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# The Nexus of Audit Quality and Fraud Prevention: Evidence from Buleleng Inspectorate

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**Abstract:** This study aims to examine how auditor competence, supervisory independence, and internal control systems influence internal audit quality and fraud prevention in Indonesia's public sector, with particular focus on the moderating role of auditor integrity in shaping the effectiveness of these oversight mechanisms. Using Partial Least Squares Structural Equation Modeling (PLS-SEM), this study analyzes data from 53 auditors at the Buleleng Regency Inspectorate to test six direct relationships and six moderating effects of auditor integrity on internal audit quality and fraud prevention. The study reveals three key findings. First, all direct effects prove significant: internal control systems emerge as the strongest predictor of internal audit quality ($\beta$=0.431, $p<0.001$), while auditor competence most powerfully influences fraud prevention ($\beta$=0.408, $p$=0.001). Second, auditor integrity exhibits complex and counterintuitive moderation patterns: it negatively moderates the competence-audit quality relationship ($\beta$=-0.264, $p$=0.034) and independence-audit quality relationship ($\beta$=-0.095, $p$=0.029), indicating compensatory mechanisms or contextual pressures in corrupt environments. Third, integrity does not moderate any relationships with fraud prevention nor internal control system relationships with either outcome, revealing that fraud prevention is more heavily determined by structural factors than individual ethical characteristics.

**Keywords:** internal audit quality, fraud prevention, auditor competence, independence of supervision, internal control system.

## INTRODUCTION

Occupational fraud results in substantial economic losses globally, with organizations losing approximately five percent of annual revenues to fraudulent activities, particularly severe in the Asia-Pacific region (Association of Certified Fraud Examiners, 2020; Suryandari et al., 2023). Internal audit functions serve as crucial defense mechanisms, providing

independent assurance regarding governance, risk management, and control effectiveness (The Institute of Internal Auditors, 2017). However, persistent fraud cases despite established oversight mechanisms raise fundamental questions about internal audit effectiveness determinants and their operational boundary conditions (Achmad et al., 2024; Aziz & Othman, 2021).

Indonesia's local government sector exemplifies these challenges, with recurring fraud incidents revealing systemic weaknesses in internal control and audit quality. The Audit Board consistently identifies numerous fraud cases in regional government financial reports (Mardiyanto, 2022; Silalahi et al., 2023), with losses reaching IDR 123.51 trillion in the financial services sector from 2018 to 2022 (Sari et al., 2023). The Inspektorat, serving as Internal Government Supervisory Apparatus, frequently fails to detect or prevent fraudulent activities before escalation (Saputra et al., 2020; Ratmono & Darsono, 2021).

Recent cases in Kabupaten Buleleng starkly illustrate this phenomenon. In March 2025, the Head of Investment and One-Stop Integrated Service Office was designated suspect in an extortion case involving approximately IDR 2 billion from property developers over five years (Badan Pemeriksa Keuangan Republik Indonesia - Perwakilan Provinsi Bali, 2025), followed by investigations into village fund corruption in August 2025 (Kusuma, 2025). These sustained corrupt practices, occurring over multiple years undetected, underscore critical failures in internal audit quality, supervisory independence, internal control robustness, and auditor integrity (Lubis et al., 2024; Arum & Wahyudi, 2021). Social relations and patron-client dynamics further compromise internal control systems, creating environments where fraud flourishes despite formal oversight (Shaleh et al., 2022; Maria et al., 2019; Zulaikha et al., 2020).

Agency theory provides a powerful lens for understanding these governance failures. Principal-agent relationships are fraught with information asymmetry, creating opportunities for self-interested behavior (Jensen & Meckling, 1976). When monitoring mechanisms are weak, moral hazard and adverse selection increase substantially (Eisenhardt, 1989). Internal audit theoretically mitigates these agency problems, but effectiveness depends on auditor competence, independence from management, internal control robustness, and crucially, auditor integrity.

The fraud triangle theory identifies three converging elements for fraud occurrence: pressure, opportunity, and rationalization (Cressey, 1953). The Buleleng cases demonstrate all three: financial pressures, weak oversight creating opportunities, and normalized practices facilitating rationalization (Lin et al., 2022). The Theory of Planned Behavior suggests that attitudes towards corruption, subjective norms, and perceived behavioral control shape fraudulent intentions (Zulaikha et al., 2020). Effective internal audit should eliminate or reduce the opportunity element through enhanced detection risk.

Empirical evidence consistently demonstrates positive associations between auditor competence and audit quality. Auditors with higher professional expertise produce more reliable findings and effectively identify irregularities (Alsughayer, 2021; Lubis et al., 2024). However, a critical gap concerns boundary conditions under which competence translates into effective outcomes. Independence significantly influences audit quality, with auditors reporting to independent bodies producing more credible findings (Arum & Wahyudi, 2021; Ratmono & Darsono, 2021). In Indonesia, structural independence remains problematic as Inspektorat typically reports to regional heads rather than independent oversight bodies (Saputra et al., 2020), complicated by potential collusive or coercive corruption among auditors themselves (Mawani & Trivedi, 2021; Lino et al., 2021).

Robust internal control systems substantially reduce fraud opportunities (Bhat, 2023; Silalahi et al., 2023; Ziorklui et al., 2024), yet implementation gaps between formal policies and operational practices remain substantial in public sectors with weak governance (Dewi et

al., 2019; Yurniwati & Afdhal, 2015). Fiscal decentralization and poor governance significantly contribute to elevated corruption in Indonesia (Ratmono et al., 2021), while informal social relations and patronage networks subvert formal controls (Shaleh et al., 2021; Tarjo et al., 2021).

Critically underexplored is how these factors influence multiple organizational outcomes simultaneously and the boundary conditions determining relationship effectiveness. This study proposes an integrative model examining dual outcomes: internal audit quality and fraud prevention effectiveness. While internal audit quality represents technical excellence in audit execution, fraud prevention effectiveness represents tangible outcomes in deterring, detecting, and mitigating fraud. The model posits that auditor competence, supervisory independence, and internal control systems directly influence both outcomes through potentially different mechanisms and varying magnitudes.

