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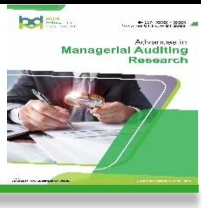

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The Failure of Governance and Internal Controls in Preventing Fraud in the Company

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ABSTRACT

Purpose: This study investigates the organizational and individual factors that contribute to the failure of corporate governance and internal controls in preventing fraud. It highlights the role of senior management, board oversight, and conflicts of interest in enabling fraudulent activities within organizations.

Research Design and Methodology: The research utilizes a systematic literature review (SLR) approach to analyze existing studies on corporate governance, internal controls, and fraud prevention. The study synthesizes findings from various disciplines, including governance theories, forensic accounting, and organizational behavior, to identify patterns and trends contributing to governance failures.

Findings and Discussion: The findings reveal that governance failures often arise from weak board oversight, a lack of commitment from senior management, and conflicts of interest within audit committees. Additionally, an overemphasis on regulatory compliance at the expense of ethical standards and short-term financial pressures exacerbates the risk of fraud. The study discusses how these structural and behavioral weaknesses create opportunities for fraud and how technologies like AI and blockchain, combined with ethical corporate culture, can strengthen internal controls and fraud detection systems.

Implications: The research emphasizes the need for companies to foster ethical values alongside technological advancements in internal controls. It provides practical recommendations for improving governance systems through substantial leadership commitment, independent board oversight, and integration of advanced technology to detect and prevent fraud.

Introduction

In recent years, corporate governance and internal control mechanisms have become critical focus areas for preventing fraud within modern businesses. Despite implementing various regulations and ethical codes to ensure transparency and accountability, fraud cases continue to emerge, even in large corporations with seemingly robust governance systems (Solomon, 2020). Cases such as the Volkswagen emissions scandal and Wirecard in Germany illustrate that, despite having robust internal control frameworks, weaknesses in implementation create opportunities for fraudulent activities, ultimately damaging corporate reputation and stakeholder trust. For instance, Volkswagen's manipulation of emission software, which went undetected for a long time, highlighted significant internal control failures designed to prevent such practices (Kakade & Haber, 2020). Similarly, Wirecard's inflated financial statements, which reported fictitious revenues, demonstrated how weak internal controls failed to properly oversee the company's reporting. One of the primary challenges companies face in fraud prevention is the tendency to implement governance in a formalistic manner. Many organizations focus on regulatory compliance without fully embedding strong ethical cultures to prevent fraud. The Wirecard case exemplifies how even Germany's rigorous regulatory and audit framework could not detect fraudulent financial reporting over several years (Daly & Touron, 2022). This issue underscores the importance of corporate governance practices that go beyond administrative compliance and foster the internalization of transparency and accountability values.

From a theoretical perspective, agency theory is a dominant framework used to explain the relationship between owners and managers, where managers may act in ways that do not align with the owners' interests (Bosse & Phillips, 2016). However, the persistence of fraud in companies with seemingly strong governance, such as the Toshiba case in Japan, suggests that additional factors must be considered. In Toshiba's case, despite internal control mechanisms, weak oversight by senior management allowed accounting manipulations to persist for several years (Hass et al., 2018). Additionally, the fraud triangle theory developed by Donald Cressey highlights three key elements that trigger fraud: pressure, opportunity, and rationalization (Cressey, 1953). In Toshiba's case, the pressure to meet financial targets, opportunities created by weak internal controls, and the rationalization of the manipulations as a temporary measure were crucial factors driving the fraud. The organismic integration theory expands this view by explaining how psychological and organizational pressures contribute to fraudulent actions. Zahra et al. (2007) demonstrate that individual motivations, such as pressure to meet unrealistic targets or maintain the company's image, also play a role in encouraging fraud. Therefore, structural weaknesses and individual motivational factors explain why internal controls often fail to prevent significant fraud (Zakaria et al., 2016).

Several recent studies have explored the complex dynamics between corporate governance and fraud prevention, highlighting advancements and limitations in the field. For instance, a systematic review by Shahana et al. (2023) emphasized the growing importance of data analytics tools, explanatory variables, and evaluation metrics in detecting financial statement fraud. These technological advancements have undoubtedly strengthened fraud detection efforts, yet significant challenges remain in adapting these tools across different industries. Adopting such tools can be limited in sectors lacking adequate digital infrastructure and technological resources, thus impeding fraud prevention efforts. Similarly, a European study by Hazaea et al. (2023) examined the role of internal auditing in private and nonprofit organizations, revealing substantial gaps in the understanding and implementation of internal audit functions. The study found that many organizations fail to leverage the full preventive potential of internal audits due to resource constraints or a lack of expertise. This gap highlights a critical issue: despite the centrality of internal audits in mitigating fraud risks, their utilization is often inadequate in many organizations, creating opportunities for fraudulent activities.

