The Effect Of Internal Control System Implementation In Realizing Good Governance And Its Impact On Fraud Prevention

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Abstract—This study aims to find empirical evidence on the effect of the internal control systems implementation in realizing good governance and its impact on fraud prevention in Bengkalis District. This research was conducted in 34 Regional Apparatus Organization (RAO), with a total of 93 respondents. Data analysis technique used Partial Least Square (PLS) method with warpPLS 3.0 software. The results of the study concluded that there was an effect of the internal control system implementation and good governance on fraud prevention with P-value of 0.01 <0.05; The variable of good governance can mediate part of the relationship between the government's internal control system implementation and the fraud prevention with the results of the VAF calculation of 36%. This value ranges between 20% -36% -80%.

Index Terms—Internal Control Systems Implementation, Good Governance, Fraud Prevention

1 Research Background

Fraud in Indonesia still occupies a very high position. Transparency International released the annual report on the corruption perception index (CPI) in 2018, finding that from 180 countries in the world two-thirds scored less than 50. These results illustrated the high level of corruption in many countries in the world. Score ranges from 0-100 in which score of 100 shows the corruption free country. Indonesia is a country with a score of less than 50, specifically, getting score of 38 which ranked 89 below Singapore, Malaysia and China. Compared to 2017, Indonesia's CPI score rose by 2 points with a ranking of 96.

The results of the Indonesia Corruption Watch (ICW) study showed that regional government officials from the provincial and district/city level dominated the list of corruption perpetrators in 2018. The data of Supreme Court, which was processed by beritagar.id team, showed that from the court order on corruption that had occurred in 2001-2018, there were 1,002 convicted corruption cases of civil servants (PNS) from echelon 1-4 (RommyRoosyana, 2019).

Meanwhile, The Audit Board of the Republic of Indonesia (BPK RI) in 2018 found 1.7 trillion IDRstate losses in Riau including Siak District Government was 145.8 billionIDR; Bengkalis was 271.2 billionIDR; Indragiri Hulu was240.8 billionIDR; Dumai city government was71.7 billionIDR; and the Provincial Government of Riau was as much as972.4 billionIDR. It has not been followed up by provincial, district, and city governments in Riau. It was revealed when Public Accountability Agency (BAP) of the Regional Representative Council (DPD) held a working meeting with the local government (cakaplah.com January 30, 2019).

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Pradiptyo, et al, (2015) conducted research using panel data in 168 countries from 1995-2013, then he found positive and significant relationship between the corruption perception index (CPI) and government effectivity and quality. The higher the CPI value of a country, the lower the level of corruption, and the more effective and qualified government. Conversely, the lower the value of the CPI, the higher the level of corruption, and the lower economic performance of the country.

Seeing the high level of fraud and the magnitude of the impact on all levels of society, fraud must be prevented. According to Suradi (2006), to be able to prevent fraud can be done by: recruiting honest employees and training them on the awareness of the fraud risks, creating a positive work environment, spreading good understanding and respect for ethics codes or ethics, and providing training programs for employees.

Meanwhile, according to (association of certified fraud examiners) and Ardeno, 2015, fraud prevention on the government can be done by designing and applying an internal control system that is free of loophole, so as to be able to eliminate the opportunity (prevent and ward off) of corruption. In the law on state finances, the management of state finances must be managed in a manner of accountable, transparent, orderly, controlled, efficient and effective.

According to United Nations Development Programme (UNDP) (State Administrative Agency-Finance & Development Supervisory Agency/LAN-BPKP, 2000) in implementing good governance, there are 9 principles namely; participation, rule of law, transparency, responsiveness, consensus oriented, fair, effectiveness and efficiency, accountability, strategy vision. From the 9 principles mentioned, the government must at least apply the principles of accountability, transparency, and participation (Corruption Eradication Commission/KPK, 2003).

