

The Effect of Internal Auditing on Fraud Prevention in State-Owned Enterprises

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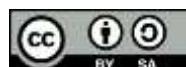
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ABSTRACT

This study investigates the impact of internal audits on fraud prevention in Indonesian state-owned enterprises (SOEs). Using a quantitative approach, data were collected from 105 respondents consisting of internal auditors, finance officers, and managers across various SOEs. A structured questionnaire employing a five-point Likert scale was used to measure the dimensions of internal audit (independence, competence, audit quality, and management support) and fraud prevention (control effectiveness, ethical culture, and monitoring mechanisms). Statistical analysis was conducted using SPSS version 25 through descriptive statistics, classical assumption tests, and simple linear regression. The results revealed that internal audits have a significant positive effect on fraud prevention, with a determination coefficient (R^2) of 0.541, indicating that internal audit explains 54.1% of the variance in fraud prevention. The findings confirm that auditor competence, audit independence, and management support play a critical role in strengthening fraud prevention systems. This study supports the Agency Theory and Fraud Triangle Theory, emphasizing internal audit as an essential governance mechanism to mitigate fraud risk and enhance accountability in SOEs. The results provide theoretical and practical insights for policymakers and management to strengthen audit practices and ethical frameworks in public sector governance.

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1. INTRODUCTION

Fraud remains a persistent challenge in state-owned enterprises (SOEs), where misappropriation, financial manipulation, and procurement irregularities undermine public trust and institutional integrity. High-profile cases in Indonesia highlight the need for effective internal audit mechanisms to ensure transparency, accountability, and sound governance. Internal audits play a strategic role in fraud prevention by

identifying vulnerabilities and recommending corrective actions [1]. They also strengthen internal controls, maintaining the integrity of financial reports [2]. Whistleblowing systems, though established, need improvements to enhance their effectiveness in fraud prevention [1]. Forensic audits, particularly in government procurement, are key to detecting and preventing fraud [3]. The integration of big data analytics with forensic audits further enhances fraud detection by analyzing large

datasets for suspicious patterns [2]. Moreover, implementing good corporate governance (GCG) principles, supported by audits and internal controls, is essential for improving SOE transparency and compliance [4].

State-Owned Enterprises (SOEs) occupy a pivotal role in Indonesia's national economy, contributing significantly to employment, infrastructure development, and fiscal revenues. However, their large operational scale, complex bureaucratic structures, and public accountability make them particularly vulnerable to fraud risks. As mandated by Government Regulation No. 60 of 2008 concerning the Government Internal Control System (SPIP), internal audit functions within SOEs are expected to provide independent and objective assurance on the effectiveness of risk management, control, and governance processes. The proper functioning of these audits ensures that management actions and operations align with organizational objectives, legal frameworks, and ethical standards, thus preventing fraudulent activities and enhancing financial reporting quality. Internal audits serve as an independent oversight mechanism, ensuring operational integrity and regulatory compliance within SOEs [5]. They are crucial in identifying areas vulnerable to fraud and providing corrective recommendations, as demonstrated in PT Pos Indonesia [1]. The effectiveness of internal audits is linked to the professionalism and training of auditors, which are often suboptimal (Novatiani et al., 2022). The implementation of Good Corporate Governance (GCG) principles is vital for improving transparency, accountability, and compliance within SOEs [4]. Internal audits, along with management audits and internal control systems, significantly support GCG practices [4]. These elements interact to create a robust control environment, enhancing transparency and accountability in SOE management [5]. A formal whistleblowing system is established in some SOEs, but its effectiveness requires improvement through better protection for whistleblowers [1]. Organizational culture, grounded in values

like AKHLAK, enhances employee integrity and discourages fraudulent behavior [1]

Despite the existence of regulations and oversight mechanisms, cases of fraud continue to emerge, raising concerns about the effectiveness of internal audits in mitigating such occurrences. Previous studies have emphasized that the success of internal audits in detecting and preventing fraud depends largely on auditor competence, audit independence, organizational support, and the quality of audit recommendations. However, many SOEs still struggle to translate internal audit findings into concrete corrective actions due to limitations in resources, management commitment, and enforcement mechanisms. This condition underscores the importance of empirical research examining how internal audits influence fraud prevention within the context of Indonesian SOEs. Studies have shown that internal audits positively affect fraud prevention by identifying vulnerabilities and recommending corrective actions. For instance, research at Bank BRI Unit Selaawi Garut and PT Asuransi Jasa Indonesia demonstrated that internal audits significantly contribute to fraud prevention efforts [6], [7]. In the public sector, internal audits, along with internal controls, have been found to significantly reduce fraud, as evidenced by research conducted at the Inspectorate of North Sumatra Province [8].