In addition, Kalia & Gill (2023) explored how corporate governance mechanisms, such as institutional ownership and board diversity, influence corporate risk mitigation, affirming that sound governance practices can reduce the likelihood of fraud. However, their study also pointed to the complexity of integrating corporate social responsibility (CSR) into governance structures, as ethical priorities often conflict with financial objectives. This tension suggests that governance structures focused solely on regulatory compliance may not be sufficient to address the moral dimensions of fraud prevention. Moreover, traditional theories such as the fraud triangle and agency theory, which have long dominated discussions on fraud motivations, are increasingly being challenged by new perspectives. Orth et al. (2023) introduced organismic integration theory, suggesting that fraudulent behavior may stem from various motivational processes, including organizational pressures and individual psychological factors, rather than greed or opportunity. These insights build upon existing literature by examining governance failures through organizational structures and personal motivations, thus offering a more comprehensive understanding of why governance and internal controls often fail to prevent fraud.

Despite the substantial progress made in understanding corporate governance and fraud prevention, several gaps hinder the full effectiveness of these mechanisms in practice. One of the most significant gaps is the inconsistency in applying governance frameworks across different industries and organizational sizes. While more giant corporations may have the resources to implement comprehensive governance structures and data-driven fraud detection tools, smaller organizations often struggle with limited access to such technologies. Hazaea et al. (2023) pointed out that many private and nonprofit organizations lack the resources or expertise to fully leverage internal audits, which are critical in preventing fraud. This discrepancy creates a significant gap between the theoretical frameworks and their practical implementation, especially in sectors where technological infrastructure and financial resources are constrained. As a result, organizations in these sectors remain vulnerable to fraud despite the existence of governance mechanisms designed to mitigate such risks. Another notable gap lies in integrating ethical and social responsibility considerations into corporate governance. Kalia & Gill (2023) observed that corporate governance mechanisms, such as board diversity and institutional ownership, can reduce fraud risks. However, there is often a disconnect between ethical priorities and financial objectives. This gap reveals a limitation in the traditional governance models, which focus primarily on regulatory compliance and financial performance without adequately addressing the ethical dimensions of fraud prevention.

Moreover, traditional theories such as the fraud triangle and agency theory, which focus primarily on economic incentives and conflicts of interest, may no longer fully capture the complexity of modern fraud schemes. Orth et al. (2023) introduced organismic integration theory to address this gap, emphasizing the role of psychological and organizational pressures in motivating fraudulent behavior. The gap between traditional governance theories and the evolving realities of organizational behavior underscores the need for more comprehensive frameworks that account for both structural weaknesses and individual motivations behind fraud.

This research offers a novel contribution by systematically examining organizational and individual factors contributing to the failure of governance and internal controls to prevent corporate fraud. By integrating insights from traditional governance theories with newer motivational frameworks, such as organismic integration theory, this study aims to bridge the gap between established governance practices and the complexities of modern fraud schemes. Traditional approaches, such as agency theory and the fraud triangle, have long provided the foundation for understanding corporate fraud. However, these approaches focus more on financial incentives and conflicts of interest while often overlooking the psychological and organizational pressures that drive individuals to commit fraud. This study incorporates these broader dimensions, acknowledging that governance failures are influenced not only by structural weaknesses but also by individual motivations and the organizational environment.

The novelty of this research lies in its systematic review of both structural and behavioral aspects of governance and fraud. While existing studies often explore these factors in isolation, this research synthesizes them, offering a more comprehensive understanding of why governance and internal controls frequently fail to address complex fraud schemes. Utilizing the systematic literature review (SLR) method, this study consolidates findings from various disciplines, including corporate governance, organizational behavior, and forensic accounting, to identify patterns and trends that can inform the development of more effective fraud prevention frameworks. This integrated approach highlights the limitations of current governance mechanisms. It provides insights into how these mechanisms can be improved by accounting for individuals' evolving organizational motivations and behaviors. The main research questions guiding this study are: What organizational factors contribute to the failure of governance and internal control mechanisms in preventing fraud? And what individual motivational and psychological factors lead to governance and internal control failures in preventing corporate fraud? This research uses the SLR method to provide a comprehensive, evidence-based understanding of the interplay between organizational structures and individual behaviors in fraud prevention. By answering these research questions, the study offers practical recommendations for improving governance systems, focusing on integrating structural reforms and behavioral insights to enhance the effectiveness of fraud prevention strategies in modern society.

