

# Effectiveness of Internal Control System towards Fraud Prevention in Malaysia's Small and Mid-size Enterprises

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**Abstract:** Work retrenchment, business downsizing and other forms of stress might lead to an SME employee's intention to commit fraud, hence could destroy the former's growth. Fraud must be prevented even if the value is negligible. Setting the right tone from the top is essential, and senior management should actively encourage ethical behaviour in a transparent manner. With this point of view, internal control is compulsory for every company. The main objective of this study is to examine the effectiveness of internal control system towards fraud prevention in Malaysia SMEs of all sectors. A successful organization with no fraud allegations is thought to have a solid internal control system. This research result is based on designed questionnaires that were distributed to respondents employed by SME companies. The effectiveness of internal control depends and interrelated to five components of internal control system. The study statistically proved that risk assessment has strong positive correlation towards fraud prevention in Malaysian SMEs. Information, communication, and internal audits moderately effect fraud prevention in SME companies, whilst control environments and monitoring have no correlation to fraud prevention. It is recommended that there is still need to improve internal control system in Malaysian SMEs. This research may provide better understanding to organizations concerning the importance of internal controls. Better command of internal control can help SME organizations reduce the possibility of fraud, prevent poor management, safeguard a company's brand, and make organizations more transparent and reliable. This study also recommends the significance of internal controls system to prevent fraud in the time of post Covid19 pandemic.

**Keywords:** Internal Control, Fraud, Fraud Prevention, Malaysia SMEs, Effectiveness.

## 1. INTRODUCTION

Small and medium enterprises (SMEs) have emerged as an important economic growth entity in Malaysia. In the most recent data from the Department of Statistics, Malaysia (DOSM) in the Malaysia Statistical Business Register (MSBR) stated that, there was a total of 1,226,494 MSMEs in 2021, or 97.4% of all businesses in Malaysia. The total in 2016 was 1,086,533 MSMEs. This displays an increase of approximately 140,000 businesses, representing an average annual growth rate of 5.2% for the past six years.

Focusing on the importance of economic based sectors, the services industry has continuously represented over 80% of all MSMEs across the time period. The services sector made up 83.8% of the most recent MSMEs profile for 2021, totalling 1,028,403 businesses. The second-largest contribution, with 8.0%, was the construction sector (98,274 firms). Approximately 5.8% of MSMEs (71,612 enterprises) were engaged in manufacturing, 1.9% (23,633 firms) were engaged in agriculture, and 0.4% (4,572 firms) were engaged in mining and quarrying.

Micro-enterprises were important in terms of business size as they made up the majority of MSMEs. More than 150,000 micro-businesses were added between 2016 and 2021, with an average annual growth rate of 5.6%. In 2021, small companies made up 19.8% (242,540 firms) of MSME establishments, while micro-enterprises made up 78.6% (964,495 firms) of the total. The remaining 1.6% of establishments (19,459 firms) were medium-sized MSMEs. *Given that small and medium-sized enterprises (SMEs) made up 98.5% of commercial establishments and 38.9% of the nation's GDP in 2019, the significance in Malaysia's economic development is apparent. In 2019, SMEs accounted for a total of 907,065 businesses and 48.4% of the employment in the nation. SMEs encountered difficulties in 2020 as a result of the COVID-19 epidemic. The PRIHATIN Economic Stimulus Package and the PENJANA Recovery Plan were introduced by the Malaysian government in response to the corona virus threat. This plan works to reassess and rethink the ways business are conducted in line with a 'new normal'. Additionally, a crucial part to be taken into consideration is how this pandemic impacted fraud cases among employees in SMEs.*

*Work retrenchment, business downsizing, movement control orders and other forms of stress might lead to an increase in the number of SME employees' intending to commit fraud*

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and this could destroy the SME companies' growth. With this perspective, internal control should be compulsory for every company. Based on Tuan Mat et al., (2013), regulators must enhance their investment in fraud control to combat this and lower the incidence of fraud. Kranacher (2009) proposed that the greatest approach to reduce fraud losses is to prevent them from happening. Internal control might also assist the business in minimizing errors that are not necessary, which would result in future cost savings (Puryati & Febriani, 2020). Therefore, this study is executed to examine how internal control system in Malaysian SMEs including control environment and activities, monitoring, information and communication, internal audit, and risk assessment impact on the prevention of fraud.

## 2. LITERATURE REVIEW

### 2.1. Fraud

The global financial crisis has significantly hampered and challenged societies everywhere. One cannot easily fulfil all of their desires. People could thereby readily commit financial crimes, including fraud (Noori & Rashid, 2017). Fraud is the practice of someone or a group of people obtaining an unfair advantage within an organization. Most certainly the most expensive and prevalent type of financial crime worldwide is occupational fraud. Occupational fraud is the phrase for frauds that individuals have committed against the organizations that utilize them. The consideration of fraud in a financial statement under Statement on Auditing Standards no 99: Consideration of Fraud in a Financial Statement Audit (Ruin, 2009; Auditing and Assurance Standards Board, 2002) defined fraud as an intentional act intended to produce a major untruth in the financial reporting, including falsifying accounting records, appropriating corporate assets by theft, fraud, or other means, and fraudulent expenditure. According to Holtfreter (2004), fraud differs depending on the organizational setting. However, and little is known about fraud and financial crime. Institute of Chartered Accountants of Nigeria (ICAN) Study Pack (2006b) stated that fraud includes both the intentional falsification of financial information by one or more members of management, staff, or third parties and the use of deception to acquire an unfair or illegal financial benefit. This statement was cited by Wan Noor Asmuni in her 2019 study.

Fraud scandals do not only jeopardize large companies, but also affect small businesses. According to the (ACFE) Occupational Fraud 2022 report to the Nations, frauds reported by survey participants happened in for-profit businesses, with private businesses making up 44% of the victims with a median loss of USD 120,000. Fraud affects the Malaysian SMEs reputation and the stakeholders' confidentiality in addition to causing financial losses (customers, shareholders, creditors, etc.). Furthermore, fraud contributes to the failure of Malaysian SMEs in strategic endeavours and, in severe circumstances, it may result in the closure of the entire organisation. According to the fraud diamond theory, financial pressures, rationalization, opportunities, and capabilities are the root causes of fraud. Personal issues including addiction, divorce, bankruptcy, homelessness, or health issues frequently lead to financial difficulties. However, they could also be the result of making poor financial choices or living beyond

one's means. In any case, everyday events frequently give people incentive, which is the first stage in deception.