Central to this model is auditor integrity as a critical moderating variable fundamentally altering relationship strength and effectiveness. Integrity—adherence to moral and ethical principles including honesty, courage, and professional ethics (International Ethics Standards Board for Accountants, 2020)—represents the ethical foundation upon which technical competence and structural independence must rest.

The theoretical argument for integrity as moderator rests on three key propositions. First, while competence provides capability to detect irregularities, integrity determines whether auditors act on professional knowledge or suppress findings. High integrity ensures competence translates powerfully into audit quality and fraud prevention; low integrity substantially weakens these relationships. Second, structural independence is meaningful only when auditors possess moral courage to exercise independence when confronting sensitive findings. The Buleleng cases illustrate this: formal independence existed, but auditors lacked integrity to resist improper influence or actively participated in collusive arrangements. High integrity amplifies independence's positive effect on outcomes, particularly critical in fraud prevention involving senior officials. Third, robust internal controls are effective only when auditors have integrity to enforce compliance rather than collude in circumventing controls. High integrity strengthens the relationship between control system quality and outcomes; compromised integrity allows systematic control bypass through collusion.

This moderating role applies across all six primary relationships in the research model, creating twelve distinct hypothesized relationships. Integrity operates as a fundamental boundary condition determining whether technical capabilities and structural arrangements translate into effective governance outcomes.

Despite theoretical foundations and emerging insights, significant research gaps persist. First, most studies examine audit quality and fraud prevention determinants in isolation, failing to capture complex interdependencies among competence, independence, internal controls, integrity, and multiple outcomes simultaneously. The literature lacks comprehensive models examining both outcomes as distinct yet related, missing opportunities to understand differential effects and potential complementarities. Second, research has focused predominantly on corporate contexts with limited attention to public sector internal audit, particularly in developing countries where governance challenges are most acute (Rana et al., 2021; Paterson et al., 2019; Jeppesen, 2018).

Third, while integrity has been studied as an antecedent, its potential moderating role—as a boundary condition determining when and how strongly other factors influence outcomes—remains largely unexplored empirically. This gap is critical: theoretically, it suggests technical and structural reforms alone are insufficient without ethical infrastructure; practically, it implies integrity development should be prioritized alongside competence building and independence enhancement. Fourth, research examining post-fraud contexts where oversight failures have been publicly revealed is relatively rare (Helmi & Iskandar,

2020). The Buleleng context offers a valuable research setting where oversight failure consequences are evident. Furthermore, limited research examines how psychological factors, organizational culture, and informal social dynamics interact with formal controls to facilitate or deter fraud in Indonesian local governments (Dewi et al., 2021; Puspasari & Suwardi, 2016; Sara et al., 2023).

This study addresses these gaps by developing and testing an integrative model examining how auditor competence, supervisory independence, and internal control systems influence both internal audit quality and fraud prevention effectiveness, while systematically investigating auditor integrity's moderating role across all relationships. The Inspektorat Kabupaten Buleleng setting provides particularly relevant context given recent high-profile fraud cases. The study contributes to agency theory by elucidating specific mechanisms through which internal audit effectively reduces public sector agency problems, extends fraud triangle theory by demonstrating how audit-related factors systematically reduce fraud opportunities, and advances understanding of ethical infrastructure as necessary condition for translating technical capabilities and structural arrangements into effective governance outcomes. The dual-outcome approach reveals whether factors enhancing audit quality necessarily translate into fraud prevention effectiveness.

The practical significance extends across multiple levels. At the institutional level, findings will inform reforms to internal audit functions in Indonesian local governments, providing evidence-based guidance for competency development, organizational restructuring, internal control strengthening, and integrity cultivation. The moderating role of integrity, if confirmed, suggests investments in technical training and structural reforms must accompany systematic efforts to build ethical culture. At the policy level, the research contributes to evidence-informed policymaking regarding oversight mechanisms in decentralized governance structures. The dual-outcome framework provides insights for prioritizing interventions. Broadly, the study contributes to strengthening public sector governance and accountability, particularly relevant to Sustainable Development Goal 16. The research urgency is underscored by ongoing fraud investigations in Buleleng, national bureaucratic reform and anti-corruption priorities, and the critical need to restore public trust through demonstrably effective oversight mechanisms.

## METHODS

This study employs a quantitative explanatory design using cross-sectional survey data collected from internal auditors at Inspektorat Kabupaten Buleleng, Bali Province, Indonesia. The research site was purposively selected due to recent high-profile fraud cases that revealed systematic failures in internal oversight mechanisms. Census sampling was employed, targeting all auditors meeting the inclusion criteria of at least one year of audit experience. After distributing structured questionnaires and screening for completeness, 53 respondents meeting these criteria were obtained for analysis, which exceeds the minimum sample size requirement for PLS-SEM analysis (Hair et al., 2019). All constructs are measured using reflective multi-item scales adapted from established instruments in prior research and anchored on a five-point Likert scale ranging from strongly disagree to strongly agree.

Data analysis employs Partial Least Squares Structural Equation Modeling (PLS-SEM) using SmartPLS version 3, which is appropriate for complex models with moderating effects and relatively small samples (Hair et al., 2019; Sarstedt et al., 2017). The analysis follows a two-stage approach: first, the measurement model is evaluated through indicator loadings (>0.70), composite reliability (>0.70), Cronbach's alpha (>0.70), average variance extracted (>0.50), and discriminant validity using Fornell-Larcker criterion and HTMT ratio (<0.85) (Hair et al., 2019; Henseler et al., 2015); second, the structural model is assessed through path coefficients estimated via bootstrapping with 5,000 resamples at significance level $p<0.05$, $R^2$

for variance explained, effect size ($f^2$), predictive relevance ($Q^2$), and variance inflation factors (VIF<5.0) to check multicollinearity (Hair et al., 2017; Cohen, 1988). Moderating effects of auditor integrity are tested using the two-stage approach with standardized variables and interaction terms, with significance determined through path coefficients of the interaction terms and interpreted via simple slope analysis (Hair et al., 2017).

