

## THE INFLUENCE OF INTERNAL AUDIT AND WHISTLEBLOWING SYSTEM EFFECTIVENESS ON FRAUD PREVENTION



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### Abstract

This research aims at finding out and analyzing how much influence internal audit and whistleblowing system effectiveness had on fraud prevention at rural banks (BPR) in Bandung Regency. The sample of this research used an internal auditor who worked at a rural bank in Bandung Regency. The results of simple linear regression data processing showed that the effectiveness of internal audit and whistleblowing system can prevent fraud

## INTRODUCTION

Rural Banks (BPR) are financial institutions whose activities are collecting funds in the form of savings, lending and time deposits. Rural banks activities are simpler compared to commercial banks. Previously, Rural banks were better known as Village Banks, Village Barns, Farmers Banks, and Village Trade Banks or Market Banks. Rural banks became known since the issuance of the deregulation policy package (opening the establishment of new banks) in October 1988. This policy was regulated in Law Number 7 of 1992 concerning banking and was amended by Law Number 10 of 1988. The aim remains the same, namely to encourage and improve community economic development and micro, small and medium enterprises.

Even though rural banks activities are simpler than commercial banks, there are several cases of fraud that have occurred them. Therefore, rural banks are starting to prepare steps to prevent fraud, including improving the function of the internal auditor and implementing a whistleblowing system. Fraud prevention is an integrated effort that can reduce the occurrence of factors that cause fraud. One way to prevent fraud is through internal audit (Single, 2012). Internal audit played an important role in monitoring activities to ensure that fraud prevention and programs are effective. This internal audit activity can prevent and overcome fraud (Tunggal, 2012). Implementation of government activities regulated in PP No.60 of 2008. The government

required every government agency to establish control. Internal control can help the government to minimize the occurrence of weaknesses, errors and the risk of fraud. Weak organizational internal control systems could identify efficient government operations and so on become opportunities for fraud.

The first case related to fraud was the banking crime case committed by the commissioner of Multi Artha Mas Sejahtera Rural Bank with a value of Rp. 6.280 billion which was used for personal gain. The mode of operation carried out by the commissioner of MAMS Rural Bank was by false recording in the books or the process of reports, as well as in documents or reports on business activities, transaction reports or accounts of a bank and/or intentionally caused the recording to be not carried out in the books or reports or documents or reports on business activities, reports transactions or accounts of Multi Artha Mas Sejahtera Rural Bank in Bekasi. MAMS Rural Bank realized that the company has not managed the fraud prevention system optimally. Even though MAMS Rural Bank itself already has a fraud prevention system such as the whistleblowing system which has been implemented in the company for a long time but has not been used optimally. Rural Bank has had its business license revoked by OJK since August 26, 2016 ([www.ojk.go.id](http://www.ojk.go.id)).

The mode used by the Main Director as well as the shareholder of KS BAS Rural Bank was to instruct its employees to process the granting of credit to 54 debtors with a total value of Rp. 24.225 billion in the period March 2014 to December 2014, the process of which was not following procedures resulting in the recording of counterfeit and did not carry out the necessary steps to ensure the Bank's compliance with banking regulations. The OJK explained that KS Bali Agung Sedana Rural Bank was negligent in internal audits which resulted in fraud. OJK through the Decree of the Board of Commissioners (KDK) Number KEP-202/D.03/2017 concerning revocation of the business license of KS Bali Agung Sedana Rural Bank, revoked the business license whose address is Jalan Raya Kerobokan Number 15Z, Kuta, Badung Bali as of November 3 2017. ([www.topbusiness.id](http://www.topbusiness.id)). The third case related to fraud, namely the embezzlement incident at the regional company People's Credit Bank (PD Rural Bank) Buleleng 45. Customer service (CS) PD Buleleng Rural Bank 45 embezzled customer money amounting to Rp. 635.3 million. The embezzlement of customer money occurred in 2017, to be precise in the March-June period. In September 2017, a suspect detected a leak of embezzled customer money, after one of the customers asked about the discrepancy because his savings balance had decreased without any withdrawals. The Director of PD Buleleng Rural Bank admitted that he did not implement a fraud prevention system ([www.nusabali.com](http://www.nusabali.com)).