According to a study by Jaya Kumar Shanmugam (2018), employees of SMEs will commit fraud when given the chance. Two distinct but related ideas exist about the causes of employee fraud. According to research by Hollinger and Clark on 12,000 employees, approximately 90% of the workforce engaged in "workplace deviant" behaviour, which includes actions like theft, slowdowns at the workplace, abuse of sick time, and goldbricking. In addition, one-third of workers admitted to stealing goods or money while at work.

Jaya Kumar (2018) studied on Exploratory Study of Internal Control and Fraud Prevention Measures in SMEs and added financial pressure is a second theory as to why employees commit fraud. Criminalist Donald R. Cressey spoke with almost 200 imprisoned embezzlers, including CEOs who had been found guilty, in the late 1940s. He discovered that the majority of people committed fraud to pay their debts. According to Cressey, there are two additional conditions that must be met for employees to conduct fraud. They must be able to rationalise their crimes as anything other than criminal behaviour and see an opportunity to commit and conceal their crimes.

Regardless of the nature of the sectors, numerous financial and professional crimes, such as swindles and breaches of employee trust, occur. Two behaviours that can result in material misrepresentation in the event of financial fraud are asset theft and fraudulent financial transactions. Asset misappropriation, often known as embezzlement of funds or improper use of facilities, is the deliberate misuse of business assets for personal gain. Financial statement fraud, commonly referred to as false financial reporting, is the deliberate distortion or omission of data with the objective of deceiving the report's readers.

### 2.2. Fraud in SMEs

A perceived opportunity, such as a lax internal control, that allows the fraudster to carry out their operations without being discovered is necessary (Girgenti and Hedley, 2011). In a similar vein, ACFE (2012), Laufer (2011), and Wells (2004) asserted that SMEs are more susceptible to fraud than large corporations since they have less anti-fraud mechanisms in place.

Literature review made by Azwadi Ali (2012) indicated that the most frequent fraud kinds are probably those that have an effect on the profit and loss account as a result of overstating expenses or understating income. Small and medium-sized firms (SMEs) may not be able to have as many internal controls as larger companies, but it is crucial that their managers assess the risks that their companies face and make sure that they at least have defenses in place in their critical areas.

Theft is one of the main sorts of fraud that can happen in SMEs, but there are other types as well. As a result, theft is a constant problem for small businesses. The phenomenon of computer-related fraud enters the picture as a result of developments in information processing technologies. Fraud did exist before the development of computers, but it took different forms. As an example, embezzlers can now steal by creating electronic entries in books of accounts rather than

pen and ink or electro-mechanical entries. Therefore, the computer did not bring in a new wave of fraud, but only change the form of earlier thefts.

Azwadi Ali (2012) in his study discovered that small companies frequently respond to crime by altering their hours of operation, boosting their pricing to make up for their losses, moving outside of the neighbourhood, or even just ceasing operations. Owners of SMEs should carefully examine and be aware of their companies' physical layout, personnel count, hiring procedures, and general security to assess their susceptibility to various types of crime, from theft to robbery.

Numerous empirical research in Malaysia on fraud demonstrated the detrimental effects of senior management's repeated deception and mistreatment of commercial organisations (Burns & Kedia, 2006; Chen, Wang, & Xing, 2020; Khanna, Kim, & Lu, 2015; Suh, Sweeney, Linke, & Wall, 2020). In Malaysia, as in most developing countries, SMEs are considered the top contributors to the economy. Based on PwC's (Global Economic Crime and Fraud Survey 2020), incident of fraud remains high compared to other South East Asian countries. 43% of organizations experience fraud incidence and this is due to inadequate application of anti-fraud measures compared to large organizations or the disregard for anti-fraud policies and procedures on the part of SMEs employees or the owner themselves.

Numerous empirical research on corporate fraud demonstrated the detrimental effects of senior management's repeated deception and mistreatment of commercial organisations. (Burns & Kedia, 2006; Chen, Wang, & Xing, 2020; Khanna, Kim, & Lu, 2015; Suh, Sweeney, Linke, & Wall, 2020). It is also a possibility that less effort is being made by practitioners and scholars to highlight the fraud problems in SMEs. Due to the resource imbalance that exists between large and small organizations, it is challenging to advise SMEs to completely implement fraud prevention measures that result from research that is primarily focused on large enterprises. Consequently, it is critical to conduct additional research, hence and this study is one of those efforts. It focuses mostly on fraud prevention mechanisms in SMEs.

### 2.3. Fraud Prevention Framework

Fraud prevention can be connected to actions taken to stop fraud and reduce fraud exposure. Yusuf et al., (2021) from The Institute of Internal Auditor's research explained that fraud prevention is an endeavour to lessen the likelihood that fraud will occur by lowering employee pressure to complete assignment needs, reducing opportunities to conduct fraud, removing justifications for fraud, and preventing all members of the organization from committing fraud.

Effective internal controls are essential no matter how small the company is for many valid reasons. Fraud prevention, embezzlement detection and accurate financials are all reasons to justify for good internal control practices. Results of research conducted by Mappanyuki et al., (2012) showed that there is a positive and significant effect of internal control implementation either partially or simultaneously on the prevention of procurement fraud. The theory of fraud, fraud awareness, and methodology is the systematic steps that can

be done to detect fraud in financial reporting (Suprajadi, 2009). Tuanakotta (2012) also stated that it is more than a concept of internal control in the prevention of fraud, in which it is to create awareness towards the fraud (fraud awareness).

It is essential to create a framework for preventing fraud in order to stop it from happening. There is a tonne of other frameworks that Deloitte, KPMG, and others have established. The goal of introducing a framework is to reduce the likelihood of fraud occurring. However, the number has not yet been decreased and is instead continuing to rise yearly. As a result, it is not particularly helpful in keeping these fraudulent actions to a minimum (Razif et al., 2017).

