating the effectiveness of internal control systems. It comprises five core components: the control environment, risk assessment, control activities, information and communication, and monitoring of controls (Rif'an et al., 2023).

Internal Control as Fraud Prevention in Public Institutions

Fraud prevention is a primary objective of internal control systems. Research emphasizes that a robust control environment, characterized by ethical leadership, clear accountability, and transparent operations, significantly reduces fraud risks. Additionally, regular risk assessments and monitoring mechanisms enable early detection of irregularities. Case studies indicate that the integration of advanced audit technologies enhances fraud detection capabilities.

Fredy et al. (2024) assert that regression analysis reveals that only internal control has a major impact on fraud prevention. This finding aligns with the findings of Kesuma et al. (2024), which emphasizes internal control as a crucial technique for reducing accounting fraud in public sector enterprises. Yasmin et al. (2021) similarly discovered that the efficacy of internal control systems, alongside the adoption of sound corporate governance and high-quality financial reporting, favorably influences fraud prevention.

Empirical Findings on Compliance and Fraud

Recent audit results from East Nusa Tenggara (NTT) Province in Indonesia reveal significant compliance issues. The 2023 audit identified 315 instances of non-compliance, resulting in financial losses amounting to IDR 46.65 billion. Key issues included excessive travel expenditures, overpayments for procurement projects, and administrative shortcomings. The findings highlight systemic weaknesses in internal controls and highlight the urgent need for corrective measures to address governance gaps.

RESEARCH METHODS

This research employs a qualitative descriptive research methodology aimed at comprehensively and naturally understanding phenomena. The primary objective is to provide a systematic, factual, and accurate depiction of the characteristics or factors associated with specific phenomena. The research focuses on the exploration and analysis of data obtained through interviews, observations, and documentation. (Sugiyono, 2013). Qualitative descriptive research is widely recognized as a method that emphasizes naturalistic inquiry, seeking to capture the meaning, processes, and experiences of individuals within their specific contexts. According to Creswell (2014), this method is particularly suited for studies requiring detailed descriptions of phenomena as they occur in real-life settings, without manipulation or experimental intervention. It allows researchers to explore complex issues through inductive reasoning, focusing on emerging patterns and themes within the data.

This research utilized questionnaires to gather data aimed at assessing the implementation of internal control systems within the Kupang City Government. The questionnaire items were designed based on the COSO framework, encompassing its five key components of internal control. In addition to the questionnaires, interviews were conducted to gain deeper insights into existing internal control practices and to explore the root causes of non-compliance with laws and regulations identified during the 2023



fiscal year. Quantitative data for this study was derived from the 2023 Regional Audit Summary for East Nusa Tenggara Province and the Audit Report on the Financial Statements of the Regional Government of Kupang City. Moreover, supplementary references, including books, articles, and scholarly journals, were incorporated to enhance the depth and quality of the analysis.

RESULTS AND DISCUSSION

Based on interviews with the heads of relevant Regional Work Units, utilizing questions designed around the five components of internal control in the COSO framework, it was identified that the primary cause of compliance findings within the Kupang City Government is the suboptimal implementation of internal control systems. This conclusion is substantiated by the following five explanations:

Control Environment

Based on interviews with relevant officials, it was identified that weaknesses exist in the control environment, as explained below. Employees in the public sector are key assets and play a critical role in ensuring clean and transparent governance. Therefore, employees must be provided with adequate knowledge related to their duties and responsibilities. A robust control environment begins with selecting employees whose competencies align with the tasks and responsibilities they will perform. Continuous education and training are also essential to ensure employees can work effectively within their area of expertise. Interview findings revealed that the qualifications of employees appointed to specific positions often do not align with the tasks and responsibilities assigned to them. Appointments to certain positions are made without proper competency testing. Additionally, there is a lack of optimal education and training programs, coupled with insufficient support from the Kupang City Government to enhance employees' education. As a result, employees holding specific positions are not equipped with adequate knowledge.

According to the COSO framework, an effective control environment involves the enforcement of integrity, ethical values, and accountability. To achieve this, implementing a system of rewards and punishments is crucial to foster a strong work culture. However, the Kupang City Government has not optimally implemented a reward and punishment mechanism. Employees with exemplary performance are not rewarded, and those with subpar performance are not subjected to appropriate consequences. Furthermore, the roles and responsibilities held by the financial department within an organization are critical and highly susceptible to fraud risks. The COSO framework highlights the importance of fostering a culture of integrity and accountability. To address this, employee rotation is a vital measure to establish a transparent work system and reduce the likelihood of individuals retaining prolonged control over processes, which could increase fraud risks, particularly in financial management. Additionally, when viewed through the lens of the fraud triangle theory, employee rotation mitigates the "opportunity" factor by eliminating excessive control by a single individual over certain financial processes.

