

Does the Internal Control System Play a Strong Safeguarding Role Against Fraud in Local Communities?

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Abstract This paper investigates the application of appropriate mechanisms and procedures for identifying, reducing, and suppressing fraud. Challenges and obstacles faced by municipalities in the implementation of internal controls for the prevention of fraud are also discussed. A survey was conducted in various Belgrade municipalities, and 162 usable responses were received. It was observed that there is a lack of internal control or that, where it exists, it is not sufficient to effectively manage fraud. Further, the results of the study indicate that only one element of fraud risk management, the level of education of employees, is significant in reducing fraud incidents. Namely, the education and training of employees contribute the most to fraud detection. The implications of these findings are discussed. Through the analysis of the relevant literature and research, this paper offers recommendations for improving internal control in local municipalities in order to reduce the risk of fraud and to increase responsibility in the management of public resources.

Keywords: • fraud risk management • local self-government units • fraud detection • internal control • ethic perception • education

1 Introduction

“Local government is the third tier of government, which is closer to the people” (Baba, Babajo, & Namahe, 2017).

As pointed out by Abd Aziz, Ab Rahman, Alam, and Said (2015), governance in public administration has become a global issue as a result of a continuous series of governance failures, fraud, inefficiencies, corruption, and poor internal control and financial management. In the past, the issue of whether formalization and internal control systems can be used by companies as anti-corruption measures has not received much attention. This suggests that in the absence of effective institutions, organizations should develop appropriate internal control mechanisms to prevent the harm caused by bribery (Le, Vu, V. P. A. Do, & Do, 2022). Internal controls enrich the understanding of management requirements and are necessary to distinguish between good and bad management practices (Ncgobo & Malefane, 2017). At the local level, municipal government manifests in a variety of structures, typically aligned with the size of the respective municipality. These structures include cities, boroughs, townships, villages, and hamlets that may exist within larger municipalities (Petrucelli & Peters, 2016). The continuous presence of corruption, embezzlement, fraud, theft, abuse of power, nepotism, favouritism, clientelism, and discretionary misconduct within governments have resulted in the need for proactive action. Effective risk management is closely linked to financial sustainability. Wällstedt, Grossi, and Almqvist (2014) point out that achieving financial sustainability in municipal organizations requires customized solutions based on factors such as the organization's size and structure, as well as shifts in political power within the municipality. Further, the findings highlight the significant influence of the municipality's management or governance system on obtaining financial sustainability. The Republic of Serbia implements various types of activities in order to restrain the effects of the grey economy that lead to a decrease in budget revenues (Knežević, Cvetković, M. Mićović, Mitrović, & Milojević, 2021). This paper investigates the importance of internal control in preventing fraud in municipalities (local self-government units). The focus is on the analysis of the role of internal control in detecting, preventing, and suppressing fraud in the financial operations of municipal bodies.

Fraud is a significant problem recognized at the global level, both for private and public sector entities. However, quantifying the extent and costs of fraud is difficult due to concealment by perpetrators and lack of reliable reporting. According to the assessment of the Australian Institute of Criminology (Australian Institute of Criminology, n.d.), it is estimated that for every identified fraud, there are three that remain unreported or undetected. This is precisely why it is important to increase awareness of the importance of ethics in managing the resources of organizations in the public sector. This paper supports this idea,

finding that internal control is not sufficient to detect fraud in the organization, which represents a discussion for future research.

If municipalities are not effective in dealing with the risk of fraud, the significant resources they manage will be at risk. As in numerous countries around the world, fraud and corruption remain a significant concern in Serbia as well. Fraudulent activities appear in various forms and across different sectors. In municipalities, an important aspect of financial management and protection of public resources is fraud risk management. There are three critical stages included in the risk management process: identifying risks, analyzing and assessing risks, and implementing risk mitigation strategies while continuously monitoring their effectiveness. In order to achieve effective risk management, it is essential to take proactive measures that focus on controlling future outcomes rather than responding reactively to events. Identifying and safeguarding the value within an organization using an approach specific to that organization is the most effective way to mitigate fraud risk. The attempts to foresee the individuals within an organization's stakeholders who may engage in fraudulent activities are challenging. A customized approach that considers the unique nature of organizations in terms of their structure, staff, and individual characteristics is essential (De Aquino & Cardoso, 2017). It is especially important to improve the system of managing the risk of fraud through the educational system (Knežević, Milojević, & Špile, 2021).