Research conducted to see the effect of internal control on fraud prevention has been carried out by Hermiyetty (2011),

RusmanSoleman (2013), and ChairunNisa, Prasetyono, Fitri Ahmad Kurniawan (2013), OgudaNdegeJosep, Odhiambo Albert, John Byaruhanga (2015), ZuraidahMohd-Sanusi, Norhayati Mohamed, Normah Omar, Mohd-Daniel Mohd Nasir (2015).they found that internal control had a positive effect on fraud prevention. While Onyefulu Deborah Iyinomen's research, Ofor Teresa Nkechi, (2016) found that internal control had no effect on fraud prevention and detection. While the research conducted by Ade de ji DB (2012), Yuedong Li, Dong Zhang, Xingyu Wang (2014), Yulius Simon, Masdar Mas'ud (2016), TaufeniTaufik, Yusralaini, YunietaAnisma (2017), found that the internal control system had an effect on good governance. While Rini Lestari (2015) found that good governance has no effect on internal control.

Meanwhile, the results of research that see the effect of good governance on fraud prevention have been carried out by: Gusnardi (2011), and Mohammad In'airat (2015). However, it is different from Wiliyanti (2013) who found that good governance does not have an influence on the level of fraud.

2 Literature Review

2.1 Fraud prevention

Fraud theory is known as fraud triangle theory. This theory explains that fraud occurs because of the opportunity, encouragement, and rationalization (W.Steve Albert, et, all, 2003). Whereas, fraud prevention is actions taken to prevent fraud from occurring. Activities is undertaken to prevent fraud by controlling and supervising public service processes, strengthening government internal control systems, and improving good governance.

2.2 Internal Control System

Internal control system is an integral process of actions and activities carried out continuously by the leadership and all employees to provide adequate confidence in the achievement of organizational goals through effective and efficient activities, reliability of financial reporting, security of state assets, and compliance with laws and regulations. (Government Regulation/PP 60 of 2008).

The effective implementation of an internal control system is very useful in preventing and making fraud difficult. This is because control, in the internal control system, combines between hard control and soft control that is implemented to prevent fraud. Hard controls such as segregation of duties and authorization of transactions are applied to prevent opportunities for fraud. Soft control such as the adoption of a code of ethics and good ethical values can prevent fraud (Ardeno Kurniawan 2015).

2.3 Good Governance

The Basically, Good governance is a concept used by the government in carrying out its duties to achieve organizational goals that can be accounted for by the government. Government bureaucracy must be managed based on the principles of good and professional governance and fully serve the interests of the people and work to provide excellent service, transparent, accountable and free from corrupt, collusion and nepotism practices (Presidential Regulation of Republic if Indonesia No. 81 of 2010). The implementation of thegood governance principles will prevent fraud from occurring in government.

3 Research Methods

3.1 Research Sites

The location of the study was conducted at the Regional Apparatus Organization (RAO) of Bengkalis District.

3.2 Population and Sample

In this study, the population are local government officials in Regional Apparatus Organization (RAO) of Bengkalis District. To determine the sample of this study, the Purposive Sampling Technique was used.

3.3 Data Types and Sources

In this study, data type is primary data obtained from respondents' answers to the questionnaire sent. Meanwhile, the data source come from the respondents' answers of the Regional Apparatus Organization (RAO) in Bengkalis District.

3.4 Operational Definition and Variable Measurement

In this study, the dependent variable is Fraud Prevention. Fraud prevention is something that is done by eliminating the possibility of potential perpetrators of fraud and making it difficult for those committing fraud (Ardeno Kurniawan, 2015). The indicators used for fraud prevention are: recruiting honest employees and training them on awareness of the fraud risks; creating a positive work environment; spreading good understanding and respect for ethics codes or ethics; providing training programs for employees (Suradi, 2006).
The independent variable is theinternal control system implementation, consisting of the control environment, risk assessment, control activities, information and communication, monitoring (Government Regulation/PP No. 60 of 2008). The intervening variable is good governance. World Bank defines good governance as an implementation of a solid and responsible development management that is in line with the principles of democracy and an efficient market, avoiding misallocation of investment funds, and preventing corruption both politically and administratively, carrying out budgetary discipline, and creating a legal and political framework for business activity growth. (Mardiasmo, 2009: 18). The indicators usedare: Accountability, Transparency, and Participation (Corruption Eradication Commission/KPK, 2003).

