EFFECTIVE CORPORATE GOVERNANCE TO PREVENT FRAUD IN PUBLIC SECTOR IN INDONESIA

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ABSTRACT
Fraud in public sector is still widespread in Indonesia. Good corporate governance and internal control can prevent fraud. This paper examine corporate governance in Indonesia. Corporate governance and prevention of fraud can affect the economy of a country. Proper law enforcement is needed to reduce fraud and corruption. Ethical culture and governmental structure is a factors to be considered to create a better institutional environment. Governmental internal control is need to be improved in order to prevent fraud. Internal Auditor can be more effective in preventing fraud than external auditor. The ACFE’s 2008 survey provides empirical evidence to this effect as the survey found that over 19% of the respondents’ fraud cases were initially detected by internal audits versus about 9% that were discovered by external audits.

1. INTRODUCTION
There is a chance of fraud in every organization including public sector organization. Corruption may occur whenever an employee is authorized to spend an organization’s money (Wells, 2003). The establishment and operation of a “perfect” governance structure is possible. Successful companies have common characteristics. One of those characteristics is an effective governance structure. Companies that fail or have serious financial and operating issues will generally suffer from ineffective governance as one of the reasons for failure. (Kaufmann, Kraay & Mastruzzi, 2010).

This study examine the weakness of internal control and fraud in the public sector inculding government, Central Bank, and State owned companies. The diversity in Indonesia also play significant role in building corporate governance. People from Jakarta and People from Papua might have different ethical behaviour. Audit Board of Indonesia, Badan Pemeriksa Keuangan (BPK) have to find the weaknesses in the internal control systems and compliance to the regulation. In 2016 BPK found 9.729 findings that contains 14.997 issues, consisting 7.284 (49%) issues related to weaknesses in internal control, and 7.549 (50%) issues related to non-compliance to the regulation costing Rp25,14 trillion, and 164 (1%) issues of efficiency costing Rp2,25 trillion.

Fraud in Financial Statement
According to Australian Securities & Investment Comission financial statement fraud involves deliberately misleading or omitting amounts or disclosures in financial statements in an attempt to deceive financial statement users, particularly investors or creditors. This might involve:
- The falsification, alteration or manipulation of material financial records;
- Material, intentional omissions or misrepresentations of events, transactions, accounts, or other significant information from which financial statements are prepared.
- Deliberate misapplication of accounting principles, policies, and procedures used to measure, recognise, report, and disclose economic events and business transaction.
- Intentional omissions of disclosures or presentation of inadequate disclosures regarding accounting principles and policies and related financial amounts.

**Conditions When Fraud Occurs**

Statement on Auditing Standards SAS No. 99, Consideration of Fraud in a Financial Statement Audit, states that three conditions are generally present when fraud occurs. First, there is an incentive or a pressure to commit fraud. Second, circumstances provide an opportunity for fraud to be perpetrated e.g., weak controls or ability of management to override controls. Finally, there is an attitude or rationalization for committing fraud. These conditions collectively are known as the fraud triangle.

Bell and Carcello 2000 find support for the existence of fraud triangle conditions for a sample of financial fraud companies. They estimate a logistic regression model predicting the incidence of fraud and find several risk factors associated with fraud: rapid growth, weak control environment, management overly preoccupied with meeting analysts’ forecasts, management that lied to auditors or was overly evasive, ownership status, and an interaction between the control environment and management attitude toward financial reporting.

**Symptoms of Fraud**

Symptoms of fraud are often referred to as “red flags.” SAS No. 99 identifies “red flags” as risk factors and further categorizes those risk factors in the three areas included in the fraud triangle: pressures/incentive, opportunity, and attitudes/rationalizations. Albrecht and Albrecht 2003 categorize the symptoms of fraud into six types: 1 accounting anomalies; 2 internal control weaknesses; 3 analytical anomalies; 4 extravagant lifestyles; 5 unusual behaviors; and 6 tips and complaints. One of the major challenges in identifying fraud is that while symptoms of fraud “red flags” are observed frequently, the presence of such issues is not necessarily indicative of fraud. Albrecht and Romney 1986 and investigation of such anomalies usually results in a conclusion that fraud was not the underlying cause. It is also difficult to combine and weight fraud risk factors to assess overall fraud risk and formulate an audit plan. Patterson and Noel 2003. Further, due to attempts by perpetrators to conceal their acts, “red flags” may be relatively few in frequency and minor in amount, at least in the early stages of fraudulent financial reporting.

**Communication with Audit Committee**

Cohen et al. 2007 review literature related to audit committees and financial reporting integrity and issues relating to auditor communication with the audit committee. While several academic studies examine the association between audit committee independence and audit committee effectiveness, these studies were discussed earlier in the section on the characteristics of fraud firms, in the subsection on opportunities to commit fraud, there is a dearth of evidence on communication between the external auditors and the audit committee.

**Board Structure**

An important function of the board of director is to minimize costs that arise from the separation of ownership and
decision control of the modern-day corporation (Fama and Jensen 1983). Fama’s (1980) and Fama and Jensen’s (1983) theory regarding board composition, prior empirical research and the various recommendations for board of director reform suggest that having a higher percentage of outside directors increases the board’s effectiveness as a monitor of management.