A study by Ziegenfuss (1996) that looked at fraud in local governments showed that there were differences in mitigation abilities based on the type of government (city vs county). Chalmers, Hay, and Khlif (2019) pointed out that the quality of internal control can have a significant effect on the decision-making of financial information users. Nogueira and Jorge (2017) found a significant and positive correlation between the level of internal control, including internal auditing, and decisions regarding financial and budgetary information at the municipal level. Similarly, Jorge, Nogueira, and Pinto (2022) note that conformity auditing is prioritized over other forms of control due to the predominant emphasis on the inputs-based budget in public financial management.

Bearing in mind the critical arguments made in the existing literature, we are particularly interested in any unexpected effects that could arise from fraud risk management itself. Policymakers should pay special attention to analysing the movement of cash flow within different governmental units. The concentrated control of operations within the federal government, the substantial financial transactions between the federal and state governments, and the direct impact of state governments on the local municipal level are the instances that can potentially lead to mismanagement and fraud. Internal control includes the entity risk management framework (Riso & Castellini, 2019).

It can be seen that there is a research gap in the literature. To the best of our knowledge, so far, very few studies have addressed this aspect, which leaves us with limited knowledge about the observed problem. The lack of relevant research in this area can make it difficult to make informed decisions in practice.

There are various ways to strengthen the system of internal control, such as introducing an adequate FRM system (fraud risk management), raising awareness of the ethical perception importance, and increasing employee education. The main goal of this paper is to find ways to more effectively manage the risk of fraud in municipalities as local self-government units within the preventive–control system. Considering this goal, the paper provides answers to the following three research questions:

Research Question 1: To what extent can local self-government units (municipalities) use fraud risk management (FRM) to effectively detect and prevent fraudulent activities in a changing business environment?

Research Question 2: How can the ethical perceptions of employees and management influence the awareness of fraud and its detection and reporting within the organization?

Research Question 3: What is the impact of education, both formal and informal, on the ability of individuals to recognize and report fraudulent activities in the work environment?

This paper is organized as follows. Section 2 reviews the literature. Section 3 describes the materials and methods. Section 4 provides the results obtained in the conducted research model. Section 5 presents the results. Section 6 provides concluding remarks.

2 Literature review

Text Serving the citizens is the fundamental purpose of municipal or local self-government. This service should be rooted in democratic values and characterized by efficiency and transparency. Expressed differently, it should operate in accordance with established ethical criteria, standards, and principles on a daily basis (Donev, 2008). Like many countries, Serbia faces challenges related to limited resources and a significant portion of its budget is allocated to public spending (Eremić-Đodić & Bosnjak, 2020). The equilibrium of economic competition can be disturbed by fraud committed by municipal officials, and distortions can be introduced into the system (Dvorak, 2023). When fraudsters misappropriate financial resources earmarked for the local community, it exacerbates social inequality and injustice, eroding the ethical foundations of society.

Without a doubt, the majority of government institutions worldwide, which differ in their legal, economic, or social objectives, encounter significant degrees of corruption and misconduct, whether it be in terms of finances or administration. However, it is important to note that this phenomenon differs in terms of the extent and prevalence of corruption between different countries. Developing countries often have significantly higher rates of corruption compared to developed countries, according to reports by Transparency International (2022).

The main purpose of internal control is to support the entity in managing its risk to achieve set goals and maintain performance (Nawawi & Salin, 2018). An internal control and whistleblowing system can have a positive and significant impact on fraud prevention, while an ethical climate can strengthen the impact of an internal control system on fraud prevention (Sultan & Damayanti, 2023). In terms of revenue collection (Mwachiro, 2013) found that weak internal controls encourage embezzlement in revenue collection, lead to loss of revenue, and create collusion with fraud. All the activities of the local government aimed at encouraging a control environment represent an excellent starting point for fraud control and management (Nuswantara, Maulidi, & Pujiono, 2017). Internal audits review internal controls for key risks, including fraud risk, and provide assurance to management about the operational effectiveness of these controls. In addition, senior managers have a role in reviewing the results of monitoring activities and using the insights to inform continuous improvement in fraud prevention (Victorian Auditor-General's Office, 2012). They are also primarily responsible for the implementation and effectiveness of internal controls. However, the entity may be exposed to danger in terms of management overriding controls in the public and private sectors (Knežević, Milojević, & Paunović, 2021).