Despite their potential, internal audits face challenges such as limited resources, lack of management commitment, and inadequate enforcement mechanisms, which hinder the translation of audit findings into concrete actions [1]. The effectiveness of internal audits is also contingent on the quality and independence of the audit process. Higher audit quality and auditor independence enhance the effectiveness of fraud prevention measures [9]. In addition to internal audits, mechanisms like whistleblowing systems and strong organizational culture are essential. For example, PT Pos Indonesia has implemented these systems to complement internal audits, although improvements in whistleblower protection are needed [1]. The internal audit

process plays a dual role—preventive and detective. On the preventive side, internal audits identify potential areas of risk, evaluate the adequacy of internal control systems, and provide early warnings before irregularities occur. On the detective side, audits uncover existing anomalies through systematic examination of financial records, operational data, and compliance adherence. The presence of a robust internal audit framework signals to employees and stakeholders that unethical behavior will be promptly identified and sanctioned, thereby creating a deterrent effect against fraudulent activities.

Fraud prevention is not solely dependent on the presence of internal audit departments but also on the effectiveness of their operations. Attributes such as auditor independence, professional competence, audit quality, and management response significantly determine the success of internal audits in fraud mitigation. Moreover, as SOEs are subject to both market pressures and government oversight, maintaining a balance between efficiency and accountability is crucial. Effective internal audits can bridge this gap by ensuring that financial integrity and operational performance reinforce one another. In the context of Indonesia's reform toward good corporate governance, enhancing the internal audit function is integral to fostering institutional resilience and public confidence. This study, therefore, seeks to empirically assess the impact of internal audits on fraud prevention in Indonesian state-owned enterprises. By employing a quantitative approach with samples analyzed through SPSS version 25, this research aims to measure the extent to which internal audit practices contribute to minimizing the risk of fraud and improving governance quality.

The findings of this study are expected to contribute to the literature on fraud prevention and internal auditing by providing empirical evidence from the public enterprise sector, which remains underexplored compared to private corporations. Practically, the results will assist policymakers, audit committees, and

management teams in designing more effective audit systems that strengthen the governance framework within SOEs. Theoretically, this study aligns with the principles of Agency Theory, which posits that effective monitoring mechanisms—such as internal audits—can mitigate agency problems by aligning the interests of managers (agents) and owners (principals).

2. LITERATURE REVIEW

2.1 Theoretical Foundation

Firm Agency theory provides a framework for understanding the dynamics between principals (such as stakeholders or the government) and agents (such as management) in state-owned enterprises (SOEs). This theory highlights the potential for conflicts of interest, as agents may pursue personal goals that diverge from those of the principals, leading to agency costs. In the context of SOEs, weak monitoring mechanisms can tempt management to engage in opportunistic behaviors, such as fraud or misuse of resources. The internal audit function is crucial in mitigating these risks by reducing information asymmetry and aligning management actions with organizational goals. This aligns with the Fraud Triangle Theory, which identifies opportunity as a key element in fraudulent activities, and internal audits help minimize this by establishing robust control systems. Agency theory posits that agents are self-interested and may act contrary to the principals' goals, necessitating monitoring systems to curb opportunistic behavior [10], [11]. Internal audits serve as a monitoring tool to reduce information asymmetry and ensure management actions align with organizational objectives [12]. The Fraud Triangle Theory identifies pressure, opportunity, and rationalization as elements leading to fraud [13]. Internal audits reduce the "opportunity" for fraud by implementing strong internal controls and promoting transparency [13]. Good

corporate governance, characterized by transparency, accountability, and fairness, is essential in reducing agency conflicts in public sectors [14]. Effective governance structures align with agency theory principles to ensure ethical compliance and control mechanisms [14].