3.5 Data Analysis Technique

In this study, data analysis tools are conducted with Structural Equation Modeling-Partial Least Square (SEM-PLS) using SmartPLS software version 3.0. PLS. it is a SEM equation model based on components or variants. Simultaneously, PLS can test the measurement model (outer model) and structural model testing (inner model) as well.

3.5.1 Evaluation of the Reflective Outer Model

Evaluation of measurement models (outer models) aims to evaluate indicator variables. Indicator variables in reflective

capital are highly correlated and interchangeable variables so that the evaluation of reflective models is based on the reliability and validity of indicator variables. Evaluation of reflective models according to (AgusWidarjono, 2015; 277) consists of:

1. Reliability Indicator
   Realiabity indicator is based on outer loading. If the outer loading value is more than 0.7, the indicator variable needs to be maintained for theoretical research while for exploratory research between 0.5-0.7, and if it is less than 0.5, the indicator variable must be removed.
2. Discriminant validity
   in discriminant validity, there are two methods, namely cross loading variables and Fornell-Larcker. Cross loading indicator variables against latent variables must be greater in value than other latent variables. Fornell-Larcker, which is the root of AVE for each latent variable, must be greater than the correlation among latent variables. Cross loading is a loose criterion, whereas Fornell-Larcker is a conservative criterion.
3. Internal consistency
   Composite reliability is used to evaluate internal consistency. The research of theory test should have a value of more than 0.7, while exploratory research has a value of more than 0.6. Cronbach's alpha is also used where the value must be more than 0.7 for theoretical tests and above 0.6 for export research.
4. Convergent validity
   Average Variance Extracted (AVE) is used to evaluate convergent validity. AVE value must be more than 0.5.

3.5.2 Evaluation of Structural Equation Models (Inner Model)

The evaluation of Inner Model according to (AgusWidarjono, 2015; 277-278) was carried out after evaluating the outer model. Evaluating the inner model explains the effect of independent latent on the dependent latent variable. There are two basic evaluations at this stage, namely:

1. The significance and magnitude of the effect of independent latent variables.
2. The coefficient of determination R^2

3.6 Hypothesis Testing

In this study, data analysis tools are conducted with Structural Equation Modeling-Partial Least Square (SEM-PLS) using SmartPLS software version 3.0. PLS. it is a SEM equation model based on components or variants. Simultaneously, PLS can test the measurement model (outer model) and structural model testing (inner model) as well.

3.6.1 Direct Hypothesis Testing (Direct Effect)

Direct hypothesis testing is:

1. Implementation of the government's internal control system influences the fraud prevention;
2. Implementation of the government's internal control system cannot affect the existence of good governance. For testing the first and second hypotheses the following criteria are used: If the T-Statistics value> 1.98% (alpha level 10%), then it can be said that Ha is accepted. If the T-Statistics value <1.98% (alpha level 10%), then it can be said that Ho is rejected.

3.6.2 Indirect Hypothesis Testing (Indirect Effect)

Direct hypothesis testing is good governance mediating the relationship between the government's internal control systems implementation and fraud prevention. The procedure for testing good governance hypotheses can mediate the relationship between the local governments' internal control system implementation on the fraud prevention. by using 2 steps (Baron and Kenny, 1986; Hair et al, 2011: Kock, 2011, 2013 in Ghozali 2014: 56) as follows:

a. Estimating the direct effect of the relationship between the local governments' internal control system implementation on the fraud prevention and good governance.
b. Estimating indirect effects simultaneously with the PLS SEM Model triangle, namely the local governments' internal control system implementation ◎ the fraud prevention (lane c) and the local governments' internal control system implementation ◎ good government (lane a) and good governance with the fraud prevention (lane b).