The primary financial responsibility within an entity lies with the Head of the Financial Subdivision and the Spending Treasurer. Often, the appointment of a Spending Treasurer does not adequately consider the required qualifications, and regular rotation is not conducted due to a lack of qualified personnel to replace the existing treasurer. In conclusion, the compliance issues within the Kupang City Government's control environment component, as outlined in the COSO framework, stem from several factors: the absence of a clear classification for employee qualifications in specific roles, inadequate training to support employee expertise, a lack of employee rotation within financial management roles, and the absence of an effective reward and punishment system.

Risk Assessment

Based on the information gathered regarding Risk Assessment conducted on the Kupang City Government, it was identified that there are weaknesses in internal control, particularly in the lack of anticipation for personnel changes, such as replacements in the financial department, as well as insufficient mitigation of potential collusion among employees with familial relationships. This condition arises when employees with family ties are placed in strategic and interconnected positions. Such circumstances create opportunities—a critical factor in the fraud triangle—for fraud to occur. Employees with familial connections can collaborate easily to commit fraud without sufficient oversight.

Additionally, the pressure on employees to complete financial reports within short timeframe contributes to weaknesses in internal control. According to Government Regulation (PP) No. 12 of 2019, Article 191, local governments are required to submit financial reports to the Audit Board of Indonesia (BPK) no later than three months after the fiscal year ends. The limited reporting



period, coupled with the insufficient number of personnel responsible for preparing financial reports and supporting accountability documents, creates significant pressure on the entity to expedite the completion of financial statements. This pressure is one of the components of the fraud triangle that can lead to fraudulent behavior. Consequently, these conditions may contribute to the occurrence of fraud, such as the preparation of financial reports that are not supported by actual accountability documents.

Control Activities

Control activities within the COSO framework encompass preventive and detective measures designed to mitigate errors and prevent fraud. These measures can be implemented through the segregation of duties. For instance, the responsibilities for disbursing funds or issuing checks should be separated from those for receiving funds. In local government operations, the duty of making payments is assigned to the expenditure treasurer, while the task of receiving cash revenues is handled by the revenue treasurer. Regarding cash storage, effective control involves securing cash in a vault with adequate security measures.

Based on information gathered from relevant entities within the Kupang City Government, weaknesses in internal controls have been identified. Some entities have not yet implemented proper segregation of duties between employees responsible for issuing checks and those tasked with receiving cash revenues from manual deposits. This creates a significant risk of direct usage of revenues by employees who also have responsibilities for cash disbursement.

In carrying out financial administration, the Kupang City Government utilizes the SIPD (Regional Government Information System) and SIPKD (Regional Financial Management Information System). It is observed that within the management of these systems, there is no clear separation of access rights between users responsible for entering transactions and those tasked with approving them. The functions of system administration and approval within the financial handling entity are held by a single staff member, whereas authorization should ideally be conducted by the Head of the Entity. This condition creates the potential for misuse of authorization by financial staff who lack the authority to perform approvals or make corrections to financial transaction data.

Furthermore, another internal control weakness was observed in cash storage practices. Certain entities do not store cash in secure vaults due to the unavailability of such facilities. Cash managed by the expenditure treasurer, who is responsible for handling and accounting for cash transactions, is instead kept in the treasurer's bag and taken home. This practice increases the risk of loss or personal misuse of the funds.

These control activity weaknesses, including the absence of preventive measures such as segregation of duties and the lack of secure storage facilities like vaults, provide opportunities for fraud. Without addressing these deficiencies, the likelihood of fraud occurring within these entities is significantly heightened.

Information and Communication

Information and Communication is one of the five key components of the COSO Internal Control–Integrated Framework. This component underscores the importance of collecting, managing, and disseminating relevant and high-quality information within an organization to support internal control and achieve organizational objectives.

The Kupang City Government's data collection revealed control weaknesses in the areas of information and communication, particularly the lack of validation testing for attached transaction evidence. The responsibility for validating transaction evidence lies with the Financial Subdivision Head in each entity. This task can be challenging, especially if the expenditure treasurer, who is accountable for spending, manipulates the supporting evidence. However, the controls implemented by the Financial Subdivision Head can serve as a deterrent to the occurrence of invalid transaction evidence.

