

# Effects of Integrity and Controls on Financial Reporting Fraud

Author : Dr. Neeraj Kumar Sharma  
Project Faculty, MGNCRE, Hyderabad

## Abstract

This study aims to explain how ethical considerations and internal controls affect how often accounting fraud occurs. We employed descriptive methods, literature reviews, and bibliometrics to analyze the data we gathered from journal articles and library databases. Individual morality and internal control are shown to have significant negative effects on the propensity for accounting fraud in this study.

**Keywords : Accounting fraud, internal controls, and personal ethics.**

## I. BACKGROUND

Expansion in the accounting industry is now rapid. However, every narrative has an opposing viewpoint. While advancements in accounting are usually positive, they may sometimes lead to new forms of fraud including bribery, manipulating financial records, and embezzling cash. The prevalence of accounting fraud is a sad reality in Indonesia. Accounting fraud has been widely discussed in the media as a major issue for businesses all over the world. Financial benefit is obtained by the perpetrators of fraud to the detriment of the victims, who are usually left in the dark about the scheme.

Corruption is a common kind of fraud committed in Indonesia. Corruption unfortunately remains widespread in Indonesia. This is a major cause for concern. The people the public should be able to put their confidence in are using their positions for wrong purposes, and this is why the public loses faith in them. Since there is still a deficiency in anti-corruption education taught from a young age, the number of incidents in various parts of Indonesia has become an additional difficulty for the government to combat.

Several factors may influence the frequency with which fraud happens. The chance for dishonesty is a powerful inducer of dishonest action. When people have the chance to do fraudulent acts, they often do so in harmful ways. The "gap" that allows for wrongdoing may have several causes, some of which are a result of a faulty internal control design, while others may stem from deficiencies in the company's work process or organizational structure. Two processes deviate from the operational plan, a third has inconsistencies in the monitoring (management) of the business processes it has implemented, and a fourth has an evaluation that is not carried out in tandem with the applicable business processes.

Some of the contributing factors to fraud include breakdowns in internal control. Human resources and information technology departments are two common places for fraud to occur in businesses. Internal controls may assist detect and prevent this.

Lack of an effective internal control system is a major contributor to fraud. Due to a lack of management or direction, dishonesty, sloppy procedures, and low output, fraud may flourish with little fear of punishment. Human nature itself is a potential breeding ground for deceit. Character is a person's disposition and way of thinking; sincerity and fairness are vital qualities that must be fostered so that we do not defraud ourselves financially.

## **“Effects of Integrity and Controls on Financial Reporting Fraud”**

---

Fraudsters' methods have become more sophisticated and varied in tandem with the explosion in the volume of available data. Fraudsters' schemes rely heavily on information: it's used to rationalize bad behavior, escape detection, and find weak spots in internal controls. Businesses and government agencies have so started to switch to an automated system, which can more consistently provide consumers with reliable information.

If the company regularly evaluates and updates its procedures, it may be able to achieve a satisfactory level of internal control. Lack of internal controls is a potential catalyst for accounting fraud in a commercial context. Internal control needs support from many different stakeholders and the many different parts that represent them in order to successfully avoid accounting fraud. Accounting fraud may be uncovered by a company's internal audit department.

Personal decency is often overlooked as a driving factor in financial crimes. A person's own moral code affects their tendency to commit fraud. Knowing what is morally good and wrong requires a strong conviction that one should act in accordance with those principles. Important features of understanding may include empathy and the ability to see the world from the perspective of others. And they need to be able to control their emotions, hear out opposing viewpoints before making snap decisions, embrace diversity, understand wrongdoing, feel compassion, behave justly, and treat people with dignity and decency.

Everyone has their own degree of moral thinking. Accounting fraud is more common among those with low moral reasoning skills because their actions are driven by greed. Good individuals, on the other hand, know better than to commit accounting fraud and put the needs of others ahead of their own. It's impossible for a business or group to thrive without a leader who is honest and committed to its goals. Good values and a clear commitment from management are essential for enforcing ethical behavior in the workplace. It's possible that zero instances of accounting fraud would occur if the company's culture and ethics were given top priority in the workplace.