A study by Abdoulaye N'Guilla Sow (2018) with a statement from PwC (2003) revealed that the effectiveness of the deployed fraud prevention measures depends on the firm's fraud experience. In other words, a company without a history of fraud is more likely to adopt non-tangible preventive measures like a code of conduct and a fraud reporting procedure. In contrast, businesses that have been victimised by fraud rely on concrete procedures like employee education and training on fraud issues as well as a whistle blowing policy.

The Commercial Angles' Newsletter (2001) implemented a two-stage counter fraud process which includes fraud prevention and fraud deterrence. Organizations must first guarantee that there are few opportunities for fraud to occur, if not impossible. Second, organizations will take action during the period of fraud prevention to discourage prospective fraudsters from thinking they are being detected. The establishment and compliance of more successful regulations would eliminate incentives for fraudsters which would take only a limited volume of supervision in terms of time and resources.

According to Nawawi and Puteh Salin (2016), the majority of fraud falls victim to theft of cash and inventory, as well as misappropriation of assets, which can occur at both the lower-level and executive levels. The higher class is not the only one familiar with this deceit; the lower class has also participated. They have been unconcerned by this treatment since they believe they have improved themselves. The techniques identified as social weighting, transferring of blame, denying injury, attitude, and prior fraud history from the entire level of workers, whether from management and non-management staff studied by Zuberi and Mzenzi (2018) have been used by fraudsters to rationalize their fraudulent behaviour.

Adams et al., (2006, p. 56) said, "the most cost-effective way to deal with financial loss through fraud is prevention" but numerous studies have revealed that most businesses prioritise its deterrence over its prevention and prefer to handle its occurrences on an individual basis (Bishop, 2004; Omar & Abu Bakar, 2012; KPMG, 2013). Sule et al., (2019) discovered that a good ethical culture and an effective internal control system is a process of fraud prevention and detection that may lower the likelihood of fraud happening in organisations.

Internal control is essential for preventing fraud. A study by Abdoulaye N'Guilla Sow (2018) revealed from the investigation made by Moffett and Grant (2011), concluded that alt-

though internal control is crucial for fraud prevention, the ways in which top management interacts with this internal control will either improve it or undermine it. This study demonstrated that management must lead by example and "walk the talk" in order to effectively prevent fraud. Rahman et al. (2016) explained that certain corporate executives in charge of financial reporting lack the methods to create and apply efficient internal controls for recognising contractual revenues. Due to insufficient internal control procedures, there were more than 30 business scandals reported in the United States between 2010 and 2013 (Gray & Ehoff, 2015). This illustrates that internal control is the main contribution to fraud prevention.

According to Al Furqan and Tobing (2017), the organisation can reduce the risk of fraud by taking preventive measures. A study by Astriana and Adhariani (2019) stated that an anti-fraud strategy consists of four steps: awareness, prevention, detection, and a response that includes an investigation. Companies are exposed to risk either internal or external. There are numerous different preventative strategies, such as developing policies and procedures and monitoring all business activities. Fraud causes losses for organizations, and the easiest method to reduce losses is to stop fraud before it starts. According to Sow et al., (2018), businesses should take proactive actions to stop fraud from happening. The fraud will not take place in an environment that is more trustworthy and open.

This study is conducted with a purpose to evaluate the extent to which fraud prevention mechanisms are present in SMEs notably for employees. Previous studies had the drawback of overlooking the fraud difficulties in small firms. Additionally, this study offers small business managers and owners practical fraud protection strategies.

#### **2.4. Internal Control in SMEs**

According to Larry Rittenberg, a former COSO chairman, small and medium-sized businesses (SMEs) require a strong internal control (Tysiac, 2012). He also believed that successful businesses are those that have effective internal control (Tysiac, 2012). Contrarily, a lack of or a weak internal control was seen to be one of the main causes of fraud in SMEs (ACFE, 2012; Laufer, 2011; Wells, 2004). Thus, there is research showing that SMEs are more likely to provide an effective fraud prevention mechanism when they apply effective internal controls.

A strong internal control system can offer a reasonable level of assurance regarding the company's success, the efficacy and efficiency of operations, the accuracy of the financial report, and compliance with laws and regulations. The internal control system is an action that are frequently carried out by work units, both leaders and employees, in order to ensure the accuracy of financial reports, protect corporate assets, and ensure management compliance with company regulations (Ayem & Kusumasari, 2020). An organization or institution needs to have an internal control system which contributes to increase the effectiveness of preventing fraud. A mix of controls, including both internal and external controls, are used in the control system. External controls, for

instance, can help to prevent fraud by separating roles and authorizing transactions. Contrarily, putting in place a code of ethics and ethical principles can stop fraud (Taufik, 2019).

According to Danial and Nurhusnaida (2015), internal control is the integration of people's plans, actions, and activities within organizations to make sure that the organizations fulfil their goals and purposes. Jang and Lib (2010) stated in reality, SMEs must build up a reliable internal control to safeguard their assets and reduce risks. Internal control supports organizations in achieving their performance objectives. Internal controls that are strong and efficient assist with enhancing corporate governance and reducing risks for firms (Shanmugam et al., 2012). Effective internal controls give businesses a competitive edge or support business growth, according to IFAC (IFAC, 2012; Wang & Ding, 2019). On the basis of the characteristics of SMEs, a small number of internal control components for SMEs were taken into consideration. Control environment, control actions, and control monitoring were three crucial elements (Nyakundi et al., 2014).

All internal control elements were treated as independent variables in the regression of SME performance in a number of additional research (Adegboyegun et al., 2020; Kamau, 2016). Relationship of Internal Controls and Fraud prevention mechanism in Malaysia SME based on Kamau (2016), Internal control has proven to have a significant role in the operation of SME. Kamau (2016) also stated, internal control has therefore been a reliable and useful technique that has assisted in enhancing company governance, achieving goals, and reducing risks.