Literature Review

Significance of Governance and Internal Control in Preventing Fraud

Good corporate governance (GCG) and internal controls are essential for maintaining corporate integrity and transparency in today's complex business environment. These two elements work together to ensure companies operate transparently, accountable and responsible for their stakeholders. GCG emphasizes principles like transparency, accountability, commitment, and independence, which help organizations build trust with stakeholders. Internal controls, on the other hand, consist of policies and procedures designed to monitor corporate activities, reduce risks, and prevent fraud (Herawati & Hernando, 2020). Combining effective GCG and robust internal controls creates a solid foundation that helps organizations prevent fraud and protect their integrity. The role of GCG in fraud prevention is critical. Fraud, which encompasses financial statement manipulation, asset misappropriation, and corruption, often occurs when oversight within a company is weak (Kalia & Gill, 2023). When properly implemented, GCG reduces the risk of fraud by fostering transparency in decision-making processes. Research by Kassem (2022) indicates that companies with strong governance practices experience significantly reduced fraud risks. Transparent auditing and financial reporting processes create a system of accountability that facilitates opportunities for fraudulent activities (Roszkowska, 2021). However, many organizations struggle to consistently apply these governance principles across all levels, particularly under senior management oversight.

Despite having internal controls, many companies still face challenges in effectively detecting and preventing fraud. Failures in internal controls can stem from several issues, including ineffective monitoring, insufficient staff training, and lack of top management commitment. Root (2000) found that a lack of coordination between departments responsible for oversight often leads to internal control failures. Moreover, reliance on manual processes in financial reporting increases the risk of human error, which can be exploited by individuals committing fraud. Without sufficient technological support and staff training, internal control systems become vulnerable, especially in companies with complex operations (Florid et al., 2023). One major challenge in implementing effective GCG and internal controls is the complexity of modern organizational structures. Multinational companies, for instance, often struggle to ensure consistent application of internal controls across their global operations. Briand (2022) pointed out that complex organizational structures usually render internal controls ineffective, especially with challenges like remote monitoring and differing regulations across countries. External pressures to meet short-term financial targets can also push management to prioritize immediate financial performance over long-term fraud prevention (Zahra et al., 2007). Focusing on short-term gains creates opportunities for fraud, as companies may neglect the importance of sustainable fraud prevention strategies (Cohen et al., 2012).

Beyond regulation and internal controls, the effectiveness of fraud prevention also relies on an organization's ethical culture. Companies with a strong ethical culture are more likely to prevent fraud because employees feel personally responsible for maintaining integrity and transparency. Orth et al. (2023) suggest that integrating ethical values into corporate culture significantly reduces the risk of fraud. When values like transparency, integrity, and accountability are deeply embedded in the workplace, employees are more likely to act ethically and less likely to engage in fraudulent activities (Khusnah & Soewarno, 2022). Conversely, organizations focusing solely on regulatory compliance without fostering a robust ethical culture are more vulnerable to fraud, as employees may not feel obligated to uphold corporate integrity (Mamaysky, 2021). Recent high-profile fraud cases illustrate the consequences of weak governance and internal controls. For instance, the Volkswagen emissions scandal involved manipulating emissions test results to meet regulatory standards, demonstrating how weak internal oversight and governance failures can severely damage a company's reputation and financial standing (Kano et al., 2023). Volkswagen's failure to implement adequate internal controls to detect this fraud highlights the need for stricter oversight and more robust GCG practices at all levels of an organization.

Failures in Governance Practices and Supporting Factors

Good corporate governance is crucial for maintaining the integrity, transparency, and sustainability of an organization's operations, but failures in governance still occur, often leading to fraud and financial mismanagement. These failures are typically influenced by weak senior management, ineffective board oversight, and conflicts of interest within audit committees. An imbalance between economic priorities and ethical standards, along with insufficient transparency and accountability, further undermines the effectiveness of corporate governance. Senior management plays a crucial role in ensuring good governance, but governance failures frequently happen when they lack commitment to enforcing principles across the organization. When senior management fails to engage in oversight and fraud prevention, opportunities for fraud increase. Abu Khadra & Delen (2020) note that, especially in private and nonprofit sectors, boards often do not fulfill their supervisory roles effectively, leaving organizations vulnerable to fraud. The board of directors is responsible for overseeing management and ensuring corporate governance, but many companies suffer from inadequate board oversight due to a lack of independence or internal conflicts. Achmad et al. (2022) highlight that internal conflicts within the board can hinder fraud detection. Without autonomy, boards struggle to provide objective oversight, increasing the risk of governance failures. Ensuring that boards are independent and free from conflicts of interest is essential for adequate supervision and fraud prevention.