The internal auditor holds the authority to promptly notify the internal audit unit's manager if, during an audit, there arises any suspicion of irregularities and/or fraud that might lead to criminal, violation, or disciplinary proceedings (Dimitrova & Paneva, 2019). The implementation of a robust system of established internal financial controls has a pivotal role in enhancing financial discipline and ensuring transparency in the utilization of funds, particularly when it comes to public funds derived from taxpayers (Radović, Vitomir, & Popović, 2019). These controls are instrumental in safeguarding the integrity of financial processes and preventing misuse of resources. Nevertheless, internal audits alone cannot guarantee the prevention and elimination of fraud, violations, and misconduct. The responsibility for overseeing and managing these processes falls entirely on the institution's leadership. The entire process should be effectively managed and monitored by the head of the institution, while also implementing an efficient internal control environment and considering any recommendations made. The leadership's crucial role is to facilitate the enhancement of managerial functions within the institution (Zhvania, 2023).

The local authorities in Croatia are perceived to be at the third highest level of corruption, following the judiciary and healthcare sectors (Bađun, 2009). This suggests that corruption is a significant concern within local government institutions in the country, highlighting the need for efforts to address and mitigate corruption at the local level. For the purpose of maintaining public trust and ensuring the proper functioning of local governance, effective measures to combat corruption, enhance transparency, and strengthen accountability are essential.

Dewi, Mahmudi, and Maulana (2021) have identified that information asymmetry, religiosity, organizational culture, and regulatory enforcement exert significant influence on the village government officials' inclination to engage in fraudulent activities. The research results by Permana, Perdana, and Kurniasih (2017) show that when compensation is considered appropriate, it has a positive impact on reducing the occurrence of fraud within government agencies. Within municipalities, it is of crucial importance to have access to reliable statistical information to effectively prevent corruption and financial crimes. The municipal authorities responsible for prevention cannot identify the areas with the highest risks without this data. In essence, at the local level, reliable statistical information is indispensable for informed decision making and targeted efforts to combat corruption and financial wrongdoing.

As the first line of defence against fraud, internal control plays a critical role. With regard to the fraud triangle (a model used to explain the factors that contribute to fraud), opportunity is one of the key determinants (Huefner, 2011). Internal control is structured as a systematic set of procedures and responsibilities involving all individuals who participate in the financial and economic processes of both direct and indirect budget beneficiaries, as well as social insurance organizations (Davey, 2009). The effective implementation of an internal control system is very useful for discouraging fraud and reducing opportunities for fraud to take place. This is due to the combination of hard control and soft control that is implemented to prevent fraud. Hard controls, such as segregation of duties and authorization of transactions, are applied to prevent opportunities for fraud. Soft controls, such as the adoption of a code of ethics and good ethical values, can discourage fraud.

Local self-government units should develop a control strategy that aligns with the strategies, policies, and programs established to achieve their objectives. Adequate addressing of critical risks within the organization is closely linked to the effectiveness of internal audits and their value in the organization. Ensuring an impartial and objective evaluation of the internal control system is the primary objective of internal audits within the public sector (Nestorovska, 2013). In

addition, the effectiveness of the internal control system is shown to have a negative effect on fraud in government agencies.

3 Methodology

For this paper, a special questionnaire was developed with questions related to the function of internal control in managing the risk of fraud in municipalities, which represent important units of local self-government in terms of the size of the resources they manage. Different measurement scales for different statements or variables were used. The survey questionnaire used in the research was adapted to the research area according to the ACFE (2022) and based on Ziegenfuss (1996). Respondents from the municipality participated in the sample. This study covered a population of 162 employees in units for financial and material affairs and audit affairs, in management or non-management positions.

According to Article 11 of the Law on Territorial Organization of the Republic of Serbia, "Municipality is the basic territorial unit in which local self-government exists, that is capable of independently exercising all rights and duties within its competence through its organs and which has at least 10.000 inhabitants". The municipalities, as units of local self-government, have the obligation to respect the following laws: Law on the budget system, Law on Local Self-Government, Law on Local Self-Government Financing, Law on the Budget of the Republic of Serbia, Law on Public Debt, Law on Audit, and Law on State Audit Institution. The following are the areas of knowledge and skills for special functional competence for the field of financial and material affairs: 1) budget system of the Republic of Serbia; 2) international accounting standards in the public sector; 3) methods and procedures of financial planning, analysis, and reporting; 4) terminology, standards, methods, and procedures from the field of budget accounting and reporting; 5) budget planning procedure and reporting; 6) budget execution procedure; 7) relevant software; and 8) financial management and control. The areas of knowledge and skills for special functional competence in the field of audit work are 1) international standards in the field of internal audit in the public sector and the code of professional ethics; 2) internal audit methods and tools; 3) system audit, performance audit, financial audit, information technology audit, and regulatory compliance audit; 4) COSO model of internal control; and 5) the procedure for implementing the annual internal audit plan.