2.2 Internal Audit

The effectiveness of internal audits in State-Owned Enterprises (SOEs) is influenced by several critical factors, as highlighted by various studies. These factors include audit independence, auditor competence, management support, and the integration of information technology. Each of these elements plays a vital role in ensuring that internal audits can effectively evaluate and improve risk management, control, and governance processes within organizations. Independence is crucial for auditors to perform their duties objectively, free from management interference, allowing for unbiased evaluations and recommendations [15], [16]. Internal audits must have unrestricted access to all company data to conduct thorough examinations [15]. The professional proficiency of auditors is essential for identifying, analyzing, and responding to fraud risks effectively, with competent auditors providing valuable insights and suggestions for improvement, enhancing the organization's value [15]. Management support is vital for the successful implementation of audit recommendations, ensuring that audit findings are transformed into corrective actions [15], [16]. The level of management cooperation significantly influences the effectiveness of internal audits, as it facilitates the adoption of recommended changes [15]. The use of information technology in internal audits can enhance the quality and efficiency of the audit process, allowing for more comprehensive data analysis and

improving the overall effectiveness of internal audits [16].

2.3 Fraud and Fraud Prevention

Fraud prevention in State-Owned Enterprises (SOEs) is a critical concern due to the significant financial losses and reputational damage it can cause. Effective fraud prevention mechanisms are essential to mitigate these risks, involving a combination of internal audits, robust internal controls, and fostering an ethical organizational culture. Internal audits play a pivotal role in fraud prevention by evaluating internal control systems, monitoring compliance, and identifying potential vulnerabilities. This proactive approach not only detects irregularities but also acts as a deterrent by signaling vigilant monitoring within the organization [17], [18]. Internal audits are crucial in assessing the effectiveness of internal controls and ensuring compliance with established policies and procedures [17]. They help in early detection of anomalies and contribute to the development of whistleblowing systems and anti-fraud education [17]. The presence of internal audits can deter potential fraudsters by creating an environment of accountability and transparency [17]. Effective internal control mechanisms, such as segregation of duties, authorization processes, and access controls, are vital in minimizing fraud risks [18]. Detective controls, including reconciliation processes and internal audits, are essential for identifying and exposing fraudulent activities [18]. Continuous monitoring and employee training are recommended to enhance the effectiveness of internal controls [18]. Challenges such as managerial pressure and resource limitations can hinder the effectiveness of fraud prevention efforts [17]. Organizations are encouraged to allocate adequate resources and support to internal audit functions to strengthen fraud prevention systems [17]. Embracing

technology-driven solutions and fostering a culture of ethical behavior are also recommended to build resilient fraud prevention systems [19].

2.4 Empirical Studies

Several empirical studies have reinforced the significance of internal audits in preventing fraud. For example, it was found that internal audit effectiveness positively correlates with the organization's governance quality and control environment. Their study showed that the frequency of audits, auditor experience, and board audit committee involvement improved the detection and prevention of fraud. Internal audits significantly impact fraud prevention by enhancing internal controls and promoting ethical culture within organizations [20]. Auditor competence and independence are crucial for effective fraud detection and prevention, as they ensure unbiased and thorough audits [21], [22]. The adoption of technology in auditing processes aids in risk identification and enhances the internal audit function's ability to prevent and detect fraud [22]. Good corporate governance practices, including the involvement of audit committees, positively influence fraud prevention efforts [23]. Management support, while not directly affecting internal audit effectiveness, is essential for implementing audit recommendations and fostering an environment conducive to fraud prevention [21]. The combination of internal audits and whistleblowing systems has been shown to improve fraud prevention effectiveness, particularly in government institutions [20]. Collaboration between internal and external auditors enhances the overall audit effectiveness, contributing to better

fraud prevention outcomes [21]. Studies have examined internal audit effectiveness in Nigerian public sector organizations and concluded that internal audits significantly influence fraud control when management support and professional training are present. Similarly, other research found that internal audits reduce the likelihood of fraudulent reporting by improving internal controls and ethical culture. In Indonesia, studies discovered that internal audit quality had a direct positive impact on fraud detection and prevention among SOEs, emphasizing the importance of auditor independence and adherence to professional standards. Moreover, Putra and Sujana (2020) revealed that internal audit and whistleblowing systems synergistically improve fraud prevention effectiveness in government institutions.