Accounting fraud via unethical behavior is positively and strongly associated with personal character and information asymmetry. The incidence of accounting fraud is inversely related to the strength of internal controls. The extent to which accounting fraud is impacted by internal control and information asymmetry varies. The prevalence of accounting fraud is unrelated to either individual morality or the appropriateness of pay. The likelihood of fraud rises in the face of information disparity, strong internal control, and unequal treatment inside an organization. Individual morality is detrimental to the overall fraud tendency (Eska Sari Putri). Accounting fraud is on the rise, and the effectiveness of internal controls is a major contributing factor (Riskah Nur Rahma, Haryso, 2018). Organizational culture, accounting rule compliance, and internal controls all have a negative impact on the likelihood of accounting fraud. Meanwhile, according to Yustiana Djaelani, head of the West Halmahera district government's SKPD, management ethics have no bearing on the rise of accounting fraud.

### **II - Defining the Issue at Hand**

The author of this article raises the questions of whether or not internal control has a significant impact on the trend of accounting fraud and whether or not individual morality has any significant effect on the trend of accounting fraud.

Specifically, the author focuses on the impart of morals and internal controls on accounting fraud.

### **III - Discussion of the Secondary Literature**

Fraud in financial reporting that occurs due to the purposeful mishandling of misstatements is known as accounting fraud. Accounting fraud is an unethical practice whereby dishonest claims are made about a company's financial situation and its assets are mismanaged with the intention of gaining an unfair advantage or causing harm to another

## **“Effects of Integrity and Controls on Financial Reporting Fraud”**

---

party. To commit accounting fraud is to deliberately or carelessly make a false statement regarding a financial situation in order to gain an unfair advantage. However, causing damage is a crime in certain circumstances (especially when done on purpose).

An essential aspect of what it means to be human is whether or not one's actions are ethically justifiable or immoral. Your morality is your own code of conduct. When discussing ethics, morality, or morals, we are referring to a way of life or a set of activities.

A person's morality is only one of several aspects that might influence accounting fraud. Agencies and organizations also have a moral obligation. Both unethical conduct and the rising tide of accounting fraud may be influenced by the moral stance taken by top-level management. This means a much more extensive accounting process. It is often believed that dishonest accountants are more likely to be people with poor ethical standards.

Values, social norms, and the ties that hold individuals accountable are all factors in moral reasoning. Moral reasoning is the act of conceptualizing alternative solutions to moral conundrums. According to Kohlberg, moral reflection is essential to moral reasoning. This way of thinking provides a guideline for deciding how to respond in a moral dilemma. In moral reasoning, the motivation behind an action is more important than its consequences.

The term "internal control" refers to a set of rules and processes that may be put in place to lessen the likelihood of security breaches and help businesses achieve their goals. If there aren't enough checks and balances inside the corporation, then the future success of the business is uncertain, and the data presented isn't verified. Further, the company's operations are inefficient and ineffective since management rules have not been followed. Anti-fraud measures are only one good example. Integrating adequate levels of internal control into the structure of your system makes it difficult for outsiders to imitate it.

Business risks that might compromise the company's goals are the primary focus of internal control planning and implementation. A company's downfall, public humiliation, and significant financial loss might all result from inadequate internal controls. One advantage of excellent internal control is that it lessens the likelihood of assets being lost, helps avoid and identify errors, ensures the reliability of financial reporting, and keeps a company in line with applicable legislation.

A person's morals will have a role in whether or not they are likely to commit accounting fraud. An individual with higher moral standards will make an effort to suppress any tendencies toward accounting fraud since he will be paying more attention to the interests of society as a whole.

The moral may be deduced from the general principles that are accepted in a community and that are associated with the evaluation of norms of behavior. Someone's propensity to engage in accounting fraud will have a direct bearing on their personal morals. Consequently, an organization's vulnerability to accounting fraud depends on the quality of the people who work there. There are likely many people working in various capacities within a company. Thus, each of these individuals will have a unique impact on the potential for accounting fraud.

Those who struggle with moral thinking are more likely to act in their own self-interest and avoid breaking the law. Grouping, leave alone one's own pursuits

Internal controls are useful in minimizing instances of fraud in the accounting system. Internal controls help reduce the risk of misconduct in an organization, which is typically motivated by vested interests. Any attempt to explain these out of the ordinary behaviors away must inevitably lead to an urge to perform some kind of accounting fraud.

## **“Effects of Integrity and Controls on Financial Reporting Fraud”**

---

In order to spot accounting fraud, businesses need an internal auditing department. To prevent and identify fraud in its earliest stages, an organization needs an effective internal control system.

### **IV. METHODOLOGY**

#### **Formulation of a Study**

This research plan employs a qualitative strategy with an open, iterative, or evolving framework. Design strategies in qualitative studies are often broad rather than specific, open to uncertainty, and adaptable. The technique centers on making sense of information gathered by earlier researchers. Global, simple, uncomplicated, and adaptable best describe qualitative research schemes.