Conflicts of interest within audit committees also undermine governance. Audit committees are tasked with detecting and preventing fraud, but external pressures or influence from management can compromise their effectiveness. Abbas et al. (2021) argue that independent audit committees ensure transparency and fraud detection for financial reporting. Companies must ensure that audit committees operate independently to maintain integrity in economic processes. Governance failures are often caused by prioritizing short-term financial goals over long-term sustainability. Pressure to meet ambitious financial targets can push managers and employees to engage in fraud. Hald et al. (2021) explain that focusing on short-term profits undermines ethical standards and fraud prevention efforts. Building an ethical corporate culture that values long-term integrity is essential for reducing the likelihood of governance failures.

Another factor contributing to governance failures is the lack of senior management involvement in overseeing financial operations. Hazaea et al. (2023) found that senior management often does not engage in audit processes and internal controls, allowing gaps that fraudsters can exploit. Active involvement from senior management is essential to strengthening internal controls and reducing fraud risk. Inadequate transparency and accountability in decision-making also contribute to governance failures. Boards and management lacking transparency create environments where fraud can thrive. Efunniyi et al. (2024) emphasize that transparency in governance structures is crucial for effective oversight and accountability. Companies that foster a culture of openness and hold individuals accountable are better positioned to prevent fraud. Case studies such as the Volkswagen emissions scandal and Toshiba's accounting scandal highlight the severe consequences of governance failures. Volkswagen's manipulation of emissions test results and Toshiba's financial report manipulation demonstrate how weak governance and internal controls can lead to significant economic and reputational damage (Bellucci et al., 2021). These cases underscore the importance of strong governance and effective oversight in protecting companies from fraud and its damaging consequences.

Gaps in Internal Control Implementation

In corporate governance, internal controls are the first line of defense against fraud, comprising policies and procedures to ensure that organizations adhere to operational, financial, and administrative standards. However, the practical implementation of these controls often varies between small and medium-sized enterprises (SMEs) and more giant corporations. Many companies view internal controls as regulatory formalities rather than strategic tools for mitigating fraud risks. Abouelghit & Gan (2024) found that SMEs often underdevelop their internal controls, focusing primarily on regulatory compliance rather than fraud prevention, which increases vulnerability to fraud. One major challenge in implementing adequate internal controls is the lack of resources and expertise, particularly for internal audits (Kashona, 2019). Internal audits are essential for evaluating the effectiveness of control systems and detecting potential fraud risks early. However, many organizations, especially in the nonprofit and private sectors, lack skilled auditors and sufficient resources, undermining these controls' effectiveness (Buabeng, 2020). Consequently, internal audits are often superficial, failing to protect against fraud risks meaningfully. Addressing these resource and expertise gaps is crucial for strengthening internal control systems, especially for organizations with limited financial capacities.

Large corporations are not immune to internal control failures. The collapse of Wirecard in Germany illustrates how companies with vast financial and technological resources can still experience significant breakdowns in internal controls. Wirecards manipulated financial reports and concealed fictitious revenues for years despite having access to advanced audit technologies (Christensen & Latifa, 2021). This case demonstrates that internal controls must be robust and supported by management at all levels. Without management's commitment to independent audits and strong internal controls, even large corporations remain vulnerable to fraud. Technological advancements, such as data analytics and automated audit tools, offer promising solutions for enhancing internal control systems, particularly in fraud detection. Richardson & Dull (2016) highlight that although these technologies are increasingly accessible, many organizations, especially SMEs, lack the infrastructure to integrate them into their internal controls. Even larger companies sometimes fail to leverage these tools effectively due to poor integration between technology and control processes. Therefore, proper technology adoption is critical for closing gaps in internal controls and improving early fraud detection.

Senior management's commitment is a critical factor in management controls. Hightower (2008) emphasizes that internal controls often fail due to a lack of support from top management. Without consistent backing from leadership, internal control systems lose their effectiveness as tools for fraud prevention. For these systems to work, they need to be embedded into the overall business strategy, with continuous monitoring and resource allocation from senior management. Internal controls can only function as intended to prevent fraud and protect operational integrity through sustained commitment. Case studies such as the Wirecard scandal and the Volkswagen emissions scandal demonstrate the consequences of inadequate internal controls. Volkswagen's manipulation of emissions data revealed significant internal control failures and a lack of transparency within the company (Christopher, 2019). These cases underscore the need for robust internal control frameworks supported by senior leadership's commitment to fraud prevention. Without such frameworks, companies risk severe financial and reputational damage.