Monitoring

Monitoring within the COSO framework is a critical component of internal control systems, focusing on the continuous observation and evaluation of the sustainability and effectiveness of all internal control components. Monitoring encompasses two types of activities: ongoing monitoring and periodic monitoring (separate evaluations). The purpose of this process is to ensure that internal controls remain relevant and effective in addressing changes in environmental and business conditions. Effective monitoring enables organizations to identify weaknesses in the internal control system early and implement necessary improvements to minimize risks that may hinder organizational objectives.

Based on data and information gathered through interviews, it was revealed that there are weaknesses in monitoring controls, particularly the lack of periodic cash balance reviews by supervisors. This issue is compounded by weaknesses in control activities, such as the absence of secure cash storage facilities, like safes with locks. The failure to conduct periodic cash balance reviews by



supervisors increases the risk of fraud, such as personal use of cash by the expenditure treasurer, or the risk of cash loss. If entities performed periodic cash balance reviews, it would improve control over cash balances. Furthermore, any discrepancies identified during the reviews could be addressed more swiftly, thereby reducing the likelihood of personal use of cash by the expenditure treasurer.

Internal Control System as Fraud Prevention

Based on the audit report on the financial statements of the Kupang City Government for 2023, findings related to compliance with laws and regulations were identified, including improper payments for employee expenditures, goods, and services expenditures, as well as discrepancies in the volume of contracted work. These compliance findings have resulted in state losses that must be recovered through deposits into either the state or regional treasury.

In light of the internal control weaknesses observed in the Kupang City Government, deficiencies in the five components of control under the COSO framework are a contributing factor to the suboptimal prevention of fraud. This has led to ongoing compliance findings that result in state losses requiring restitution. Therefore, the role of the Head of Regional Work Units (SKPD) is crucial in implementing the five components of control within the COSO framework to address these issues effectively.

CONCLUSION

Research on the effectiveness of internal controls in the Kupang City Government, which involved collecting data through interviews, questionnaires, and supporting documents such as the 2023 audit reports from the Supreme Audit Board (BPK) and the IHPD, revealed compliance issues with laws and regulations. These issues have led to state losses that require restitution, suggesting potential fraud. It can be concluded that the Internal Control System (ICS), as stipulated in Indonesian Government Regulation No. 60 of 2008 and based on the five main components of the COSO framework, has not been effectively implemented in the Kupang City Government.

First, about the control environment, there are internal control weaknesses that were identified in employee selection, as the recruitment process has not aligned with qualifications and competencies. This issue arises due to inadequate competency testing and a lack of efforts to improve staff education. Additionally, there has been insufficient rotation of employees, particularly those in financial roles, contributing to weakened internal controls. Second, in risk assessment, there are weaknesses in internal control that were identified related to employees with familial relationships being placed in interrelated divisions, which poses a risk of collusion. Moreover, pressure to prepare financial reports within short deadlines increases the likelihood of fraud, as it provides an opportunity within the fraud triangle.

Third, regarding the control activities, internal controls in this area are suboptimal. Some entities have not implemented proper task segregation, such as separating responsibilities for preparing checks or payments from those for receiving cash revenues. Additionally, certain entities lack secure cash storage facilities, such as safes with proper security measures, which increases the risk of fraud. Fourth, in information and communication, weaknesses were observed, particularly the lack of task segregation between data entry and transaction authorization within the system. A staff member can access and use a user account intended for entity leadership to authorize or correct financial transactions, creating risks of misuse. Fifth is about monitoring; there are also some weaknesses that were observed, particularly the absence of periodic cash balance reviews by supervisors. This deficiency increases the risk of cash misuse by custodians or loss of cash.

The analysis of information and research on the effectiveness of internal controls as a fraud prevention tool in the Kupang City Government reveals that internal controls have not been effectively implemented. These weaknesses hinder the internal control system's ability to prevent fraud, contributing to compliance findings in the Audit Report (LHP) of the Kupang City Government for 2023, which resulted in state losses requiring restitution.