#### **Quantitative Information**

This research relies on textual and conceptual data. That's why we call this investigation a literature review. The inquiry was based on a review of the relevant literature. Literature sources are available to researchers, and they include summaries of study findings, journals, theses, and pertinent reference books.

#### **Procedure for Gathering Information**

Inquiry is at the heart of qualitative research. What then will be gleaned from an identical probe is what will gather such main and supplementary data. In order to gather information from a wide range of sources, several different methods are used.

A literature review is a kind of research. Researchers gathered information on the prevalence of accounting fraud by reading journals about personal ethics and internal controls.

### **V. CONCLUSIONS AND IMPLICATIONS**

Financial statements that are purposely misleading or inaccurate are examples of accounting fraud. Fraudulent financial statements and the diversion of funds are two examples of accounting fraud. For the purposes of users of financial reporting, fraud in financial reporting is defined as a misrepresentation, omission of a particular amount, or the purposeful disclosure of misstatements with the aim to deceive. Contrarily, fraud involving the misappropriation of assets is known as misappropriation of assets or corporate entity theft. Usually only low-level staff are responsible for such theft.

According to proponents of the notion of individual moral development, people's propensity for immoral conduct is a function of how well developed their moral reasoning skills are. When confronted with moral difficulties, persons with high and poor levels of moral reasoning react in various ways.

Researchers uncovered studies concerning morality on the part of individuals and internal controls in relation to accounting fraud as a consequence of their extensive searching. Multiple research have addressed the prevalence of accounting fraud.

Twenty journals have been collated and analyzed for this research. Personal integrity and internal controls have been shown to have a more detrimental influence on the prevalence of accounting fraud than their positive counterparts.

#### **Morality's Role in the Increasing Prevalence of Accounting Fraud**

## **“Effects of Integrity and Controls on Financial Reporting Fraud”**

---

The pursuit of financial gain might motivate someone to engage in accounting fraud. As a result, engaging in accounting fraud requires some degree of moral justification on the part of the perpetrator. People with poor moral judgment are more likely to further their own interests when there is no system of internal controls in place. A company's or organization's internal controls will prevent fraudulent accounting that might hurt the business and the community.

The propensity for unethical action in the form of accounting fraud is positively and significantly correlated with an individual's moral character. So, as a person's moral fiber strengthens, their propensity to overstate their financial gains diminishes.

There is less accounting fraud in villas in the Umalas region when residents have high moral standards (Anak Agung K. Finty Udayani, 2017). Fraud is reduced when people have high moral standards. Personal integrity has a negative and substantial impact, which may help prevent accounting fraud. Personal ethics are detrimental to anti-fraud efforts.

As one's morals increases, one's propensity to commit accounting fraud decreases, and vice versa. Moreover, different people have varying propensities for fraudulent accounting practices due to their unique moral codes

### **Internal Control and the Increasing Prevalence of Accounting Fraud**

The company's internal control system includes safeguards for all financial transactions. To ensure the safety of the company's assets, internal management of the business is essential. Reports provided to leadership may be verified as accurate by means of internal control. Through effective internal control, the administration's policies have been implemented as intended. To prevent financial losses, businesses need a system of internal controls that can recognize and respond to signs of fraud and waste quickly.

The risk of fraud decreases when there are adequate systems of internal control in place (Putri, 2018). The effectiveness of an internal control system in identifying fraud in a business increases with the system's depth and rigor.

The prevalence of accounting fraud in Umalas villas is reduced by strong internal control. The likelihood of accounting fraud due to dishonest actions is negatively and marginally correlated with the quality of internal controls. Accounting fraud is becoming more common due to weak internal controls. Having a strong system of internal controls in place may significantly lower the likelihood of fraudulent activity in the accounting department.

## **VI - Conclusions and Suggestions**

### **Conclusion**

Seven out of the twenty research analyzed (35%) found a positive relationship between ethics and the propensity for accounting fraud. But 13 research, or 65%, argue that morality are slowing the rise in accounting fraud. Each person's degree of moral thinking determines how they will behave, and this has a profoundly detrimental effect on the prevalence of accounting fraud. When confronted with moral challenges, people with strong and poor levels of moral reasoning respond in various ways. A person's propensity to conduct accounting fraud decreases with the perceived moral standing of that person, and increases with the perceived moral standing of that person.

There is strong evidence that the prevalence of accounting fraud is significantly reduced by the presence of strong internal control. When an organization has a strong internal control system in place, the incidence of accounting fraud is reduced, and vice versa when the opposite is true.