Integrative Solution Through Technology-Based Approach and Organizational Motivation

Fraud prevention is increasingly critical in today's business landscape, and technology has become a vital tool in addressing this challenge. Technologies like data analytics, artificial intelligence (AI), and blockchain have proven essential in enhancing corporate governance and internal control processes by identifying patterns of anomalies that manual systems might miss. Shahana et al. (2023) highlight that advanced data analytics help companies detect hidden fraud patterns using explanatory variables and detailed evaluation metrics. These tools improve the speed and accuracy of fraud detection and allow for real-time monitoring, enabling swift action before fraud escalates (Winner Olabiyi & Joseph, 2024). Technology, therefore, plays a crucial role in strengthening internal controls, and more attention is needed to understand how these technologies can be effectively integrated into corporate oversight. Blockchain and AI are two technologies promising to improve internal control systems. Blockchain's decentralized and transparent nature provides an immutable transaction record, making data manipulation difficult. Danh (2022) emphasizes that blockchain integration in internal control systems significantly reduces fraud risks, particularly in the financial sector and supply chains. Blockchain ensures that transactions cannot be altered, boosting system transparency and trust.

Meanwhile, AI can process vast amounts of data, identifying anomalies that could indicate fraudulent behavior. AI's machine learning capabilities allow it to improve over time, becoming more effective at detecting fraud as it learns from past patterns (Potla, 2023). As fraud schemes grow more sophisticated, AI can evolve to maintain high detection rates. Blockchain and AI create a more robust internal control framework, and companies should explore efficient implementation strategies for these technologies to enhance fraud detection. Despite the benefits of technology in fraud prevention, there are limitations to relying solely on a technology-based approach. Many small and medium-sized enterprises (SMEs) lack the resources to implement sophisticated technologies like AI and blockchain effectively. Sdiri et al. (2023) note that while data-driven audit technologies are available, many organizations struggle to fully leverage them due to inadequate infrastructure and a shortage of skilled professionals. Budget constraints prevent SMEs from investing in technology to combat fraud comprehensively. Therefore, it is essential to explore ways to make fraud prevention technologies more accessible to businesses of all sizes. However, technology alone is not enough to prevent fraud. Organizational motivation is critical in fostering a culture that promotes ethical behavior and prevents fraud. Orth et al. (2023) stress the importance of integrating ethical values into a company's structure to encourage integrity and responsibility among employees. When companies focus solely on financial performance without considering ethical principles, the risk of fraud increases as employees may feel pressured to engage in unethical behavior to meet targets. Therefore, organizations must foster ethical values in their fraud prevention strategies.

The most effective approach to preventing fraud is combining advanced technology with solid organizational motivation. While technology can detect potential fraud quickly and accurately, employees may still exploit gaps not covered by technological controls (Cappelli et al., 2012). Thus, companies must balance technological investments with cultivating a culture of integrity and transparency. By integrating technology with organizational motivation, companies can create a system that detects and prevents fraud by fostering a healthy and transparent workplace environment. In terms of practical implications, implementing integrated solutions poses challenges. Technologies like AI and blockchain require significant investments in infrastructure and workforce training. At the same time, creating an ethical organizational culture demands long-term commitment from leadership to ensure that moral values are embedded throughout the organization. Despite these challenges, combining both approaches will ultimately lead to more effective fraud prevention systems, safeguarding companies against future fraud risks.

Research Design and Methodology

Study Design

This research employs a qualitative methodology using a systematic literature review (SLR) approach. The SLR method provides a comprehensive and structured analysis of existing literature on integrating technology and organizational motivation in fraud prevention. The primary goal of this study design is to identify, evaluate, and synthesize relevant studies that explore the role of advanced technologies, such as artificial intelligence (AI) and blockchain, alongside organizational culture and ethics in reducing fraud risks. By utilizing this design, the research aims to uncover gaps in the current literature and offer insights for future studies and practical applications.

Sample Population or Subject of Research

This research's sample population or subject consists of peer-reviewed academic articles, conference papers, and relevant reports published between 2018 and 2023. These sources focus on fraud detection and prevention, the application of AI and blockchain in corporate governance, and the role of organizational ethics in preventing fraud. The inclusion criteria for the literature are based on studies written in English that specifically address the intersection of technology and organizational culture in combating fraud. A rigorous selection process ensures that only high-quality, relevant studies are included in the review.