## RESULTS AND DISCUSSION

### Results

This study examines the relationships between auditor competence, independence of supervision, and internal control systems on internal audit quality and fraud prevention, with a particular focus on the moderating role of organizational culture. The analysis was conducted using Partial Least Squares Structural Equation Modeling (PLS-SEM) to test the proposed hypotheses. The results section presents the path coefficients, t-statistics, and p-values for both direct and moderating effects, which form the basis for hypothesis testing and theoretical contributions of this research.

**Table 1. Hypothesis Testing Results**

| Hypothesis Path | Original Sample | Sample Mean | Standard Deviation | T Statistics | P Values | Decision |
|---|---|---|---|---|---|---|
| Auditor Competence (X1) → Fraud Prevention (Y2) | 0.408 | 0.432 | 0.131 | 3.123 | 0.001 | Supported |
| Auditor Competence (X1) → Internal Audit Quality (Y1) | 0.352 | 0.372 | 0.084 | 4.202 | 0.000 | Supported |
| Independence of Supervision (X2) → Fraud Prevention (Y2) | 0.306 | 0.313 | 0.149 | 2.047 | 0.021 | Supported |
| Independence of Supervision (X2) → Internal Audit Quality (Y1) | 0.268 | 0.297 | 0.093 | 2.873 | 0.002 | Supported |
| Internal Control System (X3) → Fraud Prevention (Y2) | 0.290 | 0.263 | 0.138 | 2.109 | 0.018 | Supported |
| Internal Control System (X3) → Internal Audit Quality (Y1) | 0.431 | 0.403 | 0.091 | 4.753 | 0.000 | Supported |
| X1*M-Y1 → Internal Audit Quality (Y1) | -0.264 | -0.201 | 0.144 | 1.83 | 0.034 | Supported |
| X1*M-Y2 → Fraud Prevention (Y2) | -0.175 | -0.124 | 0.170 | 1.027 | 0.153 | Not Supported |
| X2*M-Y1 → Internal Audit Quality (Y1) | -0.095 | -0.083 | 0.050 | 1.904 | 0.029 | Supported |
| X2*M-Y2 → Fraud Prevention (Y2) | -0.120 | -0.104 | 0.082 | 1.463 | 0.072 | Not Supported |
| X3*M-Y1 → Internal Audit Quality (Y1) | 0.151 | 0.089 | 0.135 | 1.119 | 0.132 | Not Supported |
| X3*M-Y2 → Fraud Prevention (Y2) | 0.063 | 0.009 | 0.173 | 0.366 | 0.357 | Not Supported |

Note: Significance level at $p < 0.05$;

The analysis reveals that all direct relationships in the research model are statistically significant and therefore supported. Auditor competence demonstrates a significant positive effect on both internal audit quality ($\beta = 0.352$, $t = 4.202$, $p < 0.001$) and fraud prevention ($\beta = 0.408$, $t = 3.123$, $p = 0.001$), indicating that higher levels of auditor competence substantially contribute to improved audit outcomes and fraud mitigation.

Independence of supervision also shows significant positive relationships with internal audit quality ($\beta = 0.268$, $t = 2.873$, $p = 0.002$) and fraud prevention ($\beta = 0.306$, $t = 2.047$, $p = 0.021$), confirming that supervisory independence is crucial for maintaining audit effectiveness and preventing fraudulent activities.

Similarly, the internal control system significantly influences both internal audit quality ($\beta = 0.431$, $t = 4.753$, $p < 0.001$) and fraud prevention ($\beta = 0.290$, $t = 2.109$, $p = 0.018$). Notably, the internal control system exhibits the strongest effect on internal audit quality among all predictors, highlighting its critical role in ensuring high-quality audit processes.

The moderating role of organizational culture yields mixed results. Organizational culture significantly moderates the relationship between auditor competence and internal audit quality ($\beta = -0.264$, $t = 1.830$, $p = 0.034$), with a negative coefficient suggesting that organizational culture may weaken this relationship under certain conditions. This finding is supported and warrants further investigation into the specific cultural dimensions influencing this dynamic.

Similarly, organizational culture significantly moderates the relationship between independence of supervision and internal audit quality ($\beta = -0.095$, $t = 1.904$, $p = 0.029$), also demonstrating a weakening effect. This hypothesis is supported.

However, the moderating effect of organizational culture on the relationship between auditor competence and fraud prevention ($\beta = -0.175$, $t = 1.027$, $p = 0.153$) is not statistically significant, leading to the rejection of this hypothesis. Likewise, the moderation of organizational culture on the relationship between independence of supervision and fraud prevention ($\beta = -0.120$, $t = 1.463$, $p = 0.072$) fails to reach statistical significance and is therefore not supported.

Furthermore, organizational culture does not significantly moderate the relationships between the internal control system and internal audit quality ($\beta = 0.151$, $t = 1.119$, $p = 0.132$) or between the internal control system and fraud prevention ($\beta = 0.063$, $t = 0.366$, $p = 0.357$). Both of these hypotheses are rejected.

Out of twelve hypotheses tested, eight are supported by the empirical evidence, while four are rejected. All six direct effect hypotheses are accepted, demonstrating the fundamental importance of auditor competence, independence of supervision, and internal control systems in enhancing internal audit quality and fraud prevention. Among the moderating effects, only two hypotheses related to organizational culture's moderation on internal audit quality are supported, while the moderating effects on fraud prevention and one relationship with internal audit quality are not statistically significant.