The respondents were surveyed from the territory made up of the municipalities of the city of Belgrade, namely Barajevo, Voždovac, Vračar, Grocka, Zvezdara, Zemun, Lazarevac, Mladenovac, Novi Beograd, Obrenovac, Palilula, Rakovica, Savski Venac, Sopot, Stari grad, Surčin, and Čukarica (17 municipalities in total). Novi Beograd is the largest Belgrade municipality and the second largest in Serbia

- (209.812 inhabitants) (Prvi rezultati Popisa stanovništva, domaćinstava i stanova 2022, 2022). The respondents were classified according to the following divisions:
1. Top management (heads of departments for budget, treasury affairs, and local economic development).
 2. Middle-line management (heads of departments for budget, treasury affairs, and local economic development).
 3. Operation management (senior officers).
 4. Administration (liquidator jobs and related jobs).
 5. Other (independent advisers, accountants, persons in charge of treasury, internal auditor, persons in charge of internal control).

Before starting the research, the respondents were informed about the full academic purpose of the research and then assured of the anonymity of the research. The initial idea was for the respondents to declare themselves according to the municipality they belong to, but this was abandoned because the respondents largely refused to answer this question. Each respondent gave verbal consent to participate in the research for scientific purposes. The questionnaire was distributed online to ensure additional security in the anonymity of the respondent's identity. Hierarchical multiple regression was used to analyse the relationships between the variables that were generated based on the statements contained in the questionnaire. All calculations were made in MS Excel and SPSS v.23.

4 **Results**

The key results from the survey are presented below. After the sampling and the analysis of the received answers, it was determined that there were 162 valid questionnaires. The response rate was 43.2%, which can be assessed as adequate. The questionnaire included several categorical variables related to the respondents themselves, and the resulting descriptive statistics are presented in Table 1. Based on the data presented, it can be concluded that women made up the majority of the sample, 66.7%, while men accounted for 33.33%. The dominant age group was people over 30 years old. The majority of respondents had completed Master's studies (30.9%), followed by persons with a university degree (21.6%). As many as 43.2% of respondents belonged to the category other, where internal auditors were included. When it came to work experience, the respondents with more than 15 years of work experience dominated.

Table 1: Demographic characteristics of the respondents

Category	No	%
Gender		
Female	108	66.7 %
Male	54	33.3 %

Category	No	%
Sum	162	100 %
<i>Age</i>		
< 30	51	31.5 %
31 – 40	37	22.8 %
41 – 50	56	34.6 %
51 – 60	14	8.6 %
> 61	4	2.5 %
Sum	162	100%
<i>Education</i>		
Primary school	0	0 %
High school	30	18.5 %
College/high school	18	11.1 %
Faculty - basic studies	35	21.6 %
Faculty - master studies	50	30.9 %
Faculty – Magister's studies	17	10.5 %
Doctoral studies	12	7.4 %
Sum	162	100%
<i>Position in the organization</i>		
Top management	20	12.3 %
Middle-line management	25	15.4 %
Operation management	30	18.5 %
Administration	17	10.5 %
Other	70	43.2 %
Sum	162	100%
<i>Work experience</i>		
< 1	14	8.6 %
1 – 5	30	18.5 %
5 – 10	28	17.3 %
10 – 15	33	20.4 %
> 15	57	35.2 %
Sum	162	100%

By grouping statements from different thematic areas of the questionnaire, the following variables were created: fraud risk management (FRM), ethic perception (EP), and fraud detection (FD).

The FRM variable consisted of the following statements (answers are scaled from 1 to 7):

1. "My local self-government has policies and procedures in place to prevent and detect local self-government fraud."
2. "Employees in my local government are familiar with the responsibilities and obligations related to fraud prevention."
3. "In my local self-government, control and monitoring mechanisms have been introduced to detect abuses and frauds, as well as their prevention."
4. "In my local self-government, trainings on risks and fraud detection methods are continuously conducted."

- "Internal control is not enough to detect fraud in local self-government, but in combination with other factors, such as transparency, accountability and strong ethical principles, it can be very useful."
- "Measures have been identified to ensure transparency in procurement and contract award procedures in order to prevent abuse and fraud."
- "Cooperation with internal auditors in detecting fraud in my local government is satisfactory."