Data Collection Techniques and Instrument Development

Data is collected through comprehensive searches in academic databases, including Google Scholar, Scopus, and Web of Science. Keywords such as "fraud prevention," "AI and fraud detection," "blockchain and governance," and "organizational ethics in fraud prevention" are used to identify relevant articles. After identifying potential studies, a detailed screening process is applied, including assessing abstracts, methodologies, and findings to ensure alignment with the research objectives. No additional instruments are developed as this is a secondary data study.

Data Analysis Techniques

The data analysis for this SLR follows a thematic analysis approach. Findings from the selected literature are categorized into key themes related to technology and organizational motivation in fraud prevention. These themes are analyzed to identify patterns, contradictions, and emerging trends. The synthesis of these findings provides a holistic view of the current state of research and uncovers areas where further investigation is needed.

Findings and Discussion

Findings

Organizational Factors Contributing to the Failure of Governance and Internal Controls

One of the key findings of this study focuses on the organizational factors contributing to the failure of corporate governance and internal controls. A systematic analysis of relevant literature found that weaknesses in governance systems often stem from inadequate oversight by boards of directors and a lack of commitment from senior management. Boards of directors, tasked with ensuring the consistent application of good corporate governance (GCG) principles across all organizational levels, often fail in this role when conflicts of interest compromise their independence or when board members lack the necessary competence to fully comprehend the complexities of internal control systems (Florid et al., 2023). Similarly, studies show that a lack of senior management commitment significantly contributes to governance failures. While many companies formally adopt GCG principles, the implementation frequently remains superficial, focusing solely on regulatory compliance rather than fostering a deep-rooted commitment to ethical values (Tladi, 2021).

Consequently, internal control systems often function as administrative formalities rather than robust mechanisms for fraud prevention. The rigidity and formality of these systems make them less effective at detecting and preventing fraud, as they are frequently unable to adapt to the dynamic nature of modern business environments (Shahana et al., 2023). The literature highlights how many organizations prioritize regulatory compliance over the cultural factors necessary for more robust internal controls. The ineffectiveness of internal controls is frequently rooted in the disconnect between management oversight and an organizational culture emphasizing transparency and accountability. Companies that fail to nurture an ethical workplace culture significantly increase their risk of fraud (Orth et al., 2023). This gap between formal governance structures and the practical implementation of controls illustrates the necessity for a more holistic approach to governance that goes beyond regulatory mandates and embeds ethical considerations into the organization's core operations Hazaea et al. (2023).

Individual Motivational and Psychological Factors in Governance and Internal Control Failures

A critical finding of this study concerns the role of individual motivational and psychological factors in governance and internal control failures. Using theories like Organismic Integration Theory, the research demonstrates that employees within organizations are often driven by short-term financial goals, which can lead to unethical behavior. The pressure to meet ambitious performance targets creates a climate in which employees and managers feel compelled to engage in fraudulent activities to fulfill organizational expectations (Orth et al., 2023). These pressures can push individuals to manipulate internal controls or exploit governance system weaknesses for personal or organizational benefit. The studies reviewed reveal that the gap between personal motivations and organizational demands is a significant reason internal controls fail to detect fraud. Employees and managers overwhelmed by a competitive and high-pressure work environment may neglect ethical responsibilities, mainly when they believe weak oversight will shield their fraudulent actions from detection (Ngcobo & Reddy, 2024). This disconnect between individual motivations and organizational control systems creates exploitable vulnerabilities, further elevating fraud risk. For example, Orth et al. (2023) stress the importance of addressing employees' psychological pressures in the workplace, emphasizing that companies must strengthen internal controls and consider emotional and motivational factors that may lead individuals to circumvent those controls. Recognizing the complex interplay between behavior and organizational pressures is essential to developing more effective fraud prevention strategies that account for structural and psychological elements (Florid et al., 2023).

The Combination of Structural and Behavioral Failures in Fraud Prevention

Another key finding of this research is the interconnectedness of structural and behavioral failures in corporate fraud prevention. The study demonstrates that when weak governance structures and ineffective internal controls coincide with problematic individual motivations, the risk of fraud increases significantly. The combination of organizational weaknesses and individual psychological pressures creates an environment where fraud becomes more challenging to detect and prevent (Cohen et al., 2012). The literature identifies organizational patterns where structural weaknesses, such as inadequate board oversight or a lack of senior management commitment, allow individuals to exploit these vulnerabilities for personal gain (Hazaea et al., 2023). In many cases, internal control systems are insufficient in detecting fraudulent behavior because the individuals perpetrating the fraud are often more knowledgeable about the system's weaknesses than the internal auditors tasked with monitoring them. This asymmetry between knowledge and oversight allows fraudulent schemes to persist undetected for extended periods (Shahana et al., 2023). Therefore, one of the most essential conclusions of this study is the need for a more integrated approach to governance reform—one that combines structural improvements with a deeper understanding of individual behavior. Addressing both organizational and individual factors simultaneously can enhance internal controls and reduce the risk of fraud (Florid et al., 2023).