### **Suggestion**

---

## “Effects of Integrity and Controls on Financial Reporting Fraud”

---

To better understand the factors that influence an individual's propensity to commit accounting fraud, independent variables should be included in future studies. In addition, demographic characteristics (such as participants' gender, organizational position, years of work experience, age, and level of education) might be studied in order to determine how these factors influence accounting patterns.

### References :

1. Anak Agung K. Finty Udayani, M. M. (2017, Maret). Pengaruh Pengendalian Internal Dan Moralitas Individu Pada Kecenderungan Kecurangan Akuntansi. *E-Jurnal Akuntansi Universitas Udayana*, Vol.18(3), 1774 - 1799.
2. Bestari, D. S. (2016). Pengaruh Keefektifan Pengendalian Internal, Asimetri Informasi, Dan Moralitas Individu Terhadap Kecenderungan Kecurangan Akuntansi Dengan Perilaku Tidak Etis Sebagai Variabel Intervening (Studi Empiris Pada Satuan Kerja Perangkat Daerah Provinsi Riau). *JOM Fekon Vol. 3 No. 1 (Februari)*, 1436 - 1447.
3. Bestari, Delima Suma. (2016). Pengaruh Keefektifan Pengendalian Internal, Asimetri Informasi, Dan Moralitas Individu Terhadap Kecenderungan Kecurangan Akuntansi Dengan Perilaku Tidak Etis Sebagai Variabel Intervening. *JOM Fekon*, 1436 - 1447.
4. Crain, W. (1985). *Theories of Development*. New York: Prentice-Hall.
5. Devy Ervina Indriastuti, A. A. (2016, Desember). Analisis Pengaruh Asimetri Informasi, Pengendalian Internal, Persepsi Kesesuaian Kompensasi, Moralitas Individu, Dan Ketaatan Aturan Akuntansi Terhadap Kecurangan Akuntansi. *Jurnal InFestasi*, 12(No 2), 115 - 130.
6. Fera. (2018). *Pengaruh Efektivitas Pengendalian Internal, Moralitas Individu, Kesesuaian Kompensasi, Dan Asimetri Informasi Terhadap Kecenderungan Kecurangan Akuntansi (Studi Empiris pada Karyawan Divisi Keuangan dan Garment PT Dan Liris Kabupaten Sukoharjo)*. Surakarta: Universitas Muhammadiyah Surakarta.
7. Garner, B. A. (2019). *Black's Law Dictionary, Deluxe 11th*. Toronto, Ontario: Thomson West.
8. Khoiriyah, L., Asyik, N. F., & Amanah, L. (2019). Dampak Locus of Control pada Moralitas Individu dan Pengendalian Internal terhadap Kecenderungan Kecurangan Pengendalian Internal terhadap Kecenderungan Kecurangan. *JAAF (Journal of Applied Accounting and Finance)*, 108-123.
9. Liyanarachi, G. d. (2009). The Impact of Moral Reasoning and Retaliation on Whistle-Blowing.: New-Zealand Evidence. *Journal of Business Ethics*, 89 (1), 37-57.
10. Paul Coram, C. F. (2008). Internal audit, alternative internal audit structures and the level of misappropriation of assets fraud. *Accounting and Finance*, 543-559.
11. Predita Arie Ayu Putri, S. A. (2016). The determinants of accounting fraud tendency. *The Indonesian Accounting Review*, 99-108.
12. Putri, E. (2018, Desember). Pengaruh Moralitas Individu, Asimetri Informasi, Efektivitas Pengendalian Internal, dan Keadilan Organisasi Terhadap Kecenderungan Kecurangan (Fraud) Akuntansi (Studi Empiris pada Badan Usaha Milik Daerah Kota Surakarta). *Jurnal Akuntansi Syariah*, 1(No 2), 233-244.
13. Putu Santi Putri Laksmi, I. K. (2019, Maret). Pengaruh Kompetensi SDM, Moralitas dan Sistem Pengendalian Internal Terhadap Pencegahan Fraud Dalam Pengelolaan Keuangan Desa. *E-Jurnal Akuntansi Universitas Udayana*, 26(3), 2155 - 2182.
14. Wilopo. (2006). Analisis Faktor-faktor yang Berpengaruh Terhadap Kecenderungan Kecurangan Akuntansi: Studi pada Perusahaan Publik dan Badan Usaha Milik Negara di Indonesia. *The Indonesian Journal of Accounting Research*.
15. Sharma, N. K. (2022, May 15). *How to Write an Article/Research Paper of Social Science for Publication in an Indexed Journal*. How to Write an Article/Research Paper of Social Science for Publication in an Indexed Journal. <http://dx.doi.org/10.13140/RG.2.2.27844.71049>
16. Sharma, N. K. (2021, December 31). *Easy Way to Determine the Sample Size*. Easy Way to Determine the Sample Size. <http://dx.doi.org/10.13140/RG.2.2.35758.84808>
17. Sharma, N. K. (2020, August 21). *An Analysis of Corporate Social Responsibility in India*. An Analysis of Corporate Social Responsibility in India. <http://dx.doi.org/10.2139/ssrn.3676827>
18. Sharma, N. K. (2019, March 31). *CSR Expenditure of BSE Listed Companies in India: An Analytical Study*. CSR Expenditure of BSE Listed Companies in India: An Analytical Study . <http://dx.doi.org/10.13140/RG.2.2.23626.18882>