The EP variable consisted of the following three statements (answers are scaled from 1 to 5):

- Rate how much you believe that if a manager in your company was found to have engaged in unethical behaviour that resulted primarily in personal gain (rather than company gain), he would be immediately reprimanded?"
- Rate how much you believe that if a manager in your company was found to have engaged in unethical behaviour which resulted primarily in corporate profit (rather than personal profit), he would be reprimanded immediately?"
- "Rate how certain you are that top management in your company unequivocally states that they will not tolerate unethical behaviour?"

The FD variable consisted of the following two statements (answers are scaled from 1 to 5):

- "Rate to what extent you think that fraud can occur due to the weakness of internal control in the company?"
- "Rate how much you think internal control can help detect fraud initially?"

To test validity and internal consistency, Cronbach's alpha coefficient was used. For all observed variables, the specified coefficient reached values of 0.977, 0.860, and 0.643, respectively.

In order to test the ability for fraud detection, a hierarchical multiple regression model was developed that included several independent variables (Table 2).

Table 2: Hierarchical multiple regression analyses for fraud risk management and ethical perception of fraud detection

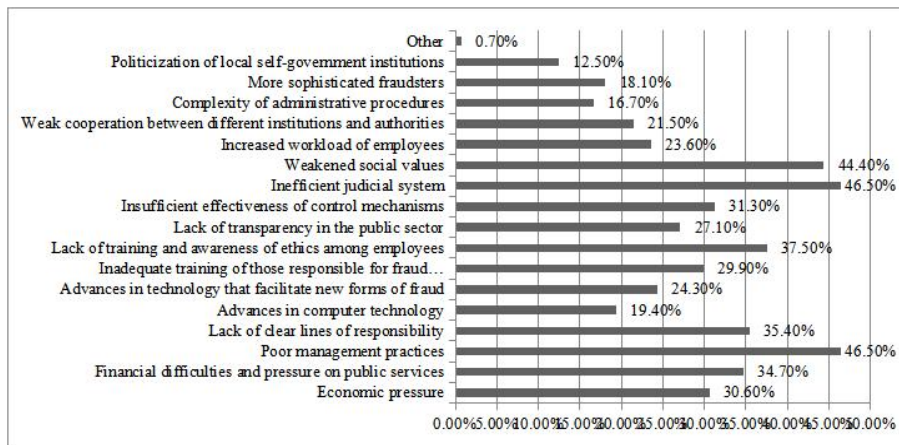
	Constructs	R ²	R ² change	F	Standardized coefficient β	t	Tolerance	VIF
Block 1: Control Variables	.055		3.059*					
	Age				.076	.574	.342	2.925
	Education				.153	1.967*	.986	1.015

	Constructs	R^2	R^2 change	F	Standardize d coefficient β	t	Tolerance	VIF
	Work experience				.093	.366	.340	2.94 1
Block 2:								
Ethic	.068	.01 3	2.863*	.11 7	1.485	.950	1.052	
Perception								
Block 3:								
Fraud Risk	.071	.00 3	2.369*	- 7	-.661	.807	1.239	
Management								

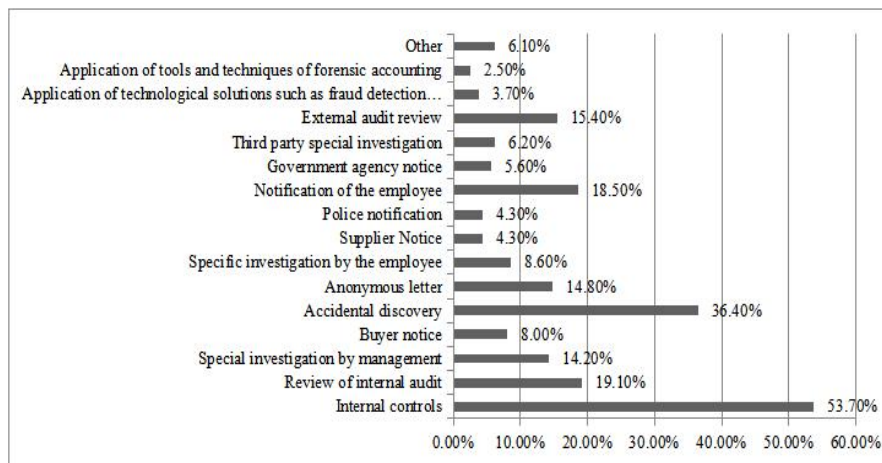
The results of the statistical analysis show that the regression model that included categorical variables had a statistically significant impact on fraud detection. Additionally, by looking at the value of the t coefficient, it could be concluded that education level had the strongest influence, with a high level of statistical significance. The variables related to fraud risk management (FRM) and ethic perception (EP) achieved a statistically significant impact, but they contributed significantly less to fraud detection than the level of education. In all observed relations, the value of the VIF coefficient was less than 3 and was in accordance with the rigorous acceptable limit. The obtained results indicate that the level of education, that is, the education and training of employees, contributed the most to fraud detection. In this way, the results of the study show that the level of education is a key factor in fraud detection. It follows from this that all other measures implemented, including fraud risk management, are not of great importance and that visible results for fraud detection can only be achieved by investments in formal employee education and training in the field of effective management of the risk of fraudulent actions. Additional results are shown through descriptive statistics in Figures 1-5. The respondents gave answers to questions with a multiple-choice option.

