The Impact of Internal Control Practices on Minimizing Fraud in Companies

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Abstract

Internal control structures are a collection of protocols and regulations that protect an organization’s properties, minimizing possibilities for theft and maintaining an organization’s potential. For an entity to operate, considerations must be identified to guarantee the organization’s smooth functioning like materials, machinery, cash, etc. Certain associations were misled by their members and consumers. This methodology concerns quantitative evidence, as the name implies. There is a range of agreed methodological criteria for the method’s feasibility, such as the number of respondents needed for statistically important outcomes. The quantitative method will be implemented to study employees’ points of view in the workplace to internal control practices. It will measure the employee’s opinion based on a Likert scale ranging from 1 representing strongly agree to 5 representing strongly disagree. Failure to comply with internal controls is one of the key obstacles to producing good financial performance in companies. While there have been many initiatives in environmental regulation and regulations and internal auditing, a firm’s financial success has seen nothing in corporate governance and government policy. Therefore, the relationship between internal control systems and the financial performance of entities must be defined. The research ends with the significant predictors of financial success that involve control setting, internal audit feature, risk reduction, control practices, and corporate governance. The research found that companies that provide effective frameworks for internal control depend on positive financial performance and investment valuation. Failure to respect internal controls is one of the main barriers to successful business success.

Keywords: Internal Control, Fraud, Financial performance, COSO Framework, Monitoring

Introduction

Internal control systems are one of the main elements in maintaining secure operations, which businesses can practice in the workplace. Ineffective internal control systems can contribute to fraud and financial distress that degrade the entire company's efficiency [1-5]. An internal control mechanism on the vitality of the internal control structures and their impact on the financial perforce of the organization has been developed by the Bank of International Settlement [6]. The main problem to be discussed in this study is the large numbers of financial misdeeds in Lebanon and worldwide, owing to a
mispresence of efficient and effective internal management structures among companies [7]. The study would highlight the value of internal management mechanisms and their effect on the overall financial results of businesses. The study will concentrate briefly on the components of internal control systems and will discuss the connections between internal control systems and their influence on fraud mitigation. Both main and secondary data were used to validate the study [8-12]. Data can be utilized in the delivery of surveys and database questionnaires. In contrast, secondary data will be gathered in various countries to discuss the impact of internal control mechanisms on fraud prevention [13-16].

Internal Control System

Drawing from the Regular auditing practices No. 6 (SAS. 6) statements defining internal control as organizational arrangements to enforce all the procedures and activities agreed by the management of the company, in order to lead to make the business activity as successful as practicable in complying with policy, legislation and regulations. Internal management is often referred to as a particular strategy and method structure intended to provide the company’s or entity with goals, and both of which must be accomplished [17-21]. It also addresses the principles and rules that businesses must use to meet their desired objectives on the market. The protocols and management policies would have accurate and credible financial details in compliance with all requested approaches. Internal management further guarantees an organization’s performance aims to make organizational quality and efficient, providing accurate and credible financial results in accordance with all rules, laws, and policies [22]. A larger field of internal management covers many of the threats of completely regulated organizations. This is a method of controlling, assessing, analyzing and tracking the wealth of businesses. Identifying and avoiding theft and security of business capital play a crucial role [23]. The analytical researcher can find many meanings of internal management since they can impact the businesses' stakeholders at several different levels of the organization, describing them under COSO [24-29].

In 1992, COSO designed an internal control assessment model adopted as the agreed internal control tool and is generally defined and recognized as the selected norm for the calculation of device performance by firms [30-34]. In an appropriate internal management structure for an organization, five components have been established to assist the agency or Organization’s task: the control setting, the risk evaluation mechanism for organizations, the database system, control operations, and control tracking [35-41]. But the researchers have limited themselves to just one aspect of the structure of internal regulation, which is the atmosphere of control, for the intent of this analysis as the other elements of the system are constant [42-51]. The selected element was known as the highest element among all components. Senior management and the board of directors’ attitudes and actions are important for the stable structure of inner regulation. Includes principles relating to ethics and honesty, dedication to excellence, Board of Directors with engagement boards, enforcement of policy created by the human resources authority and a connection to the control elements of the environment. A strong board presents the necessary resources for efficient coordination, allowing effective internal audit functions to be carried out within the effective financial and legal proceedings [52-61]. In the following words, the Audit Committee shall be accountable for: contact with the board, external and internal auditors with appropriate cooperation among stakeholders. Secondly, the CEO, CFO and other high-control management staff will acquire and review on track, demonstrating that internal control
mechanisms have been set in motion. Thirdly, dispute mediation management guarantees that all fraud allegations are reported and liable individuals are compensated [63].

