
Fraud in the Public Sector: Analysis of Causes, Impacts, and Prevention Efforts in Government Financial Management

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Abstract

This study analyzes the phenomenon of fraud in the public sector, focusing on government financial management. Fraud in this sector is often more prominent than in the private sector due to the characteristics of financial management systems that tend toward centralization and lack of transparency. The main causes of fraud include weaknesses in internal controls, lack of accountability, and the presence of pressure, opportunity, and rationalization as explained by the Fraud Triangle, Fraud Diamond, and Fraud Hexagon theories. Common types of fraud include bribery, abuse of authority, embezzlement of state assets, and extortion. The impact of fraud is very detrimental — not only causing significant financial losses to the state, estimated at hundreds of billions of dollars annually, but also damaging the government's image and eroding public trust. To prevent fraud, comprehensive efforts are required, including increased transparency, strengthened accountability, implementation of effective internal control systems, and the use of forensic accounting and investigative auditing. Additionally, the implementation of good governance and the use of fraud analytics play an important role in detecting and preventing unusual financial movements. This study concludes that fraud prevention in the public sector requires a sustainable multi-dimensional approach to maintain the integrity and efficiency of state financial management.

Keywords: *Fraud, Public Sector, Internal Controls, Good Governance, Audit.*

INTRODUCTION

Integrity and accountability in state financial management are the main pillars of good governance. However, the phenomenon of fraud in the public sector remains a serious challenge that threatens economic stability, public trust, and development effectiveness. Fraud in this sector is not limited to corruption in the form of bribery or embezzlement of assets, but also includes abuse of authority and various other forms of irregularities that harm the state.

Recent data and reports show that fraud incidents in the public sector continue to attract global and national attention. Globally, fraud has been identified as the fastest-growing sector of organized crime, targeting various parties including public entities. In Indonesia, the Corruption Eradication Commission (KPK) consistently reports corruption cases involving government agencies, indicating that prevention and enforcement efforts must continue to be strengthened. Although there have been improvements in measuring losses from fraud and the effectiveness of prevention efforts, many countries still lack reliable data on the full scale of the problem.

The causes of fraud in the public sector are often complex and multidimensional. Weaknesses in internal control systems, lack of transparency, and low accountability are the main driving factors. In addition, theories such as the Fraud Triangle (pressure, opportunity, rationalization), Fraud Diamond (adding capability), and Fraud Hexagon (adding arrogance and collusion) provide frameworks for understanding the motivations behind fraudulent actions. In the context of government financial management, systems that tend toward centralization can also create loopholes for fraud to occur.

The impact of fraud in the public sector is extensive and destructive. Financial losses amount to astronomical figures, with federal estimates in the United States alone reaching hundreds of billions of dollars annually. Moreover, fraud erodes public trust in government institutions, hinders investment, reduces the quality of public services, and ultimately slows sustainable economic development. Therefore, an in-depth analysis of the causes, impacts, and prevention efforts of fraud in government financial management is crucial to formulating effective strategies in creating a clean and accountable government.

RESEARCH METHODS

Fraud is generally defined as: "An intentional act by one or more individuals in management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage." (International Standards on Auditing, ISA 240). In the context of the public sector, fraud refers to all forms of dishonesty, irregularities, and abuse of authority committed by state apparatus or other parties that harm state finances and the public interest.

Legal Basis for Fraud in Indonesia:

| Regulation | Substance |
|---|--|
| Law No. 31 of 1999 jo. Law No. 20 of 2001 | Eradication of Corruption Crimes |
| Law No. 15 of 2004 | Examination of State Financial Management and Accountability |
| Law No. 30 of 2002 | Corruption Eradication Commission (KPK) |
| Government Regulation No. 60 of 2008 | Government Internal Control System (SPIP) |
| Law No. 1 of 2004 | State Treasury |

Corruption

- Bribery — giving/receiving bribes in procurement or licensing
- Gratification — receiving gifts related to one's position
- Conflict of interest — decisions that personally benefit the decision-maker
- Extortion — coercing others to provide something