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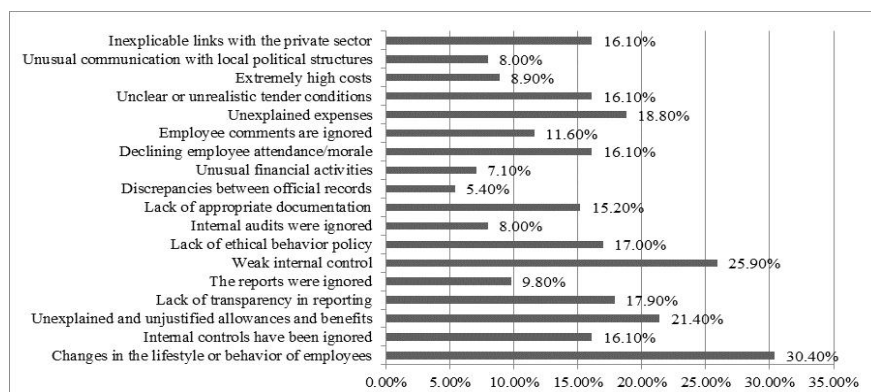
Figure 1: Prediction of the fraud probability in the public sector



Based on Figure 1, it can be seen that the intensity of the causes that can lead to the occurrence of fraud in the public sector varies, among which the following stand out: poor management practices (46.5%), an ineffective judicial system (46.5%), and weakened social values (44.4%). Also, it can be seen that lack of training and awareness of ethics among employees (37.5%) is an important factor for effective fraud risk management in the area of prediction of fraud probability in the public sector.

Figure 2: Method of fraud detection in the organization

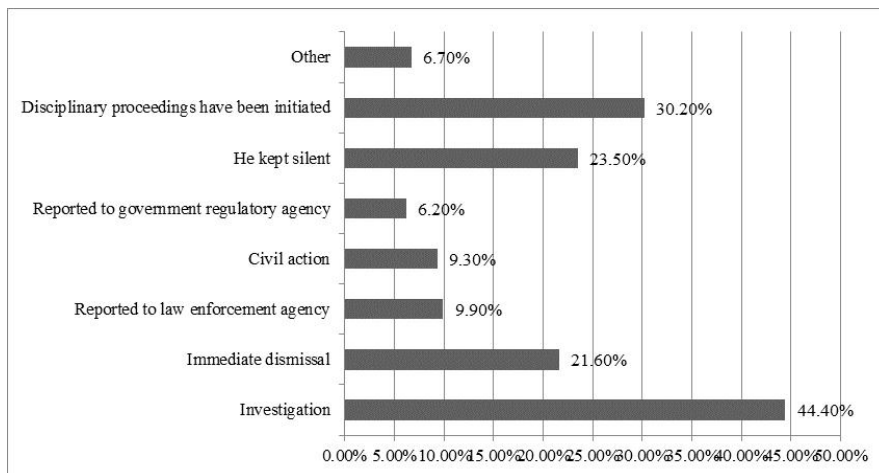
As seen in Figure 2, internal controls carried the most importance in detecting fraud in the organization (53.7%), followed by accidental discoveries of the occurrence of fraud (36.3%), employee's notification (18.5%), and review of external audit (15.4%).

Figure 3: Red flags in the public sector

Looking at the results from Figure 3, several red flags stand out that can be the cause of fraudulent actions, namely, changes in lifestyle (30.4%), weak internal

control (25.9%), unexplained and unjustified reasons (21.4%), and inexplicable expenses (18.8%).

Figure 4: List of fraud-related activities



As seen in Figure 4, the most frequently implemented fraud-related activities were investigations (44.4%), followed by the initiation of disciplinary proceedings (30.2%) and remaining silent (23.5%).