Recommendations for Improving Governance and Internal Control Systems

Based on the findings of this research, several practical recommendations can be made to help companies improve their governance and internal control systems. First, companies need to strengthen senior management's commitment to the effective implementation of GCG principles. Senior management must actively oversee internal control implementation and ensure ethical values are embedded in corporate operations. Without this top-level commitment, governance systems will continue to function merely as a formality rather than a strategic tool for preventing fraud (Young, 2013)). Second, internal control systems must be designed to be more flexible and adaptable to changes in individual behavior within the organization. Rigid internal control systems often struggle to keep pace with the evolving nature of business risks and fraud schemes. Companies must ensure that their internal controls can quickly adapt to new threats and that these systems are continuously updated to address emerging challenges in fraud detection and prevention (Shahana et al., 2023). In addition, the research recommends that companies integrate ethical values into their organizational culture. A work environment that promotes transparency and accountability will encourage employees to act with integrity and responsibility, reducing the likelihood of fraudulent behavior. Senior management must ensure that ethical values are consistently applied throughout the organization, not merely as a compliance exercise but as a fundamental aspect of the company's identity and strategy (Orth et al., 2023). Finally, this study highlights the potential of using advanced technologies like blockchain and AI to strengthen internal control systems. Technologies like blockchain provide real-time, tamper-proof records of transactions, making it more difficult for fraudsters to alter data without detection. Similarly, AI can detect behavioral anomalies that manual systems may not identify, providing an additional layer of security against fraud (Florid et al., 2023). By integrating technological advancements with structural and behavioral improvements, companies can significantly enhance their ability to detect and prevent fraud.

Discussion

This study's findings reveal several critical factors contributing to corporate governance failure (Good Corporate Governance/GCG) and internal controls in preventing fraud. The systematic literature review identified structural and behavioral weaknesses that explain why many companies remain vulnerable to fraudulent activities despite formally adopting GCG principles and implementing internal control systems. The study highlights that while many companies aim to meet regulatory standards, they often fail to internalize ethical values and incorporate the necessary flexibility in their internal controls, leading to ineffective systems for detecting and preventing fraud. The analysis reveals that one of the primary weaknesses in corporate governance stems from inadequate oversight by boards of directors. This lack of oversight is particularly problematic when conflicts of interest compromise board independence. Such conflicts hinder the board's ability to make objective decisions and undermine its capacity to identify potential fraud (Kalia & Gill (2023). In several cases examined, board members maintained close ties with management, weakening their ability to provide independent oversight. This contributed to governance failures, as ineffective oversight at the management level allowed fraudulent activities to go undetected. According to Hazaea et al. (2023), this issue is particularly prevalent in private and nonprofit sectors, where governance frameworks are often less stringent, and boards are less involved in monitoring internal controls.

The lack of senior management's commitment to robust governance plays a significant role in these failures. Senior management often views the adoption of internal controls as a formal compliance exercise rather than a genuine effort to prevent fraud. Consequently, internal control systems are designed as rigid, formalistic tools that fail to detect changes in employee behavior, which can be early indicators of fraud. Florid et al. (2023) argue that companies with overly rigid internal control systems are less effective in preventing fraud because such systems cannot adapt to the dynamic nature of business environments. This is a critical finding, as it shows that internal controls that lack adaptability cannot effectively address emerging risks and fraudulent behaviors. Organizational pressure to meet short-term financial targets is another significant factor contributing to dishonest behavior. In high-pressure work environments, employees are more likely to compromise ethical standards to meet managerial expectations. Orth et al. (2023) highlight that employees facing intense performance pressures often resort to unethical practices to meet financial goals, especially when internal controls are weak or minimal oversight. This research found that individuals under significant pressure to meet financial goals are more likely to engage in fraudulent behavior, such as financial statement manipulation or other deceptive practices. The gap between personal motivations and organizational controls—particularly in environments prioritizing short-term financial success—creates a scenario where fraud becomes more likely.