## “Effects of Integrity and Controls on Financial Reporting Fraud”

---

19. Sharma, N. K. (2015, October 31). *Emergence of SNS as Marketing Communication Tool* . Emergence of SNS as Marketing Communication Tool . <http://dx.doi.org/10.13140/RG.2.2.32958.51526>
20. Sharma, N. K. (2018, February 28). *Corporate Governance and Its Relation to Business* . Corporate Governance and Its Relation to Business . <http://dx.doi.org/10.13140/RG.2.2.16541.74729>
21. Ramesh, R., Shukla, A. K., & Sharma, N. K. (2017, May 31). *Corporate Social Responsibility in Our Changing Business World* . Corporate Social Responsibility in Our Changing Business World. <http://dx.doi.org/10.13140/RG.2.2.30674.58562>
22. Pandey, R. N., & Sharma, N. K. (2018, February 28). *Management of Stress Life* . Management of Stress Life . <http://dx.doi.org/10.13140/RG.2.2.20795.03361>
23. Sharma, N. K. (2015, November 4). *Industry Initiatives for Green Marketing in India* . Industry Initiatives for Green Marketing in India. <http://dx.doi.org/10.4172/2151-6219.1000192>
24. Sharma, N. K. (2016, February 28). *Penetration Of E-Commerce And Its Acceptance : An Exploratory Study Of Sme's In India* . Penetration Of E-Commerce And Its Acceptance : An Exploratory Study Of Sme's In India. <http://dx.doi.org/10.13140/RG.2.2.24150.47689>
25. Sharma, N. K. (2016, February 28). *Corporate Social Responsibility Is Not a Charity but a Responsibility in India* . Corporate Social Responsibility Is Not a Charity but a Responsibility in India. <http://dx.doi.org/10.13140/RG.2.2.22472.75520>
26. Shukla, A. K., Ramesh, R., & Sharma, N. K. (2018, February 18). *An Overview of Corporate Social Responsibility in India* . An Overview of Corporate Social Responsibility in India. <http://dx.doi.org/10.13140/RG.2.2.21633.89446>
27. Sharma, N. K. (2022, March 31). *Post-Pandemic Human Resource Management: Challenges and Opportunities* . Post-Pandemic Human Resource Management: Challenges and Opportunities. <http://dx.doi.org/10.13140/RG.2.2.31311.56484>
28. Sharma, N. K. (2022, May 31). *Instruments Used in the Collection of Data in Research* . Instruments Used in the Collection of Data in Research. <http://dx.doi.org/10.2139/ssrn.4138751>
29. Rachna, S. R., & Sharma, N. K. (2022, July 31). *How Garbage Dumps affect Urban Environment : A Case Study of Prayagraj District* . How Garbage Dumps Affect Urban Environment : A Case Study of Prayagraj District. <http://dx.doi.org/10.13140/RG.2.2.23364.09603>
30. Kumar , P., & Sharma, N. K. (2022, April 30). *NGO Impact On India's Development Process* . NGO Impact On India's Development Process. <http://dx.doi.org/10.13140/RG.2.2.31972.24963>
31. Yadav, G. P., & Sharma, N. K. (2022, March 31). *Marketing in India is adapting to shifting consumer attitudes and behaviours* . Marketing in India Is Adapting to Shifting Consumer Attitudes and Behaviours. <http://dx.doi.org/10.13140/RG.2.2.24422.50241>
32. Yadav, U. S., Singh, S., Bhardwaj, S., & Sharma, N. K. (2022, July 31). *The Art of Choosing a Research Sample* . PARF. <http://doi.org/10.13140/RG.2.2.10030.79682>