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EFFECTIVE CORPORATE GOVERNANCE TO PREVENT FRAUD IN PUBLIC SECTOR IN INDONESIA

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ABTRACT

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 foundthat over 19% of the respondents' fraud cases were initially detected by internal audits versusabout 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 structureis possible. Successful companies have common characteristics. One ofthose characteristics is an effective governance structure. Companies that failor have serious financial and operating issues will generally suffer from ineffectivegovernance 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 toweaknesses 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.

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- 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 FinancialStatement Audit, states that three conditions are generally present when fraud occurs. First, thereis an incentive or a pressure to commit fraud. Second, circumstances provide an opportunity forfraud to be perpetrated e.g., weak controls or ability of management to override controls. Finally,there is an attitude or rationalization forcommitting fraud.These conditions collectively areknown as the fraud triangle.

Bell and Carcello 2000 find support for the existence of fraud triangle conditions for asample of financial fraud companies. They estimate a logistic regression modelpredicting theincidence of fraud and find several risk factors associated with fraud: rapid growth, weak controlenvironment, management overly preoccupied withmeeting analysts' forecasts, management thatlied to auditors or was overly evasive, ownership status, and an interaction between the controlenvironment and management attitude toward financial reporting.

Need of External Financing

The incentive to misstate earnings can arise due to pressure to meet analysts' forecasts,compensation and incentive structures, the need for external financing, or poor performance.Dechow et al. 1996, using a sample of 92 firms subject to accounting enforcement releasesduring the period 1982–1992, find that an important motivation to manipulate earnings is thedesire to attract external financing at low cost.

Symptoms of Fraud

Symptoms of fraud are often referred to as "red flags." SAS No. 99 identifies "red flags" asrisk factors and further categorizes those risk factors in the three areas included in the fraud triangle: pressures/incentive, opportunity, and attitudes/rationalizations. Albrecht and Albrecht2003 categorize the symptoms of fraud into six types: 1 accounting anomalies; 2 internalcontrol weaknesses; 3 analytical anomalies; 4 extravagant lifestyles; 5 unusual behaviors; and6 tips and complaints. One of the major challenges in identifying fraud is that while symptomsof fraud "red flags" are observed frequently, the presence of such issues is not necessarilyindicative of fraud Albrecht and Romney 1986 and investigation of such anomalies usuallyresults in a conclusion that fraud was not the underlying cause. It is also difficult to combine andweight fraud risk factors to assess overall fraud risk and formulate an audit plan Patterson andNoel 2003. Further, due to attempts by perpetrators to conceal their acts, "red flags" may berelatively few in frequency and minor in amount, at least in the early stages of fraudulent financialreporting.

Communication with Audit Committee

Cohen et al. 2007 review literature related to audit committees and financial reporting integrityand issues relating to auditor communication with the audit committee. While several academicstudies examine the association between audit committee independence and audit committee effectivenessthese 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 authorityin a country is exercised. This includes the process by which governmentsare selected, monitored and replaced; the capacity of the government to effectivelyformulate and implement sound policies; and the respect of citizens andthe state for institutions that govern economic and social interactions amongthem" (World Bank, 2007)

Corporate governance plays an important role in protecting investors, in theprudent operation of companies and financial institutions, and in the stabilityof the financial sector. Principles of good governance have been a majorcomponent of international financial standards, and many regulators vieweffective corporate governance as "the first line of defense" in their supervisory.(Verhezen, 2016)

Good public governance practices might teach the corporate elite toimplement good corporate governance, such as manager-compensationpolicies, proper division of power within the organization, rules of successionto top positions, and institutionalized competition in core areas ofgovernance (for instance, voting rights, competitive processes, and votingRules (Benz&Frey 2007),

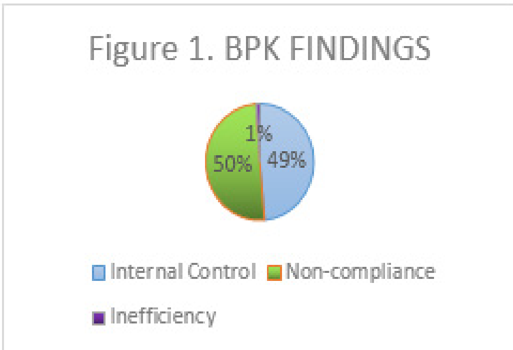
Within the Indonesian public sector, citizens as principals have little controlover the governing elites and the bureaucrats as their agents. Rarely dopublic office holders have the best interests of the public in mind. Enteringthe bureaucracy and politics is seen as employment for self-interest where thewielding 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 ABavly, (Wiley & Sons, 2004).

Disclosure is recognised 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 findingsthat contains 14.997 problems, consisting 7.284 (49%) weakness in internal control and 7.549 (50%) non-compliance to the regulation problemscosting 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

2017) are:

1. The consolidation of state government performance report in 2016 still using manual method.
2. Weakness in tax administration.
3. Control over subsidy program still not clear.
4. The use of government state budget (APBN) for public service obligationfor transportation by train still not clear.
5. Control over special allocation budget (DAK) for supporting facilities is not satisfying.
6. The settlement of deficit in social welfare fund asset was still not clear.

For the above problems the government responses are:

1. Finance ministry and directorate general of taxation (DJP) is information technlogy blueprint in order to integrate the information systems.
2. Finance ministry and directorate general of taxation will set the risk management strategy to control the subsidy.
3. Finance ministry and directorate general of taxation will ask the direcorate general of railways to make a record of the use of the budget.
4. Finance ministry will set the mechanismm of control over allocation with the provincial government need.
5. Finance ministry will make a statement relating deficit in social welfare fund.

The weaknesses in internal control systems were generally caused by:

1. The officials supervision and control in the activies was not optimal and the coordination with the unit was not optimal.
2. The executors of the activities hasn't record, input data, and reconciliate 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.

Table 1
Audit Board of Indonesia (BPK) Findings

Government/Investigation Type	Total Investigation Report	Total Findings	Total Recommendation
State Governement	133	1411	3,588
Financial Investigation	102	1322	3,330
Performance Investigation	1	11	41
Special Purpose Investigation	10	78	217
Provincial Government	537	7,950	21,351
Financial Investigation	537	7,950	21,351
State Owned Companies and Other Institution	37	368	998
Financial Investigation	6	45	133
Performance Investigation	8	104	262
Special Purpose Investigation	23	219	603
Total	687	9,729	25,937
Financial Investigation	645	9,317	24,814
Performance Investigation	9	115	303
Special Purpose Investigation	33	297	820

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 comittee 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.

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