Testing SEM-PLS mediation by using Variance Accounted For (VAF). VAF is a measure to determine how much the mediating variable is able to absorb the previously significant direct influence of the model without mediation, by looking at:

1. calculating the effect of indirect variable of the government's internal control system implementation on good governance and calculating the effect of the indirect variable of good governance on fraud prevention.
2. After that, the coefficient of each variable is multiplied
3. Calculating the effect of the direct variable of the government's internal control system implementation on fraud prevention.
4. The calculation results of the indirect effect among variables in point 1 after being multiplied, are added to the effect of the direct variable. Then, we will have a total effect
5. To calculate VAF, indirect effect/total effect.
6. If the VAF calculation results> 80%, full mediation will occur. Meanwhile, if the calculation results are between 20% and 80%, partial mediation will occur. If the VAF calculation is <20%, there is no mediating effect.

4 Result and Discussion

4.1 Inferential Statistical Analysis

Inferential statistics help researchers to find out whether the results obtained from a sample can be generalized to the population (Abdillah & Jogiyanto, 2015: 91). For this reason, in accordance with the hypotheses that have been formulated, in this study, inferential statistical data analysis is measured using warpPLS 3.0 (warp Partial Least Square), starting with the measurement model (outer model) and the structural model (inner model) and the hypothesis testing.

4.1.1 Evaluation Results of the Measurement Model (Outer Model)

Evaluation of the measurement model or outer model is carried out to assess the reliability and validity of the indicators forming latent constructs. For testing latent constructs, construct validity is used. Construct Validity is divided into 2, namely convergent and discriminant (Ghozali, 2014: 91).

4.1.1.1 Test Results of Convergent Validity

Convergent validity aims to test the correlation among items/indicators to measure the construct. Evaluation of measurement models or outer models with reflexive constructs in PLS can be started by looking at the value of indicator reliability and composite reliability. In addition to seeing the reliability and composite reliability indicators, evaluation of measurement models with reflective constructs is also conducted to test the Average Variance Extractor (EVA). The convergent validity test results can be seen in table 1.

TABLE 1.
Evaluation result of Convergent Validity

Latent Variable	*Indicator loading*	P-value	AVE
PF 01	0.711	<0,001	
PF 02	0,736	<0,001	
PF 03	0,776	<0,001	
PF 04	0,722	<0,001	0,526
PF 05	0,777	<0,001	
PF 06	0,834	<0,001	
PF 07	0,760	<0,001	
PF 08	0,730	<0,001	
SP 01	0,745	<0,001	
SP 02	0,758	<0,001	
SP03	0,747	<0,001	
SP 04	0,810	<0,001	
SP 05	0,710	<0,001	0,597
SP 06	0,795	<0,001	
SP 07	0,710	<0,001	
SP 08	0,720	<0,001	
GG 01	0,809	<0,001	
GG 02	0,853	<0,001	
GG 03	0,743	<0,001	
GG 04	0,871	<0,001	
GG 05	0,774	<0,001	0,636
GG 06	0,765	<0,001	
GG 07	0,801	<0,001	
GG 08	0,811	<0,001	
GG 09	0,763	<0,001	
GG 10	0,773	<0,001	

Source: processed data, WarpPLS 3,0

From table 1, the loading value for the construct variable is above 0.7, and the P-value is above 0.05, and the AVE value is above 0.50. Thus, it can be concluded that the construct variable meets the criteria for convergent validity.

4.1.1.2 Test Results of Discriminant Validity

The results of discriminant validity testing can be seen in the following table:

TABLE 2.
Evaluation Results of Discriminant Validity

	SPI	PF	GG
SP 01	**0,745**	-0,189	-0,027
SP 02	**0,758**	-0,023	0,068
SP 03	**0,747**	-0,50	0,010
SP 04	**0,810**	-0,061	-0,000
SP 05	**0,710**	0,238	-0,237
SP 06	**0,795**	-0,056	0,050
SP 07	**0,710**	0,063	0,060
SP 08	**0,720**	0,130	0,105
PF 01	-0,085	**0.711**	-0,170
PF 02	-0,094	**0,736**	-0,277
PF 03	0,062	**0,776**	-0,059
PF 04	0,019	**0,722**	-0,058
PF 05	-0.003	**0,777**	0,523
PF 06	0.144	**0,834**	-0,074
PF 07	-0,015	**0,760**	0,159
PF 08	0,01	**0,730**	0,173
GG 01	-0.126	0.130	**0,809**
GG 02	-0,012	-0,052	**0,853**
GG 03	-0,023	0,016	**0,743**
GG 04	-,0,028	-0,081	**0,871**
GG 05	-0,239	0.093	**0,774**
GG 06	-0,077	0.065	**0,765**
GG 07	0,093	0.047	**0,801**
GG 08	0.152	0.041	**0,811**
GG 09	0,142	-0.031	**0,763**
GG 10	0,119		**0,773**

Source: processed primary data, warpPLS 3,0

From table 2, we can see the AVE square root value for each construct is higher than the correlation among latent constructs. Then, it can be concluded that it meets the validity discriminant requirements.

4.1.1.3 Results of Reliability Test

Reliability testing is intended to test whether items/indicators from the instrument can be used to take measurements more than twice with accurate results. Generally, the reliability type that is often used is internal consistency reliability which is by averaging the correlation among items in the test. Cronbach alpha is a gauge that is often used to test internal consistency. However, this measure is then considered inappropriate for reliability testing (Raykov 1998, p.381; Rossiters 2011, p24 in Ghozali, 2014; 92). Researchers in the SEM field then developed a measure to test reliability called composite reliability. Reliability composite values are usually used to assess constructs, which must be greater than 0.7.

4.1.1.3.1Reliability Indicator

Cronbach alpha is a gauge that is often used to test reliability indicators, with values above 0.70 (Ghozali 2014, 93).

TABLE 3. Testing result of Reliability Indicator

value	SPI	PF	GG
Cronbach alpha coefficients	0,852	0,788	0.936

Source: processed data, WarpPLS 3,0

Based on the table above it can be seen that the Cronbach alpha coefficients for government control system variables are 0.852. The fraud prevention variable is 0.788, while the good governance variable is 0.936. Therefore, it can be concluded that all constructs meet the reliable criteria because the value is above 0.7.

4.1.1.3.2 Internal Consistency Reliability

For reliability testing with internal consistency reliability criteria was used composite reliability parameters with values above 0.7 (Ghozali 2014, 95). Internal consistency reliability test results in research can be seen in table 4

TABLE 4. Testing result of Internal Consistency Reliability

Value	SPI	PF	GG
Composite reliability coefficients	0,886	0,786	0.946

Source: processed data, WarpPLS 3,0

Based on table 4, it can be seen that the results of the composite reliability coefficients for the variable construct is above 0.7. Thus, it can be concluded that the variables of the government's internal control system, fraud prevention, and good governance meet the reliable criteria.

4.1.2 Evaluation Results of Structural Model (Inner Model)

In evaluating structural models or inner models with PLS by looking at the magnitude of the percentage variance explained by the R-Squares value for each endogenous latent variable as the predictive power of structural capital, Stone-Geisser (Geisser 1975; Stone 1974 in Ghozali, 2014; 94) it is test to testing the predictive relevance and Goodness of fit (GoF) to measure overall model fit. To predict causality in SEM-PLS using the warpPLS 3.0 program which can be measured by:

4.1.2.1 Coefficient of Determination

The coefficient of determination using R-square which shows what percentage of variation in endogenous/ riterion constructs can be explained by constructs hypothesized to influence (exogenous/predictors). R-square only exists for endogenous variables (Sholihin and Ratmono, 2013; 62). The R-square results in this study can be seen in table 5.