2.5 Conceptual Framework

Based on the theoretical and empirical review, this study proposes a conceptual framework that links internal audits to fraud prevention. The independent variable is Internal Audit, represented by dimensions such as independence, competence, and audit quality. The dependent variable is Fraud Prevention, represented by organizational measures such as control systems, ethical compliance, and risk mitigation. The conceptual relationship assumes that a more effective internal audit system enhances the organization's ability to prevent fraud through improved oversight, control, and ethical standards. The framework can be depicted as follows: Internal Audit (Independence, Competence, Audit Quality) → Fraud Prevention (Control Effectiveness, Ethical Compliance, Risk Reduction). Based on the literature, the following hypothesis is proposed:

H1: Internal audits have a significant positive effect on fraud prevention in state-owned enterprises.

3. METHODS

This study employs a quantitative research design to examine the relationship between internal audits and fraud prevention in Indonesian state-owned enterprises (SOEs). The quantitative approach is chosen because it allows for systematic measurement of variables, statistical testing of hypotheses, and generalization of findings to a broader population. A causal-explanatory design is applied to determine the extent to which internal audit practices influence the effectiveness of fraud prevention mechanisms. Data were collected through structured questionnaires distributed to internal auditors, audit committee members, and managerial staff of selected SOEs. The population of this study consists of all Indonesian state-owned enterprises (SOEs) that have established internal audit units or inspectorates as mandated by Government Regulation No. 60 of 2008 concerning the Government Internal Control System (SIP). Given the large number of SOEs across various sectors—such as energy, transportation, telecommunications, finance, and manufacturing—a purposive sampling technique was employed to ensure that only respondents with relevant audit experience were included. The sample includes 105 respondents comprising internal auditors, senior accountants, and risk management officers from selected SOEs. The sample size was determined based on feasibility, representativeness, and adequacy for statistical analysis using SPSS version 25. According to Hair et al. (2019), a sample size above 100 is sufficient for studies using multiple regression or correlation analysis, ensuring the robustness of hypothesis testing. Primary data were collected through a structured questionnaire distributed online and in person to respondents. The questionnaire used a five-point Likert scale ranging from 1 (strongly disagree) to 5 (strongly agree) to measure perceptions

related to internal audits and fraud prevention. Prior to full distribution, a pilot test was conducted with 20 respondents to ensure clarity and reliability of the instrument. Feedback from the pilot test was incorporated to improve question wording and consistency. The data collection process followed ethical research standards, ensuring confidentiality and anonymity of respondents. Each participant provided informed consent, and the responses were used solely for academic research purposes.

This study consists of two main variables: Internal Audit (X) and Fraud Prevention (Y). Internal audit is operationalized using dimensions such as independence, competence, audit quality, and management support. Fraud prevention is represented by organizational measures including internal control effectiveness, ethical awareness, and fraud detection mechanisms. All indicators for each variable were measured using five-point Likert scales. The research instrument was tested for validity and reliability using SPSS version 25. Validity was assessed using the Pearson Product-Moment correlation test, with items having a correlation coefficient (r) above 0.30 and a significance level below 0.05 considered valid. Reliability was assessed using Cronbach's Alpha, with a value greater than 0.70 indicating good reliability. Both tests confirmed that all items met the validity and reliability criteria, ensuring the instrument's suitability for data analysis. Data were analyzed using SPSS version 25 through several stages: descriptive statistical analysis to summarize respondent profiles, classical assumption tests for regression model accuracy, Pearson correlation analysis to examine relationships between variables, and simple linear regression to test the hypothesis regarding the impact of internal audits on fraud prevention. The coefficient of determination (R^2) was used to measure the proportion of variance in fraud prevention explained by internal audit. The t-test was used to determine if the internal audit variable significantly affected fraud prevention, with significance determined by a p-value less than 0.05.