Corporate Governance in Indonesia
Governance is defined as how “the traditions and institutions by which authority in a country is exercised. This includes the process by which governments are selected, monitored and replaced; the capacity of the government to effectively formulate and implement sound policies; and the respect of citizens and the state for institutions that govern economic and social interactions amongst them” (World Bank, 2007).

Corporate governance plays an important role in protecting investors, in the prudent operation of companies and financial institutions, and in the stability of the financial sector. Principles of good governance have been a major component of international financial standards, and many regulators view effective corporate governance as “the first line of defense” in their supervisory (Verhezen, 2016).

Good public governance practices might teach the corporate elite to implement good corporate governance, such as manager-compensation policies, proper division of power within the organization, rules of succession to top positions, and institutionalized competition in core areas of governance (for instance, voting rights, competitive processes, and voting Rules (Benz & Frey 2007).

Within the Indonesian public sector, citizens as principals have little control over the governing elites and the bureaucrats as their agents. Rarely do public office holders have the best interests of the public in mind. Entering the bureaucracy and politics is seen as employment for self-interest where the wielding of power takes precedence over serving the public.

Disclosure in Corporate Governance
Disclosure is one essential pillar of a good corporate governance system. Many scholars acknowledge that disclosure is the key factor in corporate governance and at the heart of corporate accountability and as such, its most important element. Porter cited in D A Bavly, (Wiley & Sons, 2004).

Disclosure is recognized as a key corporate governance protection for shareholders. It is believed that disclosure is ‘an effective tool for improving investor protection’ and a powerful apparatus for monitoring the risks to which they are exposed (Walsh, 2005).

Simple, clear, and informative disclosure may prevent financial fraud. There are a number of examples where poor disclosure, including complicated and technical accounting creates a distorted view of the company and constitutes dishonesty. This includes the manipulation of information of off-balance sheets and other unintended use of accounting rules. (Macey, 2004).

BPK found 9,729 findings that contains 14,997 problems, consisting 7,284 (49%) weakness in internal control and 7,549 (50%) non-compliance to the regulation problems costing Rp25.14 trillion, and 164 (1%) inefficiency and ineffectiveness problems costing Rp2.25 trillion.

The problems of weakness in internal control from the investigation report (IHPS
The weaknesses in internal control systems were generally caused by:
1. The officials supervision and control in the activities was not optimal and the coordination with the unit was not optimal.
2. The executors of the activities hasn’t record, input data, and reconcile carefully. Planning of the activities and budget was not optimal.
3. The officials and executors in charge was not following/ not comprehending the rules and procedures in carrying out activities and using the budget.

Finance ministry and directorate general of taxation will ask the directorate general of railways to make a record of the use of the budget.

Finance ministry will set the mechanism of control over allocation with the provincial government need.

Finance ministry will make a statement relating deficit in social welfare fund.

### Table 1
Audit Board of Indonesia (BPK) Findings

<table>
<thead>
<tr>
<th>Government/Investigation Type</th>
<th>Total Investigation Report</th>
<th>Total Findings</th>
<th>Total Recommendation</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Government</td>
<td>133</td>
<td>1411</td>
<td>3,588</td>
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<tr>
<td>Financial Investigation</td>
<td>102</td>
<td>1322</td>
<td>3,330</td>
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<tr>
<td>Performance Investigation</td>
<td>1</td>
<td>11</td>
<td>41</td>
</tr>
<tr>
<td>Special Purpose Investigation</td>
<td>10</td>
<td>78</td>
<td>217</td>
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<tr>
<td>Provincial Government</td>
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<td>21,351</td>
</tr>
<tr>
<td>Financial Investigation</td>
<td>537</td>
<td>7,950</td>
<td>21,351</td>
</tr>
<tr>
<td>State Owned Companies and Other Institution</td>
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<td>368</td>
<td>998</td>
</tr>
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<td>Financial Investigation</td>
<td>6</td>
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<tr>
<td>Performance Investigation</td>
<td>8</td>
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<tr>
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<tr>
<td>Total</td>
<td>687</td>
<td>9,729</td>
<td>25,937</td>
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<tr>
<td>Financial Investigation</td>
<td>645</td>
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<tr>
<td>Performance Investigation</td>
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<td>303</td>
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<tr>
<td>Special Purpose Investigation</td>
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<td>297</td>
<td>820</td>
</tr>
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</table>
2. CONCLUSION
The weakness in corporate governance in Indonesia is mainly from weak internal control systems and non-compliance to the regulation. Effective corporate governance is needed in the public sector to prevent fraud. The communication between the audit board of Indonesia (BPK) and audit committee of the government institution need to be optimized. Citizen have little control over government elite in Indonesia, more disclosure is needed in the government so the citizen can have control over the activities of the government. Government’s information systems need to be integrated and better tax administration and systems is needed. If the corporate governance is implemented effectively the public sector frauds will be reduced and minimized.

3. REFERENCES


Jeremy Cooper ASIC 2005 Financial Statement Fraud Corporate Crime of the 21st Century