Internal control system factors had a considerable favourable impact, according to a study by Sulistiyanti et al., (2021). This indicates that the business has strong internal controls and will have strong fraud prevention measures in place. According to Danial and Nurhusnaida (2015) as well as Puryati and Febreani (2020), a control environment exists when the human resources department, policies, and procedures are effective, with each employee having clear understanding of the duties expected of them, and the audit committee is both effective and efficient. Control environments, according to Artemieva et al., (2020), are those in which the leader plays a significant role as a leader, possesses strong leadership abilities, and interacts with employees in a sincere and morally upright manner.

#### **2.5. Theoretical Framework**

The correlation between the independent and dependent variables is depicted in Figure 2.3. Fraud prevention is the dependent variable in this study, whereas the five internal control components (control environment, monitoring, information and communication, internal audit, and risk assessment) are the independent variables. The fraud diamond theory served as the basis for this study, which identifies the concerns or problems that a company could face. Some firm personnel are not aware of how important internal control is to combat fraud. To prevent fraud, it is necessary to comprehend the underlying causes of the problems and improve internal control.

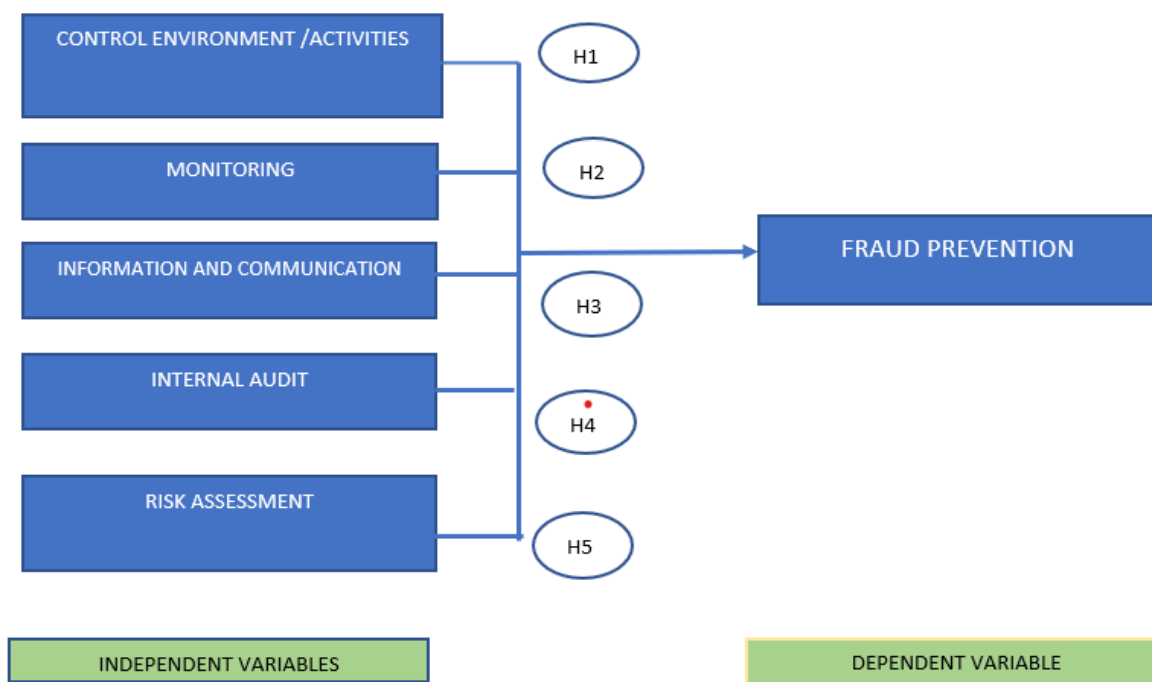


Fig. (1). Conceptual Framework.

2.6. Hypothesis Development

Internal control system efficiency can also result in effective business operations. This implies that it can reduce the likelihood of fraud. Taufik strengthened this research (2019) by stating that variables in internal control systems have a favourable effect on preventing fraud. Internal control system factors had a considerable favourable impact, according to a study by Sulistiyanti et al., (2021). This indicates that the business has strong internal controls and will have strong fraud prevention measures in place. Employee fraud may be possible due to the company's internal control system's weaknesses. Understanding that an effective internal control system will reduce the likelihood that employees will commit fraud is crucial. The greater a company's internal control a company applies, the higher the fraud prevention will be.

Positive association exists among all of the internal control's components, according to the literature review for each part. Each component is crucial in preventing fraud from happening. Each component has a responsibility to keep fraud from happening. If and only if the SMEs organizations are able to build up the internal control elements and work with them, it does help the SMEs organizations avoid becoming involved in any fraud. Hence, this study has developed several hypotheses to examine the relationship of each element with fraud prevention.

H1: Control activities /environment positively influence fraud prevention mechanisms in Malaysia SMEs

This component is the foundation for all other components of internal control. It establishes the tone at the top of an organization and offers structure and discipline.

These control activities focus on ethical values and integrity, human resource policies and procedures, organization struc-

ture, leadership and operating style, responsibility, and duty separation. In order to achieve the company's aims and objectives, it is crucial to ensure that everyone is on the same page because environmental control is a crucial administrative foundation. Controls activities play an essential role in preventing employees and others from committing fraud. Conversely, a lack of controls activities can weaken the integrity of accounting and financial reporting, an ineffectiveness operational system which may lead to increase cost and a surge in fraud and other criminal activity. In the end, these problems have an impact on the business's status in the market and reputation. According to Anh et al., (2020), control environment has a positive impact on fraud prevention. Therefore, it is hypothesized that control activities / environment positively influence fraud prevention mechanism in Malaysia SMEs.

H2: Monitoring positively influences fraud prevention mechanism in Malaysia SMEs

The findings from a research by Ibrahim Hussaini (2022) showed that ongoing monitoring, fraud identification, reporting deficiencies, separate evaluation and periodic assessment are the effects of monitoring on fraud detection on deposit money banks in Nigeria. This conclusion is supported from a research conducted by a Ebimobowei (2011), that looked at the role of internal control services in fraud detection. Ayagre et al., (2014) revealed that monitoring and control components offer reliable internal control.