**Discussion**

The empirical findings of this study illuminate the intricate mechanisms through which internal audit functions operate within Indonesia's public sector, revealing both the potency and limitations of technical, structural, and ethical factors in combating endemic corruption. The results demonstrate that while auditor competence, supervisory independence, and internal control systems constitute essential pillars of effective governance, their translation into tangible fraud prevention outcomes is mediated by complex contextual dynamics that challenge conventional theoretical assumptions about audit effectiveness in deeply corrupt institutional environments.

The robust positive relationship between auditor competence and internal audit quality fundamentally validates agency theory's core proposition that reducing information asymmetry between principals and agents necessitates technically sophisticated monitoring mechanisms (Jensen & Meckling, 1976; Eisenhardt, 1989). This finding extends beyond mere theoretical confirmation, offering practical evidence that investments in professional development, specialized training, and continuous skill enhancement yield measurable improvements in audit execution quality. The competence-quality nexus operates through multiple interconnected pathways: technically proficient auditors demonstrate superior capability in conducting risk-based audit planning, applying appropriate methodological rigor, exercising professional skepticism, and producing comprehensive, actionable recommendations (Alsughayer, 2021;

Galanis et al., 2023). This relationship assumes particular significance in the Indonesian context, where complex procurement fraud, sophisticated budget manipulation schemes, and multi-layered corruption networks demand auditors possess not merely foundational accounting knowledge but advanced forensic capabilities, data analytics proficiency, and nuanced understanding of behavioral indicators signaling fraudulent intent (Achmad et al., 2024; Lubis et al., 2024).

Contemporary research increasingly emphasizes that traditional audit competencies, while necessary, prove insufficient in detecting sophisticated fraud schemes that leverage technological vulnerabilities and exploit institutional blind spots. The integration of advanced analytical tools—including artificial intelligence-driven anomaly detection, machine learning algorithms for pattern recognition, and blockchain-based audit trails—represents an evolutionary imperative for modern internal audit functions (Adelakun, 2022; Bin-Nashwan et al., 2024; Ikhsan et al., 2022). These technological augmentations enhance auditors' capacity to analyze vast transactional datasets, identify subtle irregularities invisible to manual review, and conduct continuous monitoring rather than periodic sampling (Arham, 2025; Bính, 2025). However, technological sophistication alone cannot substitute for professional judgment, contextual understanding, and ethical reasoning that remain quintessentially human competencies (Daoud, 2023; Noordin et al., 2022). The Buleleng fraud cases exemplify this limitation: sustained corrupt practices persisted not due to insufficient technological tools but because of fundamental failures in professional skepticism, moral courage, and institutional will to confront powerful perpetrators (Helmi & Iskandar, 2020; Lino et al., 2021).

The significant pathway from auditor competence to fraud prevention validates fraud triangle theory's emphasis on opportunity reduction through enhanced detection capabilities (Cressey, 1953; Albrecht et al., 2018). Fraud prevention requires adequate human resource competence and effective internal control mechanisms (Resmiani & Diatmika, 2022). Competent auditors elevate perceived detection risk among potential perpetrators by demonstrating capacity to identify irregularities, trace complex transaction flows, and recognize behavioral red flags (Mandal & Amilan, 2023; Ziorklui et al., 2024). This deterrence mechanism operates through both direct and indirect channels: directly, through actual detection and exposure of fraudulent activities; indirectly, through reputation effects whereby known audit rigor discourages fraud attempts (Bhat, 2023; Silalahi et al., 2023). Yet the Buleleng cases reveal that deterrence effectiveness depends critically on institutional follow-through—competent detection proves meaningless when organizational or political pressures suppress findings, delay investigations, or shield powerful perpetrators from consequences (Jeppesen, 2018; Paterson et al., 2019; Bergmann & Plotnikof, 2019). This disconnected between detection and accountability represents a fundamental governance pathology in contexts where informal power networks supersede formal institutional mechanisms (Shaleh et al., 2022; Maria et al., 2019).

The positive influence of supervisory independence on internal audit quality and fraud prevention provides empirical support for agency theory's assertion that monitoring mechanisms must possess structural autonomy to function credibly (Ratmono & Darsono, 2021; Saputra et al., 2020). Independence operates across multiple dimensions—organizational positioning, assignment discretion, personal freedom from conflicts, and management support for audit functions—each contributing distinctly to overall effectiveness (The Institute of Internal Auditors, 2017; Dittenhofer et al., 2012). Research consistently demonstrates that auditors reporting to independent oversight bodies rather than entity management produce more credible findings, exercise greater professional skepticism, and demonstrate enhanced willingness to report sensitive irregularities (Arum & Wahyudi, 2021; Aziz & Othman, 2021). In the government auditing context specifically, independence has been found to significantly affect auditor professionalism, as auditors must maintain objectivity and remain free from

conflicts of interest to ensure the credibility and reliability of audit outcomes (Purnamawati & Adnyani, 2019). The Indonesian public sector context, where Inspektorat typically reports to regional heads—the very officials whose activities require scrutiny—creates structural independence deficits that fundamentally compromise audit objectivity (Saputra et al., 2020; Ratmono et al., 2021). This organizational design embeds inherent conflicts of interest, wherein auditors face implicit pressure to suppress findings that might embarrass or implicate their reporting superiors (Helmi & Iskandar, 2020).

The finding that independence influences fraud prevention more strongly than audit quality suggests that structural autonomy operates through dual mechanisms with differential impacts. First, independence enhances technical audit execution by ensuring auditors can allocate resources toward high-risk areas without management interference, access necessary information without restriction, and apply professional judgment without undue influence (Hazaea et al., 2022; Rana et al., 2021). Second, and perhaps more critically, independence signals to potential perpetrators that audit findings will be reported and acted upon rather than suppressed, thereby strengthening deterrence (Jeppesen, 2018; Branet & Hațegan, 2024). This signaling function explains why independence more powerfully influences fraud prevention: the mere perception of truly independent oversight alters behavioral calculus among potential perpetrators, increasing perceived detection risk and reducing rationalization opportunities (Zulaikha et al., 2020; Lin et al., 2022).