Asset Misappropriation

- Cash embezzlement — manipulation of state cash receipts or disbursements
- Payroll fraud — fictitious employees or manipulation of allowances
- Asset theft — use of state assets for personal interests
- Procurement fraud — price mark-ups, fictitious specifications, fictitious vendors

Financial Statement Fraud

- Overstating assets
- Understating liabilities
- Manipulating budget realization to appear on target
- Fictitious recording of state revenue or expenditure

Characteristics of Fraud in the Public Sector

| Characteristic |
|--|
| Perpetrators hold public authority (state positions) |
| Victims are the state and the general public |
| Involves state budget (APBN/APBD) |
| Often systemic and organized |
| Wide impact on public services |
| Difficult to detect due to bureaucratic complexity |
| Closely linked to political power |

3.2 Factors Causing Fraud

Fraud does not occur by chance. Every fraudulent act is always preceded by certain conditions that create opportunities and drive someone to engage in misconduct. Academics and practitioners have developed various analytical theories and models to explain why fraud occurs.

PRESSURE

- Financial pressures: personal debt, lavish lifestyle beyond means, gambling/drug addiction, large family obligations, failed investments
- Organizational pressures: unrealistic performance/budget targets, pressure from superiors to manipulate reports, threat of termination, unfair compensation
- Non-financial pressures: excessive career ambitions, desire for recognition and social status, pressure from social environment or family

Analysis: In Indonesia's public sector, pressure often arises from low civil servant salaries at lower levels, combined with political pressure from superiors or supporting parties to accommodate certain interests.

Opportunity

- Weaknesses in internal control: no segregation of duties, weak or inconsistent transaction authorization, rare or absent reconciliation, no independent review of financial transactions
- Oversight weaknesses: non-independent Inspectorates (APIP), ineffective external audits, absence of adequate whistleblowing mechanisms, rare job rotation
- Structural bureaucratic weaknesses: complex procedures creating loopholes, overlapping authority between units, disorderly documentation, non-integrated financial information systems

Analysis: Fraud opportunities in the public sector are often wide open due to complex bureaucracy, weak oversight, and a culture of reluctance to report superiors who deviate.

Rationalization

| Rationalization | Example Statement by Perpetrator |
|---------------------|---|
| Temporary borrowing | "I'm only borrowing it, I'll return it later" |

| Rationalization | Example Statement by Perpetrator |
|------------------------|--|
| Perceived injustice | "My salary is not commensurate with my hard work" |
| Social norms | "Everyone here does the same thing" |
| Minimizing impact | "The amount is small, the state won't lose much" |
| Unrecognized service | "I have contributed greatly but was never appreciated" |
| Pressure from others | "I was forced because it was ordered by my superior" |

Capability

| Capability Indicators of Fraud Perpetrators |
|--|
| Strategic position within the organization |
| Intelligence and system understanding |
| High self-confidence |
| Ability to lie and camouflage |
| Ability to manage stress |
| Technical knowledge of accounting/finance |
| Ability to influence others |

Arrogance

- Feeling immune from the law due to power or political connections
- Not afraid of consequences because of feeling protected
- Underestimating the capability of auditors or law enforcement
- Feeling entitled to something that is not rightfully theirs

Competence

- Ability to control and manipulate the work environment
- Ability to intimidate subordinates into silence
- Expertise in hiding traces of misconduct
- Ability to influence policy for personal gain

| Factor | Risk Level | Most Vulnerable Area | Solution |
|------------------------|-------------------|-----------------------------|-----------------------------|
| Financial pressure | High | Low-paid civil servants | Remuneration reform |
| Weak internal controls | High | Procurement, regional cash | Strengthen SPIP |
| Rationalization | Medium | All levels | Anti-corruption education |
| Perpetrator capability | Medium | Senior officials | Rotation & strict oversight |

| Factor | Risk Level | Most Vulnerable Area | Solution |
|--------------------|------------|----------------------|---------------------------------|
| Arrogance of power | High | Political officials | Strict law enforcement |
| Permissive culture | High | Bureaucratic culture | Bureaucratic reform |
| Political pressure | High | Regional government | Depoliticization of bureaucracy |

Impact of Fraud

Fraud in government organizations does not only cause financial losses; it delivers layered and systemic impacts affecting all aspects of governance. These impacts are both short-term and long-term, and are felt by various stakeholders from government institutions to the general public.