Fraud monitoring is the core of a modern fraud prevention strategy. Monitoring behaviours and activities can help to prevent and detect fraud by continuously analyzing all of the actions throughout an entire operation. Fraud monitoring can address both ongoing and emerging problems since it considers the entire picture to detect if anything seems odd.

Monitoring cannot only prevent fraud, but it is also beneficial to detect fraud, flag suspicious behaviour, recognizes a threat and stops the threat in real time. According to Joseph et al., (2015), monitoring has a good impact on fraud prevention since it aids in detecting fraud before it occurs. Hence, it is hypothesized that monitoring positively influences fraud prevention mechanism in Malaysia SME.

H3: information and communication positively influence fraud prevention mechanism in Malaysia SMEs

The organization needs information to fulfil its internal control obligations and supports the accomplishment of its goals. To support the operation of internal control, management acquires, creates, and uses pertinent information from both internal and external sources. Information needs to be provided, shared, and acquired continuously and interactively through communication. Internal communication is the process by which information spreads up, down, and throughout the entire organization. It helps senior management to convey to staff that control responsibilities must be taken seriously.

Inbound communication of pertinent external information is made possible through external communication, which also serves to offer information to external parties in response to requests and expectations. If done effectively and in a timely manner, information and proper communication would aid employees to understand their work (Anh et al., 2020). According to Joseph et al. (2015), internal control is influenced by information and communication in the prevention of fraud. Hence, it is hypothesized that information and communication positively influence fraud prevention mechanism in Malaysia SME.

H4: There is a significant positive relationship between internal audit and fraud prevention mechanisms in Malaysia SMEs

According to Biksa and Wiratmaja (2016), Windasari and Juliarsa (2016), Irawan et al., (2019), as well as Andriyanti and Latrini (2019) internal audit has a positive and significant influence on preventing fraud. This means that the more independent the auditor is, the easier and more likely it will be for them to prevent fraud. The auditor also needs to have an independent mindset in order to be free from the pressures and interests of any party in order to adequately identify and prevent fraud in the firm.

The effectiveness of having a separate audit committee and risk committee is examined by Abdullah and Said (2019), who also looked into the relationship between the audit committee and corporate financial fraud. The findings demonstrated that separating these two committees or having them operate independently will have a major impact on financial fraud. Internal audit is responsible for independently confirming the efficiency of an organization's risk management, governance, and internal control systems. Organizations use internal auditors to support their management teams. By spotting issues and fixing mistakes before they are found in an external audit, these audits also give management the resources they need to achieve operational efficiency. Internal auditors are able to obtain information rapidly since they are an independent department that works directly

within the organizations. According to prior studies, internal audit has a positive effect on an organization's credibility, hence it is hypothesized that internal audit positively affects fraud prevention mechanism in Malaysia SME.

H5: There is a significant positive relationship between risk assessments and fraud prevention mechanisms in Malaysia SMEs

A risk assessment can assist organizations to determine which crucial processes are most likely to make mistakes and pose substantial hazards to the business both, numerically and qualitatively. It can assist an organization to determine the potential repercussions such errors might have on the organization and help to concentrate on those that are most crucial to the operations and business plan.

Risk assessment could have a positive impact on an organization's internal control if it is established and used properly (Anh et al., 2020). It is claimed that enterprise risk management can successfully deter and detect financial fraud (Ayagre et al., 2014; Rahman & Al-Dhaimesh, 2018). According to a different study, firms can use enterprise risk management as a strategy to fight fraud in the purchase of goods and services (Venter, 2007). Risk assessment is hypothesized to have a positive relationship towards fraud prevention mechanisms in Malaysian SMEs. Mohd-Sanusi et al., (2015) looked at a number of changes to corporate governance components to lessen fraud in Malaysian banking organisations. The results of the study showed that risk management significantly affects the likelihood of fraud.

## 2.6. Population and Sample Size

The population for this study consisted of all employees working for SMEs in Malaysia, regardless of the sector or industry. As at 2022, according to SME Corp statistics, there are about 1.15 million SMEs registered in Malaysia. People who used to work but are not currently employed as well as those who still want to start working would be excluded from the respondent group. This is so because the study assesses the effectiveness of internal controls in relation to existing workplace anti-fraud awareness. As a result, giving a response based on prior performance or predicted outcomes would be unacceptable.

For this study, Roscoe's (1975) suggested general guidelines for calculating sample size used. For the majority of studies, sample size more than 30 and lower than 500 are suitable. In addition, Roscoe suggested that if the data set needs to be divided into different subgroups for comparison analysis (male/female, rural/urban, local/international), 30 respondents should be taken into account as the bare minimum for each group. The Central Limit Theorem serves as the foundation for the rule of 30's reasoning (CLT). The CLT presupposes that as sample size grows, the distribution of sample means moves closer to (or tends to move closer to) a normal distribution. For this study, 200 questionnaires distributed and 182 respondents from manufacturing industries, retailer, service provider, financial institution, construction, transportation, as well as food beverage sectors have answered the survey.

### 3. FINDINGS

#### 3.1. Demographic Profile Analysis

##### Gender

The gender data for the respondents is shown in Table 2. According to the results, there were 182 respondents, 98 responses were from women (53.8%), and 84 responses were from men (46.2%). Such a result suggests that the gender percentage gap is almost equal.

**Table 1. Demographic Profile on Gender.**

	Frequency	Percentage (%)	Valid Percent	Cumulative Percent (%)
Female	98	53.8	53.8	53.8
Male	84	46.2	46.2	100.0
Total	182	100.0	100.0	

##### Age

The bulk of respondents (39%) fall within the age bracket of 18 to 29 years old, followed by those between 30 to 40 years old (33%) and those between 41 to 50 years old (20.9%). Only a small percentage of respondents (7.1%) are above 51.