Overview of Internal Control

Arens, Elder & Beasley [64] submitted that an internal control structure requires rules and practices that guarantee management reasonability in achieving its targets and objectives. The concepts underlying the principle of 'internal regulation,' which can be extracted from the descriptions examined above, include [65-72]: management and others responsible for governance establish and retain internal controls, which is aligned with the obligation for management to file financial records according to general accounting standards (GAAP). Internal controls include all financial and non-financial elements of an entity's business. Everyone inside a company has to ensure the internal controls operate. Internal audits ensure that the goals are fulfilled, realistic but not total, and financial results are reasonably specified. Internal controls do not offer full security in the case that accidents or events are imminent [73].

Objectives of Internal Control

The ultimate function of internal management is to promote the fulfilment of the company's goals [74-81]. The internal controls intended to accomplish the following particular targets and objectives were addressed at COSO:

- Path to quality and productivity in activities. As stated previously, performance is the capacity to maximize resources and productivity ensures that the expected and anticipated targets are achieved with the results requested [82-86].
- Financial statements and transparency of these results. The credibility and legitimacy of the results let consumers take a right and reasonable economic choice and, where possible, track the steps. The financial accounts are liable for the transfer of details and communication of the company's capital, equity, and responsibilities [87].
- Accordance with the regulations and legislation. Companies in the region they work are requested to meet with both rules and legislation. Various rules, including human rights statutes, revenue codes, money laundering regulations, and much others. Breakage of any statute or procedure is dangerous and illegal under the rules [88-91].

Components and Measurement of Internal Control

Internal management comprises five interrelated components that can be found of any organization in assessing the intensity and internal control consistency [92].

Control Environment

The monitoring environment involves administrative roles and management functions with the requisite action and knowledge directed at the responsible internal control staff and is critical for the organization [93-101]. The environments establish and disseminate the tone inside the company, affecting its staff's
consciousness. It is the foundation for the systemic and essential discipline of all other elements of internal regulation. The control environment is the established environment of the company management that shapes things and the way they are conducted and how representatives of the company must adhere to and change their actions in order to achieve the company's goals [102-116]. In order to assess the firm's power and consistency of control, there are elements and factors which include: ethical principles, honesty, the devotion to excellence, the style and the procedures of the activities and assigning of authority. (The High Representative) However, the control environment requires the organization's framework in which all the activities can be organized depending on the abilities and descriptions of the workers [117]. The jurisdiction can also be differentiated based on the competence and after success evaluations have been conducted in the workplace, depending on the processes designed by the human resources at work [118].

**Risk Assessment**

The business danger would be any threat or force that may deter the organization from achieving its targets and objectives, sustainability and longevity [119]. To resolve the associated threats to the organizational objectives, the structure of internal control is required [120-125]. The examination involves the verification and measurement of risk involved with the accomplishment of organizational goals, estimation of the amount of risk to be handled, and procedures to confront, reduce, remove, and avoid those risks. However, risk control in the workplace requires controlling access to classified details for workers at work to limit challenges and barriers and limit the access of employees. Security measures, including identification systems, may also achieve this by restricting access to external devices, such as USB portals and computers, and protecting details in the workplace and many other problems [126-131].

**Control Activities**

The monitoring practices are laws and regulations that will lead to maintaining management guidelines [132]. They are ongoing steps that the organization representatives can always follow to ensure that activities are carried out properly and are structured to facilitate correct financial transactions handling [133-137]. Examples of these tasks fulfil this function, such as the division of responsibilities, appropriate oversight, assessments and performance evaluation, for the assessment of internal regulation. However, the clearance phase involves medical check-ups and task segregation depending on each employee's ability level [138-141]. The higher the qualifications of the staff, the higher the acceptance would have to reflect improved financial reports and a better management structure in the business [142].

**Information and Communication**

The communication system and information is an internal management mechanism that guarantees that the organization receives the requisite details and offers communication with involved customers [143-145]. It requires successful contact inside and outside the organization. The data and communication framework would produce reports comprising accounting, organizational and regulatory data that guarantee the quality and regulation of the organization. Enforcement processes for the
initiation, registration and processing of the organization's financial transactions and financial practices will form part of the funding of the data structure. In terms of schedules, handling transaction review and measurement of the transmission of knowledge, the efficacy of contact and information systems may be evaluated in an organization. This involves exchanging office records via email, ensuring the details are backed up with specialized tools for tracking purchases, and ensuring that workplaces are safely treated to mitigate challenges or hurdles [146-151].