Direct State Financial Losses:

- Loss of state assets due to theft, embezzlement, or misuse
- Losses from fictitious projects — payments for work not performed
- Procurement mark-ups — the state pays more than the fair market price
- Tax and levy embezzlement — state revenue does not enter the treasury
- Diverted social assistance funds — benefits do not reach entitled recipients

Budget Impact Illustration:

| Budget Area | Intended Budget | Budget After Fraud |
|-----------------|-----------------|--------------------|
| Infrastructure | 100% | ~70% |
| Education | 100% | ~75% |
| Health | 100% | ~72% |
| Social Programs | 100% | ~68% |
| Total Benefit | 100% | ~71% |

Weakening of Internal Control Systems

- Fraud proves the existence of gaps in SPIP that went undetected
- Trust in internal procedures declines drastically
- Compliance culture weakens
- Documents and financial reports become unreliable

Decline in Financial Report Quality:

| Condition Before Fraud | Condition After Fraud is Exposed |
|------------------------------------|--|
| WTP (Unqualified) opinion from BPK | Opinion drops to WDP (Qualified) or Disclaimer |
| Reliable financial statements | Financial statements' accuracy is questioned |
| Reconciliation running smoothly | Unexplained discrepancies found |

| Condition Before Fraud | Condition After Fraud is Exposed |
|----------------------------|---|
| Assets accurately recorded | Fictitious or untraceable assets discovered |

Impact on Public Services and Development

| Sector | Impact of Fraud |
|-------------|---|
| Education | School operational funds (BOS) diverted, inadequate school facilities |
| Health | Fictitious medicines, substandard medical equipment, BPJS issues |
| Social | Social aid misses targets, recipient data manipulated |
| Agriculture | Fertilizer and seed subsidies do not reach farmers |
| Housing | Public housing program targets not met |

Reputation Damage Due to Fraud:

| Short-Term | Long-Term |
|--|--|
| Negative media coverage | Deep-rooted negative perception in public consciousness |
| Public condemnation and demonstrations | Difficulty rebuilding public trust |
| Political pressure from opposition | Changing perception of younger generation toward bureaucracy |

Long-Term Impact on Democracy

- Erosion of democracy — power is used for the benefit of a few
- Oligarchy — power and wealth become increasingly concentrated
- Political apathy — citizens lose faith in the democratic process
- Dangerous populism — frustrated citizens seek leaders promising instant change
- Political instability — unproductive changes in government

Fraud Prevention & Detection Strategies

Anti-fraud strategy rests on two main pillars: (1) Prevention — reducing the likelihood of fraud occurring, and (2) Detection — finding fraud as early as possible.

1. Strengthening SPIP (PP No. 60 of 2008)
 - Conducive control environment
 - Periodic risk assessment
 - Adequate control activities
 - Continuous information, communication, and monitoring
2. Segregation of Duties
 - Authorization, recording, and asset custody functions are separated
 - No single person controls the entire transaction cycle
 - Periodic job rotation
3. Digitalization and E-Government
 - e-Procurement (LPSE/SIRUP) for procurement transparency
 - SPAN, SIMDA, SAKTI for integrated state finance
 - Creating automatic audit trails and reducing excessive discretion

4. Fraud Risk Management
 - Identification → Assessment → Mitigation → Monitoring
 - Focus on vulnerable areas: procurement, cash, assets, and human resources

Culture and Integrity-Based Prevention

- Tone at the top — leadership as role models of integrity
- Code of ethics and integrity pacts for all employees
- Tiered anti-fraud training from basic to advanced levels
- Integrity zones toward WBK (Corruption-Free Area) and WBBM (Clean Service Area) credentials

Whistleblowing System (WBS)

- Safe, anonymous, and independent reporting channels
- Whistleblower protection under Law No. 13 of 2006
- Available channels: KPK KAKI, LAPOR!, Ombudsman, Inspectorate
- Rewards for good-faith reporters