**Table 2. Demographic Profile by Age.**

	Frequency	Percentage (%)	Valid Percent	Cumulative Percent (%)
18 to 29 years	71	39.0	39.0	39.0
30 to 40 years	60	33.0	33.0	72.0
41 to 50 years	38	20.9	20.9	92.9
above 51 years	13	7.1	7.1	100.0
Total	182	100.0	100.0	

##### Working Experience

The working experience of the respondents at their current places of employment are described in Table 4. The findings indicate that 54 of the 182 respondents (29.7%) have between one to five years of working experience. Following this are 23 respondents (12.6%) with 6 to 10 years of similar working experience and 35 respondents (19.2%) with less than a year of working experience. The final 70 respondents (38.5%) have more than 10 years of experience working in an SME organisation.

**Table 3. Demographic Profile by Working Experience.**

	Frequency	Percentage (%)	Valid Percent	Cumulative Percent (%)
Less than 1 year	35	19.2	19.2	19.2
1 to 5 years	54	29.7	29.7	48.9

6 to 10 years	23	12.6	12.6	61.5
More than 10 years	70	38.5	38.5	100.0
Total	182	100.0	100.0	

#### 3.2. Business Sector

The respondents' business sectors are described statistically in Table 6. According to the results, only 1 respondent works in the agricultural business sector. The highest percentage of respondents (71 respondents with 39.2%) are from manufacturing sectors. The service sector and financial institution sector respectively represent 14.8% (27) and 14.3% (26) of total respondents. Other business sectors which have less than 10 respondents represent 12% of the respondents. The food and beverage sector also had quite a comparative percentage (6.6%) of the total respondents who participated in this survey. 12.6% (23 respondents) are from other business sectors and could be assumed as not listed in the survey. This shows that the survey has been answered by various categories of business sectors which may result in a positive implication in the findings and analysis.

**Table 5. Demographic Profile by Business Sector.**

	Frequency	Percentage (%)	Valid Percent	Cumulative Percent (%)
Agriculture	1	0.5	0.5	0.5
Construction	7	3.8	3.8	4.3
Financial Institution	26	14.3	14.3	18.6
Food & Beverage	12	6.6	6.6	25.2
Manufacturer	71	39.2	39.2	64.4
Retailer	9	4.9	4.9	69.3
Service Sector	27	14.8	14.8	84.1
Transportation	6	3.3	3.3	87.4
Others	23	12.6	12.6	100
Total	182	100	100	

#### 3.3. Numbers of Employees

Table 6 presents the description of the numbers of employees at the respondents' current workplaces.

71 respondents (39%) worked with more than 200 employees and this can be assumed that they are working in the manufacturing business sector. 39 respondents (21.4%) worked in environments with 76 to 200 employees. 33 respondents (18.1%) worked with less than 75 employees and 39 respondents (21.4%) worked with less than 30 employees. This schedule shows that 100% of respondents were categorised as working in SME organizations, hence it creates a positive implication on the findings and analysis.

#### 3.4. Occupations

Table 7 presents the description of the respondents' occupations. 72 respondents (39.6%) hold a post of assistant, 34

**Table 6. Demographic Profile on Numbers of Employees.**

	Frequency	Percentage (%)	Valid Percent	Cumulative Percent (%)
less than 5 employees	12	6.6	6.6	6.6
from 6 to 30 employees	27	14.8	14.8	21.4
from 31 to 75 employees	33	18.1	18.1	39.6
from 76 to 200 employees	39	21.4	21.4	60.9
more than 200 and less than 250 employees	71	39	39	100
Total	182	100	100	

respondents (18.7%) work as executives and 65 (35.7%) respondents work on a managerial level. 11 out of 182 respondents chose other and this can be assumed that they are categorised as consultants or trainees.

**Table 7. Demographic Profile on Occupations.**

	Frequency	Percentage (%)	Valid Percent	Cumulative Percent (%)
Assistant	72	39.6	39.6	39.6
Executive	34	18.7	18.7	58.3
Manager	65	35.7	35.7	94
Others	11	6	6	100
Total	182	100	100	

**Table 8. Demographic Profile on Departments.**

	Frequency	Percentage (%)	Valid Percent	Cumulative Percent (%)
Account and Finance	21	11.5	11.5	11.5
Admin and Human Resources	46	25.3	25.3	36.8
Operation	28	15.4	15.4	52.2
Procurement	39	21.5	21.5	73.7
Production	9	4.9	4.9	78.6
Sales	25	13.7	13.7	92.3
Warehouse	10	5.5	5.5	97.8
Others	4	2.2	2.2	100
Total	182	100	100	

**Table 9. Mean and Std. Deviation of Perception Scores on Fraud Prevention.**

Statement	Mean	Std. deviation
Fraud is an issue for an organization	4.3	0.656
Your organization has to conduct training on fraud prevention awareness	4.28	0.919
Your organizations must practice any techniques to prevent fraud	4.17	0.833
Fraud prevention may avoid or stop fraud from occurs	3.98	0.75
You seldom heard about fraud prevention in your organizations	3.93	0.914

### 3.5. Department

Table 4 presents the departments of the respondents in their workplace. Human Resource and Administration represent the highest department with 46 respondents (25.3%). 39 respondents from procurement department represent 21.5% take part on this survey, whilst 21 (11.5%) respondents from finance and account department take part in this survey. Sales and operation department each represent 25 (13.7%) and 28 (15.4%) respondents. Total number of respondent below then 10 are from production, warehouse and others.