Figure 5: Review of internal control weaknesses

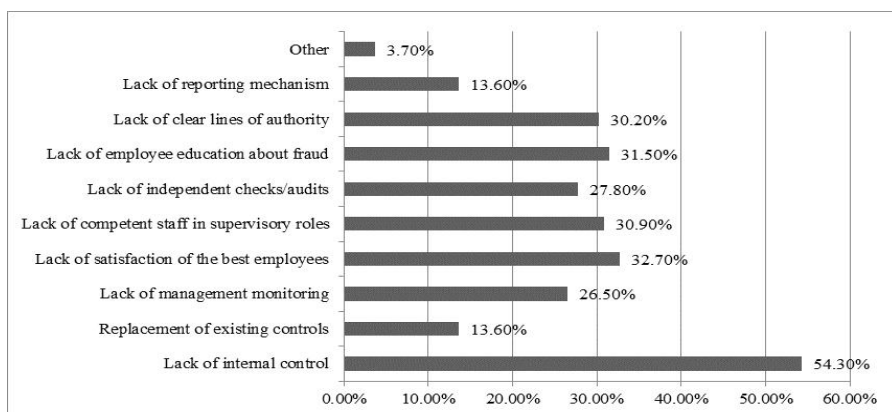


Figure 5 shows that among the internal control weaknesses, the following stand out: lack of internal control (54.3%), lack of satisfaction (32.7%), and lack of employee education about fraud (31.5%). Educating employees about the importance of internal controls and their role in preventing fraud can help strengthen the organization's control environment.

Table 3: Fraud risk management (extended version of variable FRM)

	Mean	SD
My organization has policies and procedures in place to prevent and detect fraud in the organization.	2.94	1.32
The employees of my organization are familiar with the responsibilities and obligations related to fraud prevention.	3.17	1.32
In my organization, there is an open and secure communication channel through which employees can report suspected fraud anonymously.	2.75	1.39
The employees of my organization are trained in policies and procedures related to fraud prevention.	2.65	1.28
My organization conducts regular internal reviews and audits to identify potentially fraudulent activity.	2.85	1.39
Control and monitoring mechanisms have been introduced in my organization to detect abuses and frauds, as well as their prevention.	2.98	1.37
Fraud reports in my organization are processed in a timely manner and the time taken to resolve them is justified (rational).	2.86	1.38
In my organization, if there are indications that suspicious activities are being carried out, internal investigations are conducted, and appropriate legal measures are taken.	2.99	1.35
In my organization, cooperation with competent institutions for the suppression of corruption and fraud is encouraged.	2.92	1.36
In my organization, training on fraud risks and methods is continuously conducted.	2.47	1.29
Financial transaction control and monitoring mechanisms have been established in my organization to detect irregularities.	2.91	1.35
Internal control is not sufficient to detect fraud in an organization, but in combination with other factors, such as transparency, accountability, and strong ethical principles, it can be very useful.	3.28	1.28
The possibility of a conflict of interest in my organization is taken into account.	3.02	1.31
Measures have been identified to ensure transparency in procurement and contract award procedures in order to prevent abuse and fraud.	2.88	1.30
My organization has established cooperation with other units of the organization in order to exchange information on fraud and good practices.	2.80	1.24
My organization has procedures in place to monitor and measure the effectiveness of policies and procedures for fraud prevention and suppression.	2.81	1.28
Cooperation with internal auditors in detecting fraud in my organization is satisfactory.	2.77	1.30
Appropriate procedures are carried out with employees who have been identified as fraud perpetrators.	2.93	1.29
There are special measures to prevent the manipulation of information or documents in my organization.	2.95	1.33
Integrity and responsible management are promoted in my organization.	3.09	1.34

As can be seen from the previous table, the respondents expressed the highest degree of agreement with the statement that internal control is not sufficient to detect fraud in the organization; however, in combination with other factors, such as transparency, accountability, and strong ethical principles, it can be very useful (mean = 3.28). On the other hand, they expressed the lowest degree of agreement with the statement that their organization continuously conducts training on fraud risks and methods (mean = 2.47) (Table 3).