To enhance internal controls, the Kupang City Government should consider the following steps, such as improving the recruitment processes by developing a robust recruitment system with clear criteria and competency requirements for positions. This ensures employees are selected based on their qualifications and skills. Then to improve the control activity, the government should make separation of duties among employees with familial relationships to avoid potential collusion. Besides that, they should provide secure cash storage facilities with appropriate security measures and conduct periodic cash balance reviews to prevent personal use of cash by treasurers. And the other way is to implement access restrictions to ensure that authorization tasks are exclusively performed by financial body leaders and not accessible to general staff.



By implementing these measures, the Kupang City Government can significantly strengthen its internal control system and mitigate the risk of fraud while improving compliance with laws and regulations.

REFERENCES

1. Antaranews. (2023). Kejari Sikka Tahan Dua Tersangka Kasus Korupsi Dana Covid-19. <https://kupang.antaranews.com/berita/106371/kejari-sikka-tahan-dua-tersangka-kasus-korupsi-dana-covid-19>.
2. BPK NTT. (2023). *Summary of Audit Result Year 2023* (IHPD). <https://ntt.bpk.go.id/ikhtisar-hasil-pemeriksaan-daerah-ihpd/>
3. BPK RI. (2024). *Summary of Semester Audit Results I Year 2024* (IHPS). <https://www.bpk.go.id/>. The Summary of Semester Audit Results.
4. COSO. (2013). *Internal Control-Integrated Framework*. AIGPA'S Publication Division.
5. Cressey, Donald R. 1973. Triangle Fraud.
6. Creswell, John W, (2014)., *Penelitian Kualitatif & Desain Riset*, Yogyakarta, Pustaka Pelajar
7. Detik. (2022). Kejari Kefamenanu Tetapkan 7 Tersangka Korupsi Proyek Alkes di TTU. <https://www.detik.com>. Rabu, 25 Mei 2022 : Kejari Kefamenanu Tetapkan 7 Tersangka Korupsi Proyek Alkes di TTU.
8. Detik. (2023). Korupsi Proyek RS Boking Rp165 Miliar 5 Tersangka Bupati TTS Diperiksa. <https://www.detik.com/bali/nusra/d-6821995/korupsi-proyek-rs-boking-rp-165-miliar-5-tersangka-bupati-tts-diperiksa>.
9. Frendy, Pruyudo, B., Suratminingsih, Pangaribuan, L. (2024). The Influence of Internal Control System, Motivation and Remuneration on The Prevention of Fraud in The Misuse of Funds in Local Government. *Jurnal AJIB (Audit Pajak Akuntansi Publik), Volume 3 No. 1. Universitas Sangga Buana YPKP*.
10. Government Regulation (PP) No. 12 of 2019
11. Government Regulation (PP) No. 60 of 2008
12. Government Regulation (PP) No. 71 of 2010
13. Kesuma, P.A., Fachruzzaman, F. (2024). Analysis of Internal Control and Fraud Prevention Efforts in Public Sector Accounting. *EKOMBIS REVIEW: Jurnal Ilmiah Ekonomi Dan Bisnis*, 12(1). <https://doi.org/10.37676/ekombis.v12i1>
14. Rif'an, M. J. & K. Fx. T. (2023). *Analysis Of The Effectiveness Of Internal Control On The Local Government's Financial Reports In The East Lampung Regency*. <https://dx.doi.org/10.29322/IJSRP.13.11.2023.p14324>
15. Sugiyono, D. (2013). *Educational Research Methods Quantitative, Qualitative, and R&D Approaches*.
16. Undang-Undang Nomor 1 Tahun 2004 concerning Perbendaharaan Negara
17. Undang-Undang Nomor 23 Tahun 2014 concerning Pemerintah Daerah
18. Undang-Undang Nomor 25 Tahun 1999 concerning Financial Balance between Central and Regional Governments
19. Undang-Undang Nomor 15 Tahun 2006 concerning Badan Pemeriksa Keuangan
20. Yasmin, Winarningsih, S., Mulyani, S. (2021). The Effect of The Internal Control System Effectiveness and the Quality of Financial Reporting and Its Impact on Fraud Prevention of Bandung Regency. *Jurnal Manajemen Pelayanan Publik*. <http://dx.doi.org/10.24198/jmpp.v3i2.25342>

Cite this Article: Purnayuda M.K., F.X. Kurniawan Tjakrawala (2024). *Analysis of the Effectiveness of Internal Control as Fraud Prevention in the Kupang City Government*. *International Journal of Current Science Research and Review*, 7(12), 8859-8865, DOI: <https://doi.org/10.47191/ijcsrr/V7-i12-25>