### 3.6. Fraud Prevention

Based on the perception scores on fraud prevention, it can be deduced that overall, the respondents agree on fraud prevention (mean 4.09). Based on the individual statements, the res-



Your organization or department has tendency to involve with fraud	3.91	1.164
Overall	4.09	0.353

**Table 10. Mean and Std. Deviation of Perception Scores on Control Activities.**

Statement	Mean	Std. deviation
A good management will consistently give full commitment to integrity and ethical behavior and effectively communicated to all staffs	4.38	0.810
Organizations must establish a code of conduct and/or ethics policy and need to communicate to all staff, board members, and outsourced service providers	4.32	0.834
A good management leadership in an organization may prevent fraud from happen	4.21	0.873
A set of policies and procedures provide the basis of implementing internal control in the organization	4.13	0.746
An organization chart must be frequently updated and presented to staffs to ensure on their key roles	4.11	0.847
One staff in the organization who are responsible for multitasking will more expose to do fraud compared to organizations which practice segregation of duties among staffs	3.72	0.965
Overall	4.15	0.660

**Table 11. Mean and Standard Deviation of Perception Scores on Monitoring.**

Statement	Mean	Std. deviation
Dos and Don'ts must be clearly explained and communicate among the staff in the organizations	4.29	0.798
Frequent monitoring is required in order to determine the consistency of internal control	4.20	0.790
The management or internal audit team must regularly review and access if all department follow SOP made by the organizations	4.20	0.913
Any deficiencies or issues in organizations must be reported to higher level management	4.18	0.842
Overall	4.21	0.756

pondents agree that fraud is an issue for an organization (mean 4.30), they agree that the organization has to conduct training on fraud prevention awareness (mean 4.28) and they agree that the organization must practice any technique to prevent fraud (mean 4.17). The respondents also agree that fraud prevention may avoid or stop fraud from occurring (mean 3.98), they agree that they seldom hear about fraud prevention in their organization (mean 3.93) and they also agree that their organization or department has a tendency to be involved in fraud (mean 3.91).

### 3.7. Control Activities

Based on the above table, it can be concluded that overall, the respondents agree with the control activities concerning fraud prevention (mean 4.15). Based on the individual statements, the respondents agree with the statement that good management will consistently give full commitment to integrity and ethical behaviour and effectively communicate to all staff (mean 4.38). They agree that the organization must establish a code of conduct and/or ethics policy and needs to communicate to all staff, board members and outsourced service providers (mean 4.32). They also agree that good management leadership in an organization may prevent fraud from happening (mean 4.21). In addition, the respondents

also agree that a set of policies and procedures will provide the basis of implementing internal control in the organization (mean 4.17). They agree that an organizational chart must be updated frequently and be presented to staff to ensure their key roles (mean 4.11) and finally, they agree that a staff member in the organization who is responsible for multitasking will be more exposed to commit fraud as compared to an organization which practices a segregation of duties among staff (mean 3.72).

### 3.8. Monitoring

Based on the perception scores, it can be seen that overall, the respondents agree to the monitoring of fraud prevention (mean 4.21). As per individual statements, the respondents agree to all the statements. They agree that the dos and don'ts must be clearly explained and be communicated to the staff in the organization (mean 4.29). Also, they agree that frequent monitoring is required in order to determine the consistency of internal controls (mean 4.20) and the management or the internal audit team must regularly review and access all departments and follow SOPs made by the organization (mean 4.20). Lastly, they also agree that any deficiencies or issues in the organization must be reported to higher-level management (mean 4.18).

**Table 12. Mean and Standard Deviation of Perception Scores on Information and Communication.**

Statement	Mean	Std. deviation
The information made must precise and clear to related parties to support operational achievement, reporting and compliance	4.31	.784
Information received should be relevant, timely and accurate to prevent any misunderstood	4.29	.799
Whistle blowing or encourage employees to report, with relevant proof, any suspected fraud case will help to minimize fraud incident	4.17	.909
It is compulsory for an organization to implement and monitor appropriate preventive and detective internal controls	4.1	.831
Overall	4.2198	.75054

**Table 13. Mean and Standard Deviation of Perception Scores on Internal Audit.**

Statement	Mean	Std. deviation
Having regularly a third party like external auditor, certified fraud examiners to verify an entity transactions and accounts is one way to prevent fraud	4.08	0.847
Organizations have to appoint a specific person or a department to manage fraud prevention and detection	3.84	0.953
Regular review and verify the company's transactions and reporting by internal auditors are important	4.21	0.775
Internal audit department is essential to helps detect the effectiveness of internal controls in the organizations	4.18	0.769
One of internal audit function is to conduct employees background checking before recruitment	3.77	0.868
Overall	4.02	0.709

**Table 14. Mean and Standard Deviation of Perception Scores on Risk Assessment.**

Statement	Mean	Std. deviation
An organization must perform a risk assessment of its operations related to fraudulent activity and how the operations could be impacted  with the existence risk	4.16	0.752
Regularly Identify and measure the fraud risk or perform fraud risk assessments will help to minimize fraud incident	4.14	0.820
An organization must adequately and effectively manage risks and plan to design internal controls that mitigate the identified risks	4.07	0.713
Evaluation of risk is importance to find the root cause and to decide on control measures	4.03	0.750
Make changes to the firms' activities and processes to reduce or to eliminate the fraud risk or enforce regulation	3.92	0.817
Overall	4.06	0.685

### 3.9. Information and Communication

Based on the above table, it can be summarized that the respondents agree concerning the information and communication about fraud prevention (mean 4.2198). The respondents also agree with all the individual statements. They agree that the information must be precise and made clear to related parties to support operational achievement, reporting and compliance (mean 4.31). They agree that the information received should be relevant, timely and accurate to prevent any misunderstanding (mean 4.29). Whistle blowing or encouraging employees to report with the relevant proof any suspected fraud case, will help to minimize fraud incidents (mean 4.17). Lastly, they agree that it is compulsory for an

organisation to implement and monitor appropriate preventive and detective internal controls (mean 4.10).

### 3.10. Internal Audit

Based on the perception scores on internal audit, overall, the respondents agree with the internal audit concerning fraud prevention (mean 4.02). With regard to the individual statements, they agree that having a regular third-party, like external auditors or certified fraud examiners to verify existing transactions and accounts, is one way to prevent fraud (mean 4.08). They also agree that the organization will have to appoint a specific person or a department to manage fraud prevention and detection (mean 3.84). They agree that a regular

review to verify the company's transactions and reporting by the internal auditors is important (mean 4.21) and that the internal audit department is essential to help detect the effectiveness of internal controls in the organization (mean 4.18). Lastly, they agree that one of the internal audit functions is to conduct employee background checks before recruitment (mean 3.77)

**3.11. Risk Assessment**

From the above table, it can be deduced that overall, the respondents agree with risk assessment for fraud prevention (mean 4.06). As per the individual statements, they agree that an organization must perform a risk assessment of its operations related to fraudulent activity and how the operations could be impacted by the existing risk (mean 4.16). They agree that regularly identifying and measuring fraud risk or performing fraud risk assessments will help to minimize fraud incidences (mean 4.14). In addition, the respondents agree that an organization must adequately and effectively manage risks and plan to design internal controls that mitigate the identified risks (mean 4.07) and they agree that the evaluation of risk is important to find the root cause and to decide on control measures (mean 4.03). Finally, they also agree to make changes to the firm's activities and processes to reduce or to eliminate the fraud risk or enforce regulations (mean 3.92).