TABLE 5. R-square Value or Adjusted R^2

	SPI	PF	GG
R-squared coefficients		0,440	0,25

Source: processed data, WarpPLS 3,0

In the table above, it can be seen that the R-squared value of fraud prevention is 0.440 which means that the effect of the government's internal control system implementation on fraud prevention is 44%, and the remaining 56% is influenced by other variables outside this model or the value showing a fairly good model/moderate. The R-square value of good governance is 0.25 which means that the effect of the government's internal control system the implementation is 25%, and the remaining 75% is influenced by other variables outside this model or the value indicating a weak model.

4.1.2.2 Model Fit Indices dan P Values

The fit indices and P Value models section displays the results of three fit indicators, namely the Average R-square (ARS) Average Path Coefficient (APC), and the Average Variance Inflation Factor (AVIF). To evaluate the fit model, it can be determined by several fit indicators that can be seen in table 6.

TABLE 6.

Table 6 **Indicators Value of Fit dan P Values**
Model fit indices and P Value
Average path coefficient (APC)= 0,277, P=<0.001
Average R-square (ARS) = 0,228, P=<0.001
Average variance inflation factor (AVIF)= 1.000, Good if <5
General model elements
Algorithm used in the analysis: Warp 3.0 PLS regression
Resampling method used in the analysis: Bootstrapping
Number of data resamples used: 100
Number of cases (rows) in model data: 93
Number of latent variables in model: 3
Number of indicators used in model: 26
Number of iterations to obtain estimates: 14

Source: processed data, WarpPLS 3,0

From table 6 above, it can be seen that the APC value = 0.277, with a P value = <0.001. ARS = 0.228, P value = <0.001. The p value for APC and ARS must be less than 0.05 or significant. Because the APC and ARS values are less than 0.05, it can be concluded that the research model has a good fit. AVIF value of 1,000 also meets the criteria.

4.2 Results of Hypothesis Testing

4.2.1Results of Direct Hypothesis Testing (Direct Effect)

Evaluation Results of Direct Hypothesis Testing (Direct Effect)can be seen in table 7.

TABLE 7.

Testing result of Direct Hypothesis Testing (Direct Effect)

Lane	*P-Value*	*Path Coefficients*	Description
Implementation of SPIP→Fraud Prevention	<0.01	0.046	Significant
SPI →GG	< 0.01	0.124	Significant

Source: processed data, WarpPLS 3,0

4.2.1.1 Results of First Hypothesis Testing

The first hypothesis testing results are the effect of the government's internal control system implementation on fraud prevention with p values 0.01 < 0.05. Thus, it was concluded Ho was rejected, and Ha was accepted. Based on the results of this study, it was concluded that the government's internal control system implementation could influence fraud prevention.

4.2.1.2 Results of Second Hypothesis Testing

The results of the second hypothesis testing by looking at the coefficient value and the p value from table 4.9 above. From table 7, it is found that the value of the path coefficient is 0.124 with a p value of 0.01. The result is smaller than 0.05. Thus, it can be concluded, Ho was rejected, and Ha was accepted, which means good governance affects the fraud prevention.

4.2.2 Results of Indirect Hypothesis Testing (Indirect Effect)

The results of SEM-PLS mediation testing using the VAF method can be seen in table 8.

TABLE 8. *Calculation of Variance Account For (VAF)*

Indirect Effect = 0,124 x0,661= 0.081964 SPIP → GG = 0,124; GG →PF= 0,661
Direct effect 0.046 SPIP →Fraud Prevention, without imputing GG as Mediation = 0.046
Total Effect = 0.081964+ 0,046= 0.127964
VAF= indirect effect/totaleffect=0.046/0.127964= 0.35947610265 (refined 0.36)

Source: processed data, WarpPLS 3,0

Based on the results of the VAF calculation in table 4.10, the VAF value of 36% is between 20% and 80%. Then, it can be categorized as partial mediation. Thus, it can be concluded that good governance can mediate a part of the relationship between the local governments' internal control systems implementation and the fraud prevention.

5 CONCLUSION

The conclusions of this study are: the internal control system Implementation influences the fraud prevention; The regional internal control system implementation influences good governance; Good governance can mediate as a part of the relationship between the regional internal control systems implementation and fraud prevention being as much as 36%.

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