**Monitoring**

The monitoring mechanism will measure and assess the reliability and consistency of internal control over time [152-158]. It involves a range of ongoing monitoring and management exercises to ensure that all staff fulfill their responsibilities. Budget analyses and controls will provide the instruments used to track the controls that assess machine output and monitoring. Monitoring requires the freedom of the audit work, the delivery of supervisory tasks, and the provision of standard occupational management procedures. It allows administrators to check up on workers and managers' duties at work and decide whether there are any relevant issues [159-162].

**Theoretical Framework**

**Agency theory**

In 1967 Meckling and Jensen developed the agency principle. The principle, as mentioned earlier, is an entity connected in the context of a contract with an individual or more who visits a person on behalf of a specific service, including a member of the delegation, to render a decision to the agent [163-165]. The theory of agencies describes and addresses the appropriate framework in organizations for contract maintenance, and in companies, there is a capacity for control exercise that minimizes the agent actions. The agency theory assesses the relations between two groups, namely managers and investors. The boss (agent) carries out a certain duty and obligation for the investor, and the investor, in turn, carries out the responsibility to compensate the agent [166]. The theory explains the potential relation between the agent's involvement and, for example, the principal manager and the investor. By the key activities of an expert's job for the agent's supervision, the link between the agent is reinforced. This principle is to be used in this analysis and review as internal management is one of the several mechanics for coping with the organization's dilemma by eliminating Agency costs that influence the relationship's efficiency and of the most advantages.

**Stewardship Theory**

In comparison to organization theory, it relies on the management theory not from the viewpoint of individualism, rather through the incorporation of their interests as members of the organization, the top management position is performed. Meckling and Jensen (1994) further claim that if shareholders are actively involved in the operation of the business, the expense of managing agency problems is minimized. It states that the philosophy of stewardship, since it varies from the theory of the organization, is entirely different and does not stress the need to involve supervision and agency expenses, such as establishing an internal audit team and/or system work. Nevertheless, Donaldson and
Davis (1991) have addressed that the return changes ought to be achieved by including the two hypotheses and integrating them rather than dividing them. The stewardship hypothesis in this analysis supports that higher-learning organization administrators perform as vendors, creditors, personnel and shareholder management schemes.

**Institutional Theory**

In accounting analysis, either standardized examination or constructive research is suggested. The study aimed at forecasting and describing a particular mechanism and phenomena is generally defined as optimistic research. Good hypotheses relating to experiments and studies knowledge are announced. It is intended to clarify and forecast which businesses will use and which companies will not use a certain accountable approach but do not speak about the approaches that the organization should or cannot use. The expense question concerning the Agency's partnership and applying the right mechanisms are called tracking or monitoring costs. The attribution hypothesis is a social science theory that examines how people perceive such incidents and their derived actions. The auditors were disclosed by Bonner et al. (1998) that they were more vulnerable to sued where they neglected to find errors that might result in reduced profits and that assessors assume some auditors may have noticed the fraud. Refett (2007) addressed the auditors' transparency of fraud detection in the report, which predicts that auditors are the persons most liable in the case of a fraud detection failure. The findings of the analysis undertaken by Refett (2007) were presented in the auditors' appearance if the audit procedure failed. The results further confirmed Refett's forecast. Bonner et al. (1998) have added, to assess incompetence, that the evaluators favour the usage of internal management misconduct as a criterion for evaluating the auditors' negligence.

**Financial Performance**

Before we address financial results, conception and growth, the relation must be implemented and assessed, and it must be able to consider the various facets of its performance. The success should also be used to measure how well the business does and how its targets are met. Gerigopolis and Tannebaman (2017) addressed the success sense as a performance standard for businesses perceived as social systems that achieve their targets, citation Adebawojo, Enyi and Adebawo (2015). er (2003) added that

**Empirical Review**

In his research in Kenya, Ndiwa (2014) examined the structure of internal financial output management of a training institution. There are still several public institutions in Kenya, who face very low financial results, which in some situations has led to the closing of a significant number of businesses considering the money and human resources required for maintaining them and running the enterprise. The research then carried on the ongoing bad financial results from largely neglected internal controls. The study's goal conducted by the Kenyan researchers was to create a correlation between internal control and financial results in tertiary institutions. Still, it was only confined to the African Research and Development Institute. The results showed that the internal control mechanisms had to be followed and
that the structure needed to change to improve the company's efficiency financially. In addition, it was observed that the efficiency of the firms has increased from a statistically optimistic point of view, but such constraints have not provided for more study. The internal control impact on financial output in Kenya's manufacturing industry was analyzed further in Kamau (2014). The results demonstrate that a substantial number of industrial firms have a management environment as one of the internal control components of their business with a major influence on the financial success of their companies as a whole.