**3.12. Correlation Analysis**

**3.12.1. Relationship between Internal Controls and Fraud Prevention**

**Table 15. Summary Statistics of Correlation Analysis between Fraud Prevention and Internal Controls.**

Variable	Fraud Prevention	
	Pearson Coefficient of Correlation ( r )	p-value
Control activities	0.116	0.119
Monitoring	0.133	0.075
Information and communication	0.685	0.012*
Internal audit	0.571	0.021*
Risk assessment	0.559	0.032*

\* Significant at 0.05.

**3.12.2. Relationship between Control Activities /Environment and Fraud Prevention**

Table 17 shows that there is weak correlation between control activities and fraud prevention (p>0.05). P-values for first variable (control activities), 0.119 is greater than 0.05 but the r values (0.116) indicate positive relationship. This can be concluded that control activities are still in positive relationship with fraud prevention.

H1: Control activities /environment positively influence fraud prevention mechanisms in Malaysian SMEs

**3.12.3. Relationship between Monitoring and Fraud Prevention**

The result shows there is weak correlation between monitoring and fraud prevention (p>0.05). P-values for second variable (monitoring), 0.075 is greater than 0.05. However, the correlation coefficient r values (0.113) of dependent variables indicate positive relationship. This can be concluded that monitoring has positive relationship with fraud prevention.

H2: Monitoring positively influence fraud prevention mechanisms in Malaysia SMEs

**3.12.4. Relationship between information and communication and Fraud Prevention**

Results in table 6 show that third variable of internal controls, information and communication (r = 0.685; p: 0.012<0.05), are moderately correlated with fraud prevention. That is, to a positive extent, that increases in fraud prevention are associated with an increase in information and communication. The hypothesis will be:

H3: Information and communication positively influence fraud prevention mechanism in Malaysia SMEs

**3.12.5. Relationship between internal audit and Fraud Prevention**

Internal Audit, the fourth variable of internal controls with p values 0.021<0.05 (r = 0.571;) is moderately correlated with fraud prevention. That is, to a moderate extent, that increases in fraud prevention are associated with an increase in internal audits. Hence, the hypothesis read as follows:

H3: Internal audit positively influence fraud prevention mechanism in Malaysia SMEs

**3.12.6. Relationship between Risk Assessment and Fraud Prevention**

Risk assessment, the fifth variable in internal controls (r = 0.559; p:0.032<0.05) has positively correlated with fraud prevention. In other words, rising levels of risk assessment are positively correlated with rising levels of fraud prevention. As a result, the hypothesis is read as below:

H3: Risk assessment positively influence fraud prevention mechanism in Malaysian SMEs

**3.13. Multiple Regression Analysis**

A regression equation was estimated with fraud prevention as the dependent variable, and control activities, monitoring, information and communication, internal audit and risk assessment as the independent variables. Table 20 presents the summarised statistics of the estimated regression equation.

**Table 16. Estimated Regression Equation.**

Variable	Coefficient	t-value	p-value
Control activities	0.211	1.512	0.132
Monitoring	0.147	1.078	0.282
Information and communication	0.296	2.146	0.028*

Internal audit	0.131	1.701	0.033*
Risk assessment	0.026	1.488	0.042*
F	2.22		0.044*
R <sup>2</sup>	0.593		

\*Significant at 0.05.

The regression equation is statistically significant at 0.05 ( $p < 0.05$ ), implying that there is an association between fraud prevention and any or all of the independent variables. The r-square value being 0.593 means that the five independent variables as a whole account for 59 per cent of the variation in the dependent variable (fraud prevention). Hence, the effect of control activities, monitoring, information and communication, internal audit and risk assessment as a whole on fraud prevention is moderate.

Looking at the individual regression coefficient, one finds that only the coefficient of information and communication, internal audit and risk assessment are statistically significant at 0.05 ( $p < 0.05$ ), whereas control activities and monitoring are not. The coefficient of information and communication (0.296), internal audit (0.131) and risk assessment (0.026) means that an increase in information and communication, internal audit and risk assessment increases the fraud prevention, whilst changes in control activities and monitoring have no impact on fraud prevention.

## CONCLUSION AND RECOMMENDATION

The purpose of this study was to ascertain how internal controls in Malaysian SMEs affected the prevention of fraud. The internal control factors examined in this study included control environment, monitoring, information and communication, internal audit, and risk assessment. Hypotheses for the variables were also established. 182 respondents were involved in the survey and the Demographic Profile Analysis of gender shows 98 of the respondents were women (53.8%) and 84 were men (46.2%). Such a result suggests that the gender percentage gap is almost equal. 70 respondents (38.5%) have more than 10 years of experience working in an SME organization. 81.3% of respondents hold a certificate, diploma or degree while 4.9% graduated with a Master or PhD. These results indicate that respondents tend to have more knowledge about internal controls and fraud prevention. The correlation analysis result implies that H1 (control activities / environment) and H2 (monitoring) with p values greater than 0.05 have not given a significant correlation toward fraud prevention. The insignificant correlation does not mean that control activities/environment and monitoring have less importance to be executed in organisation, without proper control and monitoring.

Correlation analysis results for H3 (information and communication) and H4 (internal audit) each represents a p-value less than 0.05 contributed to moderate significance towards fraud prevention, while H5 (risk assessment) has a good positive correlation towards fraud prevention. The need to analyse risks that could put a company at risk, whether they are local or global, is emphasized by risk assessment. The successful outcomes demonstrated that respondents from SME companies are aware of the significance of disclosing any

risks that arise during ongoing operations in order to prevent failure in the future.

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