4. RESULTS AND DISCUSSION

4.1 Data Description and Respondent Profile

A total of 105 valid responses were collected from internal auditors, finance officers, and managers of state-owned enterprises (SOEs) across Indonesia. Respondents represented various sectors, including energy (25%), transportation (18%), telecommunications (15%), manufacturing (20%), and finance (22%). Based on job position, 42% of respondents were internal auditors, 36% were finance and accounting staff, and 22% were senior managers involved in risk and compliance functions. Regarding experience, 48% of respondents had more than five years of experience in auditing or risk management, indicating a high level of familiarity with internal control systems. Educationally, 60% held bachelor's degrees, and 40% held postgraduate degrees. These characteristics suggest that respondents possessed sufficient knowledge and experience to provide reliable insights into internal audit and fraud prevention practices within SOEs.

4.2 Descriptive Statistics

Descriptive statistical analysis was conducted to obtain the mean and standard deviation for each indicator of internal audit and fraud prevention. The overall mean score for the internal audit variable was 4.21 (on a five-point Likert scale), indicating that internal audit practices in SOEs are perceived to be well implemented. The fraud prevention variable recorded an average mean score of 4.18, suggesting that most SOEs have implemented effective control systems and ethical compliance measures. Among the dimensions of internal audit, auditor competence obtained the highest mean (4.35), followed by audit independence (4.28), audit quality (4.20), and management support (4.05). For fraud prevention, ethical culture recorded the highest mean (4.31), followed by internal control effectiveness (4.22) and fraud detection mechanisms (4.09). These results imply that human expertise and ethical values

are the strongest drivers of audit and fraud prevention performance in SOEs.

4.3 Classical Assumption Tests

Before performing hypothesis testing, several classical assumption tests were conducted to ensure the validity of the regression model. The Kolmogorov-Smirnov test showed a significance value of 0.094 (>0.05), indicating that the data are normally distributed. The Variance Inflation Factor (VIF) values for all independent variables were below 10 (ranging from 1.2 to 2.8), and tolerance values exceeded 0.10, confirming the absence of multicollinearity among the variables. The Glejser test results showed that the significance values for all independent variables were above 0.05, indicating no heteroscedasticity. These results demonstrate that the data met all classical assumption requirements, validating the use of regression analysis.

4.4 Hypothesis Testing

A simple linear regression analysis was conducted to test the hypothesis that internal audit has a significant positive effect on fraud prevention. The regression equation obtained is as follows: $Y = 0.712 + 0.735X$, where Y represents fraud prevention and X represents internal audit. The regression coefficient ($\beta = 0.735$) indicates that a one-unit increase in internal audit effectiveness leads to a 0.735 increase in the fraud prevention score. The t-test result showed a t-value of 11.237 with a significance level (p-value) of 0.000, which is below 0.05. This means the hypothesis (H_1) is accepted—internal audit has a significant positive effect on fraud prevention in state-owned enterprises.

The coefficient of determination (R^2) was 0.541, indicating that 54.1% of the variance in fraud prevention is explained by internal audit, while the remaining 45.9% is influenced by other factors such as corporate culture, governance structure, and external regulatory oversight.

4.5 Discussion

The results confirm that internal audit plays a crucial role in preventing fraud within

Indonesia's state-owned enterprises. The strong and significant relationship between internal audit and fraud prevention demonstrates that well-functioning audit systems serve as effective governance mechanisms to minimize unethical practices and financial irregularities. These findings are consistent with Agency Theory, which posits that internal audits reduce information asymmetry between principals (government and stakeholders) and agents (managers) through systematic monitoring and control. The existence of independent and competent internal auditors provides assurance that management's actions align with organizational goals and regulatory compliance, thus reducing the potential for agency-related misconduct.