However, the Buleleng fraud cases starkly illustrate that structural independence, while necessary, proves insufficient when informal power dynamics, patron-client relationships, and corrupt networks pervade organizational culture. High-ranking officials sustained corrupt practices over extended periods despite formal oversight mechanisms, suggesting either systematic independence failures or active complicity within audit functions themselves (Lino et al., 2021; Mawani & Trivedi, 2021). Research on corrupt auditors distinguishes between collusive corruption—wherein auditors actively participate in fraudulent schemes for personal benefit—and coercive corruption—where auditors succumb to pressure or threats to suppress findings (Mawani & Trivedi, 2021). Both phenomena fundamentally undermine independence, transforming oversight mechanisms into enablers rather than deterrents of corruption. The Indonesian context exhibits both forms: collusive arrangements emerge when auditors share ethnic, familial, or political ties with officials under review; coercive dynamics arise when auditors face implicit or explicit threats to career advancement, personal safety, or family welfare for reporting sensitive findings (Shaleh et al., 2022; Dewi et al., 2021).

The internal control system's emergence as the strongest predictor of internal audit quality, while significantly influencing fraud prevention, aligns with the COSO framework's conceptualization of controls as integrated mechanisms providing foundational assurance regarding operational effectiveness, financial reporting reliability, and regulatory compliance (Committee of Sponsoring Organizations of the Treadway Commission, 2013). Robust control environments encompassing risk assessment processes, systematic control activities, comprehensive information systems, and continuous monitoring mechanisms provide the infrastructure upon which effective audits are conducted (Younas & Veerasamy, 2024; Ziorklui et al., 2024). Strong internal controls facilitate audit efficiency by ensuring systematic documentation, clear accountability structures, and reliable information flows, thereby enabling auditors to conduct more thorough examinations with greater confidence in underlying data integrity (Bhat, 2023; Silalahi et al., 2023). Empirical evidence from Indonesian local governments further corroborates this finding, confirming that effective internal control systems significantly reduce accounting fraud tendencies, with the control environment serving as the foundational element in preventing financial irregularities (Atmadja et al., 2024). Specifically, adequate internal control implementation encompassing its five interrelated elements—control environment, risk assessment, control activities, information

and communication, and monitoring—creates a comprehensive governance architecture that systematically minimizes opportunities for fraudulent behavior (Atmadja & Saputra, 2018)

The pronounced effect of internal controls on audit quality reflects that well-designed control systems essentially perform continuous, automated monitoring that complements periodic audit activities. Segregation of duties prevents individual actors from controlling entire transaction cycles; authorization protocols ensure appropriate approval hierarchies; reconciliation procedures detect discrepancies; and audit trails enable transaction tracing (Ziorklui et al., 2024). These mechanisms collectively reduce the audit burden while enhancing audit effectiveness, allowing auditors to focus investigative resources on high-risk areas identified through control monitoring rather than comprehensive transaction testing (Galanis et al., 2023; Younas & Veerasamy, 2024). The relationship with fraud prevention validates fraud triangle theory's emphasis on opportunity reduction through systematic controls that eliminate or minimize circumstances enabling fraudulent activities (Albrecht et al., 2018; Cressey, 1953). At the local governance level, proactive fraud audit approaches have demonstrated significant influence on fraud prevention effectiveness, particularly in village fund management where decentralized financial authority creates heightened vulnerability to misappropriation (Atmadja et al., 2019).

Yet the Buleleng cases illuminate a critical implementation gap between formal control design and operational effectiveness. Research consistently documents that developing country public sectors often exhibit substantial disconnects between documented control procedures and actual practices (Dewi et al., 2019; Yurniwati & Afdhal, 2015). Formal controls exist on paper, creating illusions of robust governance, while informal processes circumvent these controls through various mechanisms: collusion among multiple actors to override segregation of duties; exploitation of system weaknesses or technological gaps; manipulation of authorization processes through hierarchical pressure; and deliberate information suppression to conceal irregularities (Shaleh et al., 2021; Tarjo et al., 2021). The sustained nature of Buleleng fraud incidents—occurring over multiple years involving substantial sums—indicates either fundamental control design failures or systematic control circumvention through coordinated action.

Social network theory offers valuable insights into control circumvention mechanisms. Patron-client relationships, kinship networks, and political affiliations create informal solidarity structures that supersede formal organizational hierarchies and control procedures (Shaleh et al., 2022; Maria et al., 2019). When multiple actors within these networks occupy positions across nominally segregated functions—authorization, custody, recording, reconciliation—collusive arrangements easily circumvent formal controls. Research on Indonesian village fund corruption demonstrates how social relations and community pressures transform ostensibly independent control actors into complicit participants, either actively facilitating fraud or passively tolerating irregularities to maintain social harmony (Dewi et al., 2021; Sara et al., 2023). This phenomenon suggests that control effectiveness depends not merely on technical design sophistication but on organizational culture, ethical climate, and enforcement commitment that cannot be assumed in contexts where corruption is normalized (Ratmono et al., 2021; Zulaikha et al., 2020).

The moderating effects of auditor integrity reveal theoretically complex and practically significant patterns that challenge conventional assumptions about ethical infrastructure's role in audit effectiveness. The significant negative moderation of integrity on relationships between auditor competence and internal audit quality, as well as between supervisory independence and internal audit quality, initially appears counterintuitive but warrants nuanced theoretical interpretation. Several complementary explanations emerge from existing theoretical frameworks and empirical research.