5 Discussion

Looking at the broader picture, including the results of descriptive statistics, gives a more complete understanding of the research questions. Regarding the first question, it can be seen that, at the level of the Belgrade municipalities, the exposure to the risk of fraud is not effectively managed because none of the municipalities have developed a strategic and coordinated approach to fraud control. This is worrisome given the significant value of public funds and assets they manage. Without a risk-based fraud control plan, there is no formal basis for assessing whether fraud strategies are well-founded, coordinated, deliberately implemented, and audited. One issue is the formal implementation of the internal control and audit system, and another issue is how effective it is in risk management. If the internal control and internal audit functions are in passive positions, without proactive action, they may not be effective. These shortcomings increase the opportunities for fraud and thereby threaten the reputation of municipal management and lead to abuses in spending limited public funds. The results showed that, generally, bad management practices and an ineffective judicial system are the most common triggers for fraud, internal controls are most important in detecting fraud in the organization, lifestyle changes are the most common red flag that points to the possibility of fraud, and investigations are the most common activity within the set of activities carried out in connection with fraud. This research has identified a significant issue in the internal control systems of municipalities and suggests that a holistic solution is needed. It is important to consider the conditions of the control environment in the internal control system. These findings are a valuable contribution to the field and have practical implications for improving corporate governance and risk management. As such, our study fills a gap in the literature. The research results showed that adequate fraud training was not provided. For this reason, the importance of providing fraud awareness training to both new and existing employees needs to be emphasized at the outset. This is supported by the practical implication of one of the findings of the paper that stands out, namely that visible results for fraud detection can only be achieved by investing in employee education. Adopting fraud risk management policies is not enough. They need to be adequately

supported by further training and awareness initiatives that should aim to ensure that staff understand their responsibilities in the fraud control process.

6 Conclusions and discussions

The ongoing endeavour of the management of fraud risk in municipalities necessitates the active involvement of all relevant stakeholders and continual enhancement of the fraud prevention and detection framework. Promoting transparency, upholding integrity, and fostering accountability in public finance administration is the primary objective, thereby fostering public confidence in local governance. The authors of this study have concluded that the capacity of internal control in the function of preventing fraudulent activities needs to be strengthened to improve the economic efficiency of municipalities. Identifying the weaknesses, enhancing the existing processes, and establishing an internal financial control system that aligns with the unique local requirements and challenges is the ultimate objective. Strengthening the internal control system affects the organization's ability to achieve good governance on the one hand and affects fraud prevention within the organization on the other hand. Lack of employee education and lack of training and awareness of ethics among employees have shown that they are important factors for effective fraud risk management. Without proper education, training and awareness about ethical issues, employees may unknowingly engage in unethical behaviour, such as fraud, corruption, or conflicts of interest. This can lead to legal issues and damage to the organization's reputation. To address these issues, organizations should invest in comprehensive education and training programs that not only provide employees with a clear understanding of ethical principles but also empower them to make ethical decisions. This can include ethics training sessions, regular communication about ethical expectations, and the establishment of clear policies and procedures for reporting ethical concerns. The limitations of the study are related to the potential subjectivity of the respondents when giving answers and to the narrow geographical area in which the research was conducted (only Belgrade municipalities). This study could help policymakers establish greater accountability among various government departments and agencies in the area of fraud prevention and detection, especially in the fields of improving governance policies, restoring trust in the justice system, and overcoming problems related to weakened social values. In addition, four key issues arise after a critical analysis of the issue in question and the conducted research. First, having in mind that internal control is the most common way to detect fraud, it is necessary to continue to strengthen it where it already exists, as well as to implement it where it has not been formally established. The second issue of employee education emerges as one of the key factors for the weak functioning of internal controls in municipalities. Third, it is necessary to bear in mind that weak internal control is one of the key red flags (warning signs) for the possibility of fraudulent actions in

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organizations. Further, taking into consideration that investigations are the most common response to fraud-related activity, it is worth considering increasing the number of employees with a CFE credential (certified fraud examiner) in the public sector. Even the most comprehensive internal control structure cannot guarantee the prevention of fraud; therefore, the solution should involve increasing education and strengthening professional skills on the one hand and increasing awareness of the fraudulent actions' severity and consequences on the other hand. This study could be replicated with a specific focus on other public-sector entities. Such a replication could potentially yield valuable lessons and best practices by enabling a comparative analysis among distinct types of organizations. The financial management and control system is not a set of documents but, rather, procedures and actions that are "living" and can adapt to the environment to monitor and reduce as many risks as possible. The management still does not recognize the internal audit as a tool that could help them in effective management, with the consequence that they often do not act according to the recommendations of the internal audit. Therefore, it is important to further improve internal financial control and to further increase awareness and understanding of its importance to improve the realization of business goals and tasks in an economical, effective, and efficient manner.

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