The study's findings align with prior research by Coram et al. (2008), which revealed that organizations with strong internal audit departments experience fewer fraud incidents due to early detection and preventive measures. Similarly, Arena and Azzone (2009) found that audit quality and board audit committee involvement significantly enhance fraud prevention outcomes. The current study extends these findings by providing empirical evidence from the Indonesian public enterprise context, where internal audits are legally mandated under the Government Internal Control System (SPIP). Furthermore, the dimension-level analysis shows that auditor competence and audit independence are the strongest predictors of fraud prevention effectiveness. This supports the assertion by Alzeban and Gwilliam (2014) that the professionalism and autonomy of auditors are essential for credible audit results. Skilled auditors with a deep understanding of risk management and financial analysis can identify irregularities more accurately and recommend appropriate remedial actions. Conversely, lack of independence may compromise objectivity and weaken the deterrent effect of audits.

Another important finding relates to management support. Although it scored relatively lower than other dimensions, it remains an essential determinant of audit success. When top management demonstrates

a strong commitment to implementing audit recommendations, fraud prevention efforts become more sustainable. This aligns with Badara and Saidin (2013), who found that management responsiveness to audit findings enhances organizational accountability and compliance culture. From a policy perspective, the findings imply that strengthening internal audit functions within SOEs is not merely a procedural requirement but a strategic necessity. Enhancing auditor training, ensuring independence, and integrating audit recommendations into managerial decision-making can substantially reduce fraud risk. Additionally, the establishment of continuous monitoring systems, whistleblowing mechanisms, and ethical training programs can reinforce a culture of integrity throughout the organization. The Fraud Triangle Theory (Cressey, 1953) also provides a relevant interpretive lens. Internal audits effectively minimize the "opportunity" element of the triangle by tightening internal controls and ensuring transparency in operations. By doing so, internal audits reduce the likelihood of individuals rationalizing fraudulent actions. Thus, internal audits act as both a deterrent and a detection mechanism, addressing the structural and behavioral causes of fraud simultaneously.

4.6 Implications

The study provides both theoretical and practical implications. Theoretical implications suggest that internal audits are a key element in corporate governance frameworks, particularly within state-owned enterprises where public accountability is paramount. The results contribute to the empirical validation of agency theory and fraud triangle theory in the public sector context. Practical implications highlight the need for policy reform and capacity building, emphasizing that SOEs should strengthen their internal audit units by ensuring independence, enhancing technical competence, and fostering management cooperation. Regular training, certification programs, and digital audit tools can further improve the effectiveness of audit practices.

4.7 Limitations and Future Research

Despite its contributions, this study has several limitations. First, the analysis was limited to cross-sectional data, which captures perceptions at one point in time and may not reflect changes over the long term. Second, the study focused only on internal audit factors, whereas other governance mechanisms (e.g., external audits, audit committees, and ethics programs) may also influence fraud prevention. Future research could employ longitudinal or mixed-method approaches and include additional variables such as organizational culture, whistleblowing systems, or external oversight to provide a more comprehensive understanding of fraud prevention in SOEs.

5. CONCLUSION

The findings of this research empirically demonstrate that internal audits have a significant and positive impact on fraud prevention in Indonesian state-owned enterprises. The regression results show that effective internal audit mechanisms—characterized by independence, auditor competence, audit quality, and strong management support—enhance organizational control and ethical standards, thereby reducing opportunities for fraudulent activities. This study confirms the relevance of Agency Theory, where internal audits serve

as an essential monitoring mechanism that aligns the interests of agents (management) with those of principals (the government and stakeholders). Likewise, from the perspective of the Fraud Triangle Theory, internal audits effectively minimize the element of “opportunity,” which is one of the key drivers of fraud.

Practically, the study highlights the need for SOEs to strengthen their internal audit functions through continuous professional development, increased independence, and integration of audit recommendations into governance policies. The establishment of transparent reporting systems, whistleblowing mechanisms, and ethical training programs will further support fraud prevention efforts. Theoretically, this research contributes to the body of knowledge by providing quantitative evidence from the public enterprise sector, illustrating that internal audit effectiveness is a critical factor in achieving sustainable governance and public accountability. Future studies are encouraged to incorporate additional governance variables, such as external audit oversight, audit committee performance, and digital audit systems, to develop a more comprehensive understanding of fraud prevention strategies in state-owned institutions.

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