First, these findings may reflect a compensatory or substitution mechanism wherein high integrity partially offsets deficits in technical competence or structural independence. In contexts where formal competencies or structural arrangements prove inadequate, auditors with strong ethical foundations may leverage moral courage, professional skepticism, and commitment to public interest to maintain audit quality despite technical or structural limitations (Alsughayer, 2021; Galanis et al., 2023). This interpretation aligns with virtue ethics perspectives emphasizing that character-based ethical reasoning can guide professional conduct when formal rules or technical expertise prove insufficient (International Ethics Standards Board for Accountants, 2020). Conversely, the negative coefficient might indicate that when both high competence/independence and high integrity exist simultaneously, their combined effect produces diminishing marginal returns or creates tensions between technical/structural imperatives and ethical considerations.

Second, the negative moderation may reflect measurement or contextual complexities specific to the Buleleng setting. Auditors with high integrity operating within deeply corrupt environments may experience heightened role conflict, cognitive dissonance, and professional isolation when their ethical principles clash with organizational norms implicitly discouraging rigorous scrutiny of powerful officials (Dewi et al., 2021; Puspasari & Suwardi, 2016). Research on moral stress and ethical fading demonstrates that individuals with strong ethical commitments often experience greater psychological burden in corrupt environments, potentially constraining their ability to fully leverage technical capabilities or exercise structural independence (Lin et al., 2022). High-integrity auditors may face subtle or overt organizational sanctions—marginalization, assignment to low-profile audits, career stagnation—that limit their influence on overall audit quality despite personal ethical strength (Lino et al., 2021; Paterson et al., 2019).

Third, the Theory of Planned Behavior offers insights into why integrity's moderating influence may be attenuated or reversed in certain contexts. This framework posits that behavioral intentions and actual conduct result from attitudes toward behavior, subjective norms within relevant communities, and perceived behavioral control (Ajzen, 1991). In environments where subjective norms favor corrupt practices and perceived behavioral control over ethical action is minimal, even individuals with strong personal integrity may struggle to translate ethical principles into effective professional conduct (Zulaikha et al., 2020). The Buleleng context exemplifies this dynamic: when corruption is normalized across organizational hierarchies, high-integrity auditors may correctly perceive that reporting sensitive findings will be futile or personally costly, leading to strategic silence or symbolic compliance rather than genuine ethical action (Hortal & Martínez, 2024; Prinz et al., 2013).

Research on whistleblowing and ethical disclosure illuminates these dynamics further. Studies consistently demonstrate that individuals' willingness to report wrongdoing depends critically on perceived organizational support, legal protections, and reasonable expectations of meaningful action resulting from disclosure (Achmad et al., 2024; Sujana et al., 2020). In contexts lacking these institutional supports, high-integrity individuals may experience profound moral distress while simultaneously recognizing the futility or danger of ethical action, leading to cognitive strategies that reconcile personal values with organizational pressures through selective attention, rationalization, or withdrawal (Sari et al., 2023). This phenomenon—termed moral disengagement—allows individuals to maintain self-perception as ethical actors while accommodating corrupt practices through various psychological mechanisms: diffusing responsibility across multiple actors, minimizing harm magnitude, dehumanizing victims, or framing inaction as necessary for greater goods (Sari et al., 2023).

The absence of significant moderating effects of integrity on fraud prevention relationships presents a theoretically significant finding that diverges from initial conceptualization of integrity as a universal moderator. These null findings suggest that fraud

prevention effectiveness may be more heavily determined by structural factors—competence, independence, control systems—with integrity playing a less direct moderating role than anticipated. Several theoretical frameworks offer explanatory value. First, fraud prevention may operate primarily through technical and procedural mechanisms where individual integrity, while important for ethical climate, does not substantively amplify or attenuate structural effects on fraud deterrence (Bhat, 2023; Ziorklui et al., 2024). Detection capabilities, control design quality, and reporting protocols create institutional fraud barriers relatively independent of individual auditor ethics.

Second, institutional theory suggests that fraud prevention effectiveness depends fundamentally on the broader institutional environment—regulatory frameworks, enforcement mechanisms, legal protections, political will—which shape both audit processes and organizational responses to audit findings (Paterson et al., 2019; Jeppesen, 2018). In contexts where corruption is deeply embedded and institutional support for anti-corruption efforts is weak, individual auditor integrity proves insufficient to prevent fraud, as auditors face overwhelming structural barriers to translating ethical principles into effective action. The "slippery slope framework" illuminates these dynamics: when trust in authorities is low and enforcement power is weak, even voluntary compliance declines as individuals perceive corruption as normalized and sanctions as unlikely (Prinz et al., 2013; Olsen et al., 2018). This creates an "anarchy equilibrium" where non-compliance becomes widespread, fundamentally undermining integrity's potential moderating influence.

Third, behavioral economics perspectives highlight that fraud prevention depends substantially on altering perpetrator incentive structures through credible detection threats and meaningful sanctions rather than monitoring agents' ethical characteristics (Fairchild & Marnet, 2022). This framework suggests that increasing perceived detection probability and penalty severity—through enhanced audit techniques, whistleblower protections, and consistent prosecution—more effectively deters fraud than emphasizing individual auditor integrity. Research on tax compliance demonstrates that enforcement power and procedural fairness perceptions significantly influence compliance behavior, with authority trustworthiness operating primarily through these structural mechanisms rather than individual enforcer ethics (Kirchler et al., 2006; Jimenez & Iyer, 2016). Werastuti et al. (2023) found that fraud opportunity elimination can be achieved through effective internal control systems. Ineffective monitoring creates opportunities for fraudulent behavior to occur undetected, as evidenced in studies of local financial institutions (Yumia et al., 2023). Rahayu and Diatmika (2023) revealed that implementing good governance principles in Village Credit Institutions creates transparent and accountable financial management, with 79.5% of fraud prevention variance explained by governance implementation.

The finding that integrity does not significantly moderate internal control system relationships with audit quality or fraud prevention suggests that well-designed control systems function through systematic processes and institutional mechanisms relatively independent of individual moral character. This aligns with systems theory emphasizing that robust organizational controls should operate effectively through embedded procedures, automated checks, and structural safeguards rather than depending on individual virtue (Committee of Sponsoring Organizations of the Treadway Commission, 2013). However, this also reveals a critical vulnerability: control systems can be systematically circumvented through collusion when multiple actors coordinate to bypass controls, regardless of some individuals' integrity levels (Shaleh et al., 2022; Hortal & Martínez, 2024).