Based on the three phenomenons above, it indicated that there were still many fraud cases occurring in BUMD companies, especially in Rural Banks, which indicated that there was still a lack of effectiveness of internal audit in these companies so that it is still possible for fraud to occur by the company's employees themselves. According to Hery (2010). A company's internal audit that is weak and incompetent would result in fraud prevention within the company not working well and effectively. On the other hand, a strong and competent internal audit can encourage fraud prevention in a company to run well and effectively so that fraud can be minimized. The internal auditor had an important role in the company because the internal auditor acted as an independent assessor to review the company's operations by measuring and evaluating the adequacy of controls as well as the efficiency and effectiveness of the company's work (Sawyer, 2012). The internal audit helped an organization to achieve its objectives, through a systematic and regular approach to evaluate and improve the effectiveness of risk management, control and governance processes. Internal audit played an important role in monitoring activities to ensure that fraud prevention and programs are effective. This internal audit activity can prevent and overcome the occurrence of fraud.

Apart from internal auditors, the whistleblowing system was also a factor that influenced fraud prevention. With the implementation of a whistleblowing system, there would be a reluctance to commit violations and an increasing willingness to report violations, due to increasing confidence in an effective reporting system to prevent fraud (KNKG, 2008).

The whistleblowing system is a method to encourage the enforcement of company ethics and encourage the ethical behaviour of employees, or as a means of preventing unethical actions and fraudulent behaviour that had a detrimental effect on the company (Yunus, 2010). Therefore, the implementation of a whistleblowing system needed to be encouraged in every organization, both in the private sector and the public sector (KNKG, 2008).

This research aims at assisting company leaders (management) in carrying out their responsibilities by providing analysis, assessment, suggestions, and comments regarding the activities being audited and finding irregularities, whether due to intentional misstatements (fraud) or not. The report "2002 Report to the Nation on Occupational Fraud and Abuses" stated that internal auditor activities could suppress 35% of the occurrence of fraud.

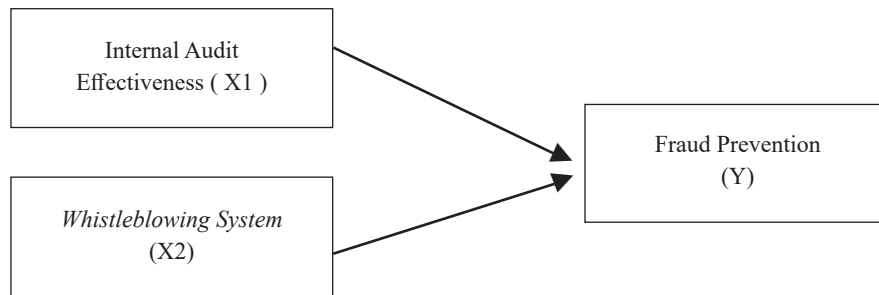


Figure 1. Research Framework

## METHODS

The population in this research are Rural Banks which had internal auditors of at least 4 members. The determination method used in this research was simple random sampling. The total population of each Rural Bank is as follows:

Table 1. Research Sample

No	Name of the Rural Bank Offices	Sample
1	PT.BPR Kredit Mandiri Jabar	4
2	PT.BPR Pangandaran	4
3	PT.BPR Mitra Kanaka Santosa	4
4	PT.BPR Duta Pasundan	4
5	PT.BPR Baleendah Rahayu	4
6	PT.BPR Jelita Artha	4
7	PT.BPR Mitra Rukun Mandiri	4
8	PT.BPR Nusantara Bona Pasogit 27	4
9	PT.BPR Kerta Raharja	8
Total Population		40

Source: Primer data processed in 2022

The variables of this research consisted of 3 types of variables, which included: an independent variable (effectiveness of internal audit and whistleblowing system), and a dependent variable (fraud prevention). The internal audit effectiveness variable was responsible as an independent assessor for reviewing the company's operations by measuring and evaluating the adequacy of controls as well as the efficiency and effectiveness of the company's working performance (Sawyer, 2012), the variable whistleblowing system served to encourage the enforcement of company ethics and encourage the ethical behaviour of employees or as a means of prevention unethical actions and fraudulent behaviour that adversely affected the company (Yunus, 2010).