Several reports on the effect of the financial performance management system on 100 firms in the United States have been published. The researcher applied studies of 200 participants of diverse ages and backgrounds with separate industries in the quantitative and qualitative approaches. In the European industries, further research was carried out to study the effect on financial organizations of risk management. In a specific group of 300 researchers, the research applied a methodological approach in various organizations. The findings indicated that the risk management and fraud level of the firms was closely integrated. The greater the degree of risk management at the office, the lower the rate of theft, which improves the overall financial efficiency. Therefore, the risk appraisal plays an important function in the analysis of device access if it is properly regulated and well-bound; if the higher the mechanism is controlled, the higher the profits would be and higher the efficiency of the organization. Studies suggest, however, that the control environment has a significant impact on the company's financial results as a whole, in which profits produced in the workplace increase when the enterprise is better organized and represent higher performance.

**Sampling**

Because knowledge from the study is focused on workers' opinions, employees employed at various organizations are the key source of information. According to a given number of workers, the sampling procedure is introduced. According to the literature, the sampling procedure involves likelihood sampling and non-probability sampling. Everyone has the following explanation. The probability approach is defined by collecting stated samples as the probability to be chosen by each member of the population is not understood. The hierarchical and layered sample approach is used. Despite the unlikely sampling, participants are subjectively and mistakenly picked. Samples, quota sampling and snowball sampling, are included. The judgmental – convenient non-probability sampling methodology has been maintained because the probability process is extremely accurate since it measures the sampling error. Frameworks were submitted to the department of staff responsible for employee delivery.
Findings

**Figure 1:** There is a direct effect between risk assessment and financial performance

The polling survey explains the financial results risk evaluation; 33% are deeply agreed, 44% agree, and 22% are favourable (figure 1).

**Figure 2:** There is a direct effect between control environment and financial performance

The study explains polling distribution in terms of impact on the control environment and financial performance, strong approval by 26% and 63% agreement and neutral by 11% reported (figure 2).
Figure 3: There is a direct effect between control activities and financial performance.

The distribution of polls in the polling sample explains the impact of control practices on the output of the financial sector; 33% agree strongly, 44% agree, and 22% react as neutral (figure 3).

Figure 4: There is a direct effect between monitoring and financial performance

In the Polling Survey, 22% firmly support, and 48% accept that the polls would be distributed on the financial results result of monitoring. Yet 26% reacted neutrally, and 4% did not agree (figure 4).

Discussion and Regression

The integration of the above variables, including the chi-square, regression and Pearson Correlations, based on a sense level of 5% will be analyzed through different statistical techniques (table 1).

Table 1: Coefficients
The study variables were integrated based on a 5 percent margin error regression analysis. The results illustrate this:

- Important convergence of risk and financial performance evaluations (0.003)
- Important convergence of financial reporting and tracking (0.019)
- Major convergence of financial and control environment (0.000)
- Substantial convergence of financial reporting and control practices (0.00)
- Major convergence of contact and knowledge with financial results (0.042)

The findings have been checked quantitatively, and the details have been verified using SPSS. The findings showed a clear influence on a company's financial success on the COSO process of internal control systems. The COSO system consists of five elements: surveillance, knowledge and correspondence, risk management, regulation and climate control. Based on these variables, the questionnaire was developed, and the findings indicated that the higher the COSO framework, the higher the rate of financial success.

**Conclusion**

The findings have been evaluated using explanation and inferences, and the SPSS statistical package has been used. The regression study was carried out using a typical 5 per cent error, and the findings indicated that the tracking of the job and the financial output was substantially interrelated. Nevertheless, surveillance appears to positively influence the company's sales and financial results, so if top managers consistently check up on workplace procedures, the risk of issues will decline and, therefore, the increased output will arise. However, past findings suggest that the more information and communication are handled in the workplace, the more the financial results and income would be stronger, the more information and communication is managed. However, financial success is the dependent variable he discussed, and knowledge and correspondence is the independent variable. The
better the information and coordination, the stronger the financial success at work. The findings have been evaluated using explanation and inferences, and the SPSS statistical package has been used. The regression study was carried out via a 5% standard error, and the findings showed that knowledge and connectivity and deception were substantially merged at work.

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