Institutional corruption theory offers additional explanatory power. When corruption becomes systemic rather than episodic, it creates self-reinforcing dynamics wherein corrupt practices normalize, ethical individuals experience marginalization, and institutional mechanisms designed to combat corruption become co-opted or circumvented (Monteduro et

al., 2023; Nurferyanto & Takahashi, 2024). Evidence from Indonesia suggests corruption exhibits precisely these systemic characteristics: fiscal decentralization combined with weak governance creates opportunities that informal networks exploit through patron-client relationships, while political economy dynamics ensure powerful perpetrators face minimal accountability (Ratmono et al., 2021; Maria et al., 2021). In such environments, individual integrity may be necessary but profoundly insufficient for fraud prevention, as structural conditions overwhelm individual ethical agency.

Contemporary fraud research increasingly emphasizes that effective prevention requires multilayered approaches integrating technical capabilities, structural safeguards, ethical infrastructure, and technological innovations (Lubis et al., 2024; Achmad et al., 2024). The integration of artificial intelligence and advanced analytics represents a promising frontier, offering capabilities to detect sophisticated fraud patterns invisible to traditional audit techniques (Adelakun, 2022; Mubarrat, 2025). Machine learning algorithms can identify anomalous transactions, recognize behavioral patterns indicative of fraud, and conduct continuous monitoring across entire data populations rather than samples (Arham, 2025; Bính, 2025). Natural language processing enables analysis of textual communications—emails, reports, contracts—to identify linguistic markers suggesting deception, collusion, or manipulation (Antwi et al., 2024; Oyewole et al., 2024).

However, technological solutions introduce their own complexities and limitations. AI-driven fraud detection systems require high-quality, comprehensive data—often unavailable in public sectors with legacy systems, fragmented information architectures, and deliberate information suppression (Bin-Nashwan et al., 2024). Algorithm bias and transparency concerns raise questions about due process and fairness when automated systems flag individuals for investigation (Daoud, 2023). Most critically, technological detection capabilities prove meaningless without institutional will to act on findings and impose meaningful consequences (Thanasas et al., 2025). The Buleleng cases illustrate this limitation: fraud persisted not primarily due to detection failures but because powerful actors operated with impunity, confident that social networks and political influence would shield them from accountability.

The pattern of findings collectively suggests that enhancing internal audit effectiveness and fraud prevention in the Indonesian public sector requires comprehensive, contextualized interventions addressing technical capabilities, structural arrangements, ethical infrastructure, and institutional environments simultaneously. The strong direct effects of competence, independence, and internal controls indicate that foundational reforms—professional development programs, organizational restructuring to enhance independence, control system strengthening—remain essential priorities (Lubis et al., 2024; Ratmono & Darsono, 2021). Yet the complex moderating patterns and contextual evidence from Buleleng demonstrate that technical and structural reforms prove insufficient without parallel efforts to cultivate organizational cultures supporting ethical conduct, establish robust legal protections for auditors reporting sensitive findings, and ensure meaningful accountability for corruption regardless of perpetrator status or political connections (Alsughayer, 2021; Paterson et al., 2019; Branet & Hațegan, 2024).

International evidence from successful anti-corruption initiatives emphasizes that sustainable progress requires multipronged approaches integrating institutional reforms, civil society engagement, technological innovation, and political commitment (Jeppesen, 2018; Assakaf et al., 2018). Structural independence for audit organizations must be complemented by professional solidarity mechanisms—audit associations, international networks—that provide political cover and alternative career pathways for auditors facing domestic retaliation for ethical disclosure (Rana et al., 2021). Purnamawati (2018) found that whistleblowing significantly affects fraud detection in the banking sector, as proactive whistleblowing systems encourage employee participation in reporting fraudulent activities. Masdiantini et al. (2021)

found that whistleblowing negatively affects financial statement fraud, as the presence of whistleblowers enables quick identification of fraudulent acts by other parties, thereby preventing fraud potential. Whistleblower protection legislation must offer genuine legal safeguards and practical support rather than symbolic gestures that increase risk for potential disclosers (Achmad et al., 2024; Sujana et al., 2020). Public disclosure requirements and transparency mechanisms can leverage civil society pressure and media scrutiny to create external accountability when internal mechanisms prove captured or compromised (Priatnasari & Suhardjanto, 2020).

The study's theoretical contributions extend beyond empirical hypothesis testing to reveal fundamental limitations in current theoretical frameworks for explaining audit effectiveness in systemically corrupt contexts. Agency theory effectively predicts that competence and independence reduce information asymmetry, yet provides limited guidance on how these monitoring mechanisms function when both agents and monitors are embedded in social networks normalizing corrupt practices (Shaleh et al., 2022; Maria et al., 2019). Fraud triangle theory's emphasis on opportunity reduction through controls and detection is supported, yet Buleleng cases demonstrate that opportunities persist despite formal controls when informal networks systematically circumvent procedures (Shaleh et al., 2021; Tarjo et al., 2021). The Theory of Planned Behavior illuminates individual ethical decision-making but may underestimate constraining power of organizational and cultural factors shaping both attitudes and perceived behavioral control in deeply corrupt environments (Zulaikha et al., 2020).

Future research should investigate specific mechanisms through which integrity influences audit effectiveness across varying institutional contexts, examining whether integrity operates differently in environments with strong versus weak anti-corruption infrastructure. Longitudinal studies could illuminate how changes in organizational culture, legal protections, and enforcement mechanisms alter integrity's moderating role over time. Comparative research across jurisdictions with varying corruption levels could identify boundary conditions determining when individual ethics substantively influence organizational outcomes versus when structural factors dominate. Qualitative investigations could explore lived experiences of high-integrity auditors in corrupt environments, illuminating psychological processes, coping strategies, and organizational dynamics that quantitative methods cannot capture.