Technology-Based Detection

- Data Analytics — Benford's Law, duplicate testing, trend analysis using ACL, IDEA, Power BI
- Artificial Intelligence — anomaly detection, predictive analytics, network analysis
- Digital Forensics — metadata analysis, system logs, and digital transaction trails

Red Flag Identification

| Category | Example Indicators |
|----------------|---|
| Individual | Lavish lifestyle, refuses leave, works outside office hours |
| Transaction | Duplicate payments, unclear vendor, unusual budget variance |
| Organizational | High turnover, frequently revised documents, incomplete audit trail |

Synergy of Oversight Institutions

- BPK — Independent examination of state finances
- KPK — Corruption enforcement and prevention
- BPKP — Development financial oversight
- PPATK — Tracing suspicious financial transactions
- Inspectorate — Internal oversight within agencies
- Civil Society & Media — Social control

RESULTS AND DISCUSSION

Concept of Fraud in the Public Sector

Fraud in the public sector is any intentional fraudulent act by state apparatus that harms state finances and the public interest (ISA 240; Tuanakotta, 2010). Based on the ACFE Fraud Tree, fraud is classified into three types: corruption, asset misappropriation, and financial statement fraud. Fraud in the public sector differs from the private sector because the perpetrators

hold public authority and the impact is felt by society as a whole. In Indonesia, the legal basis for prosecuting fraud is Law No. 31 of 1999 jo. Law No. 20 of 2001 on the Eradication of Corruption Crimes. The most fraud-prone areas include goods and services procurement, regional transfer funds, and state asset management.

Factors Causing Fraud

| Model | Elements | Scholar |
|----------------|--|--------------------------|
| Fraud Triangle | Pressure, Opportunity, Rationalization | Cressey (1953) |
| Fraud Diamond | + Capability | Wolfe & Hermanson (2004) |
| Fraud Pentagon | + Arrogance, Competence | Crowe (2011) |

Discussion:

- Pressure in Indonesia's public sector stems from low civil servant remuneration and political pressure from superiors or supporting political parties
- Opportunity is wide open due to weak SPIP, minimal oversight, and bureaucratic complexity that creates loopholes
- Rationalization develops in a permissive organizational culture where deviations are considered normal and justifiable
- Capability and arrogance of officials with broad access and political connections increase the risk of systemic fraud

Impact of Fraud on Government Organizations

| Impact Dimension | Concrete Manifestation |
|---------------------|---|
| Financial | State financial losses, investigation and audit costs |
| Governance | Weakened SPIP, distorted policies, declining audit opinions |
| Public Services | Poor infrastructure quality, disrupted basic services |
| Reputation | Loss of public trust, international image damage |
| Macroeconomic | Declining investment, slowed economic growth |
| Legal/Institutional | Overloaded law enforcement agencies, bad legal precedents |

CONCLUSION

Fraud in the public sector constitutes intentional fraudulent acts by state apparatus that harm state finances and the interests of the general public. Based on the ACFE Fraud Tree, fraud is classified into three main forms: corruption, asset misappropriation, and financial statement fraud. All three forms are consistently found in government financial management in Indonesia,

particularly in the areas of goods and services procurement, regional transfer funds, and state asset management.

Fraud does not occur by chance; it is driven by a combination of pressure, opportunity, rationalization, capability, and arrogance as explained in the Fraud Pentagon. In Indonesia's public sector, the opportunity factor is the most dominant element due to weak internal control systems, minimal oversight, and bureaucratic complexity. Additionally, permissive cultural factors and political pressure further reinforce conditions conducive to fraud.

Fraud causes multilayered and systemic impacts, including direct state financial losses, weakening of governance and internal control systems, declining quality of public services, damaged reputation of government institutions, and impeded investment and national development. The greatest impact is felt by citizens through the reduced quality of basic services in education, health, and infrastructure.

Effective fraud prevention requires a holistic approach encompassing the strengthening of SPIP, digitalization of financial governance, building a culture of integrity, and the provision of a reliable whistleblowing system. Fraud detection requires synergy between risk-based auditing, the use of data analytics technology, red flag identification, and active coordination among oversight institutions such as BPK, KPK, BPKP, and the Inspectorate.

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