All hypotheses in this research were processed using simple linear regression analysis  $Y = a + Bx$

## RESULTS

Based on tests carried out using the SPSS program, each data and questionnaire question had been declared valid through a validity test conducted. The research variables are normally distributed and met the data normality test requirements with a significance  $> 0.05$ . The research variables were then tested for reliability to measure the consistency of the research questionnaire used, which fulfilled the reliability test criteria with Cronbach's Alpha greater than 0.6. Simple linear regression results as presented in Table 2.

Table 2. Simple Linear Regression Test

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	27.603	5.445		5.069	.000
	Internal Audit Effectiveness	.456	.076	.696	5.979	.000
1	(Constant)	23.227	7.027		3.305	.002
	Whistleblowing System	.873	.167	.647	5.227	.000

Dependent Variable: Fraud Prevention (Y)

The coefficient of determination test determined how much influence the independent variable (x) had on the dependent variable (Y) in this research (Table 3).

Table 3. Determination Test

Model		Coefficients		
		Standardized Coefficients		correlations
		Beta	Zero-order	%
1	(Constant)			
	Internal Audit Effectiveness	.696	.696	.484
1	(Constant)			
	Whistleblowing System	.647	.647	.418

Dependent Variable: Fraud Prevention (Y)

As presented in Table 3, the coefficient of determination of internal audit effectiveness could be seen at 0.484 indicating that the internal audit effectiveness variable for fraud prevention partially contributed 48.4% and the whistleblowing system variable for fraud prevention partially contributed 41.8%.

## DISCUSSION

The internal audit effectiveness variable (X1) had a coefficient value of 0.456 and a significance value of  $0.000 < 0.05$  which indicated that the hypothesis of internal audit effectiveness affected fraud prevention which was rejected significantly and positively. The results of this study are consistent with the theory conducted by (Wardhini, 2010) in (Tampubolon et al., 2014) indicated that the better the effectiveness of internal audit, the better fraud prevention can be carried out. Fraud prevention can be done if the internal audit can identify the possibility of fraud. Conversely, when the internal audit is unable to identify the possibility of fraud, fraud will occur and cause losses to the company. In addition, it is also consistent with the theory conducted by (Fatmawani, 2015) which stated that Internal Audit Effectiveness affected Fraud Prevention.

The whistleblowing system variable (X2) had a coefficient value of 0.873 with a significance value of  $0.000 < 0.05$ , this showed that the whistleblowing system variable affected the fraud prevention variable (Y) which was received significantly and positively. This result is supported by the theory from (KNKG, 2008) and the study done by (Agusyani et al., 2016) stated that one of the benefits of having a good whistleblowing system is that there would be a reluctance to commit violations and an increasing willingness to report violations due to increased trust in effective reporting system to prevent fraud. This is supported by research (Hariawan, et al., 2020) and (Agusyani et al., 2016) which stated that the Whistleblowing System affected Fraud Prevention.

## CONCLUSION

This research variable affected fraud prevention based on the results of a simple linear regression test. It was concluded that the internal audit effectiveness variable had a significant effect on fraud prevention (fraud), and the whistleblowing system variable had a significant effect on fraud prevention (fraud). The whistleblowing system is a factor that influenced the prevention of fraud. With the implementation of a whistleblowing system, there is a reluctance to commit violations and an increasing willingness to report violations, due to increased confidence in an effective reporting system to prevent fraud.

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