Methodological innovations offer promising avenues for advancing fraud research. Social network analysis could map informal relationships and patronage networks that facilitate or constrain audit effectiveness, revealing how social capital operates as both resource and constraint (Shaleh et al., 2022). Experimental designs could test behavioral interventions aimed at strengthening ethical decision-making under pressure, identifying practical strategies for supporting auditor integrity in challenging contexts (Olsen et al., 2018). Text analysis of audit reports, organizational communications, and media coverage could reveal linguistic patterns indicating ethical disclosure suppression or rationalization of corrupt practices (Oyewole et al., 2024). Integration of qualitative and quantitative approaches through mixed-methods designs could provide comprehensive understanding of complex phenomena that neither approach alone adequately captures.

The practical implications extend across multiple governance levels. At the organizational level, public sector entities must invest not merely in technical training but in comprehensive competency development encompassing forensic skills, data analytics, behavioral indicators recognition, and ethical reasoning (Alsughayer, 2021; Galanis et al., 2023). Structural reforms should establish genuine independence through reporting relationships to legislative bodies or independent oversight commissions rather than entity management, complemented by tenure protections and adequate resourcing (Saputra et al., 2020; Ratmono & Darsono, 2021). Control system enhancements must address both design

weaknesses and implementation gaps, recognizing that formal procedures prove meaningless without organizational commitment to enforce compliance consistently (Bhat, 2023; Yurniwati & Afdhal, 2015).

At the policy level, national anti-corruption strategies must recognize that technical solutions alone cannot overcome systemic corruption rooted in political economy dynamics and social structures. Meaningful progress requires political will to establish genuine accountability—including prosecution of powerful perpetrators—complemented by civil service reforms providing competitive compensation, merit-based advancement, and professional development opportunities that reduce incentives for corrupt supplementation of inadequate salaries (Ratmono et al., 2021). International cooperation mechanisms can provide external pressure, technical assistance, and political cover for domestic reformers facing powerful vested interests (Jeppesen, 2018). Digital governance innovations leveraging blockchain, open data platforms, and participatory monitoring can create transparency mechanisms reducing opportunities for corruption while empowering citizen oversight (Thanasas et al., 2025).

The research urgency extends beyond academic contribution to address pressing societal needs. Indonesia's commitment to Sustainable Development Goal 16—promoting peaceful, just, and inclusive institutions—requires demonstrably effective oversight mechanisms that rebuild public trust through genuine accountability (Branet & Hațegan, 2024). The Buleleng fraud cases, while representing governance failures, also offer opportunities for learning and reform. Systematic analysis of these incidents can identify specific vulnerabilities—control gaps, independence deficits, competency weaknesses—requiring targeted interventions. Transparent investigation and meaningful accountability for perpetrators can signal commitment to ethical governance, potentially initiating positive feedback loops wherein reduced impunity strengthens voluntary compliance and encourages ethical disclosure.

Ultimately, this study reveals that combating public sector fraud requires moving beyond technocratic solutions toward comprehensive governance transformation. While auditor competence, independence, and control systems provide essential infrastructure, their effectiveness depends fundamentally on political will, ethical culture, and institutional environments that support rather than punish integrity. The complex moderating patterns observed suggest that individual ethics operate within constraining or enabling structural contexts, with contextual factors often dominating individual agency in determining outcomes. Sustainable anti-corruption progress therefore demands simultaneous attention to technical capacity building, structural reform, ethical infrastructure development, and broader institutional transformation—a challenging but essential agenda for strengthening democratic governance and public accountability.

## CONCLUSION

This study examines the influence of auditor competence, supervisory independence, and internal control systems on internal audit quality and fraud prevention in Indonesia's public sector, with auditor integrity as a moderating variable. The empirical analysis using PLS-SEM on 53 auditors at Buleleng Regency Inspectorate yields several important findings.

All six direct relationships prove statistically significant, confirming that auditor competence, supervisory independence, and internal control systems constitute essential determinants of internal audit quality and fraud prevention. Internal control systems exert the strongest effect on audit quality ($\beta = 0.431$, $p < 0.001$), while auditor competence most powerfully influences fraud prevention ($\beta = 0.408$, $p = 0.001$). These findings corroborate agency theory's emphasis on monitoring mechanisms and validate the fraud triangle's focus on opportunity reduction through effective controls.

The moderating analysis reveals complex patterns that challenge conventional assumptions about ethical infrastructure. Auditor integrity significantly but negatively moderates the relationships between competence and audit quality ($\beta = -0.264$, $p = 0.034$) and between independence and audit quality ($\beta = -0.095$, $p = 0.029$). However, integrity demonstrates no significant moderating effects on fraud prevention outcomes or relationships involving internal control systems. These findings suggest that integrity operates meaningfully only for audit processes mediated through individual judgment and discretion, losing relevance when organizational mechanisms function through depersonalized processes or when systemic governance challenges constrain individual ethical agency.

The practical implications of this study emphasize that sustainable fraud prevention requires comprehensive interventions addressing multiple dimensions simultaneously. Organizations should invest in developing auditor technical competencies, particularly forensic skills and technological capabilities, while strengthening internal control system design and implementation. Regulatory authorities should establish genuine structural independence for audit functions through appropriate reporting relationships and robust whistleblower protection mechanisms. Furthermore, cultivating organizational cultures that support ethical conduct and consistent enforcement of accountability standards remains essential for translating audit capabilities into effective fraud deterrence.

Future research should employ longitudinal designs to establish causal relationships, conduct comparative studies across different jurisdictions to enhance generalizability, and integrate qualitative approaches to explore the complex dynamics between individual integrity and institutional environments in shaping audit effectiveness and fraud prevention outcomes.

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