In addition to organizational pressures, the failure of internal controls is also due to their inflexibility. Formalistic internal control systems often lack the adaptability needed to address complex fraud schemes, particularly when fraud involves senior managers with in-depth knowledge of the system's weaknesses. Florid et al. (2023) suggest that when internal controls are overly rigid, they are less capable of responding to new fraud risks that evolve with changing business practices. Internal auditors often rely on manual oversight processes that do not leverage modern technology, which would significantly improve the detection of anomalous behavior (Shahana et al., 2023). This highlights the need for a more dynamic and technology-driven approach to internal controls. The findings also underscore the critical role of advanced technologies, such as artificial intelligence (AI) and blockchain, in strengthening internal controls. AI, for instance, can analyze transaction data in real-time and detect patterns of suspicious behavior. At the same time, blockchain provides an immutable record of transactions that makes it harder for fraudulent actors to manipulate data (Laroiya et al., 2020). However, despite the promise of these technologies, this study found that many companies, tiny- to medium-sized enterprises, have not fully utilized these tools due to limited resources and infrastructure (Hazaea et al., 2023). This finding is crucial as it emphasizes the disparity between large corporations with access to advanced technologies and smaller firms, which may struggle to invest in such resources.

The findings of this research align with several established theories in the governance and fraud prevention literature, such as agency theory and the fraud triangle. Agency theory explains that conflicts of interest between management and shareholders often lead to fraudulent behavior, as managers—acting as agents—may have incentives to manipulate information for personal gain or to meet shareholder expectations (Jensen & Meckling, 1976). This study's findings support this perspective, particularly regarding how conflicts of interest among board members and management undermine governance effectiveness. The fraud triangle, which highlights the elements of pressure, opportunity, and rationalization, is relevant to these findings. Organizational pressure to meet financial targets and opportunities created by weak internal controls foster an environment where fraud can thrive (Cressey, 1953). These factors help explain why fraud continues to occur despite formal governance frameworks being in place. This research adds to understanding the fraud triangle by addressing organizational pressures and weaknesses in governance structures. Motivational theories, such as Organismic Integration Theory, are also pertinent in explaining how external pressures influence individual behavior within organizations. This study highlights that individuals facing intense organizational pressure are more likely to disregard ethical considerations and engage in fraudulent activities, mainly when internal controls are weak and oversight is lacking (Orth et al., 2023).

The results of this study are consistent with previous research that has identified weak corporate governance and ineffective internal controls as significant contributors to fraud. Research by Florid et al. (2023) similarly found that formalistic and rigid internal control systems fail to detect fraud because they are not adaptable to the evolving nature of businesses and fraud schemes. This study builds on these findings by emphasizing the importance of creating more dynamic and flexible internal controls that can respond to changes in organizational behavior and emerging risks. However, this research also provides new insights beyond previous studies, particularly regarding organizational pressure's role and technology's impact on fraud prevention. Previous studies have primarily focused on structural governance issues. At the same time, this research takes a more holistic approach by integrating individual behavioral factors and the potential of advanced technologies such as AI and blockchain in enhancing fraud detection. This study underscores the critical role of ethical values in preventing fraud, which aligns with the findings of (Orth et al., 2023). Their research demonstrated that organizations with strong ethical cultures are significantly less likely to experience fraud. This study reinforces the importance of embedding ethical values in governance and internal control systems to reduce the risk of fraudulent behavior.

The findings of this research have important practical implications for the business world. First, companies must ensure that their boards of directors are sufficiently independent to provide adequate oversight. Providing training and improving the competence of board members is essential to ensure they can understand and address the complexities of internal controls. Second, internal control systems should be designed to be more flexible and adaptable to changes in the business environment. Companies must be open to adopting technologies such as AI and blockchain to strengthen their internal control systems. These technologies can enhance the early detection of behavioral anomalies that may indicate fraud. Finally, integrating ethical values into the organizational culture must be a priority. Management should instill transparency, accountability, and integrity into corporate operations. By fostering a strong ethical culture, companies can reduce the risk of fraud and build a better reputation with stakeholders.

Conclusion

This study provides a comprehensive analysis of the organizational and individual factors contributing to the failure of governance and internal controls to prevent corporate fraud. By conducting a systematic literature review, the study explored how structural weaknesses, such as inadequate board oversight and insufficient senior management commitment, combined with individual motivational factors like pressure to meet financial targets, create an environment conducive to fraudulent behavior. Additionally, the study examined how rigid and formalistic internal control systems and a lack of flexibility and adaptability hinder effective fraud detection. The integration of these factors offers valuable insights into why corporate fraud continues to occur despite the presence of governance frameworks and internal control mechanisms.

The significance of this research lies in its contribution to academic understanding and practical application. The study advances the literature by synthesizing organizational and behavioral factors that simultaneously influence the effectiveness of fraud prevention efforts. Unlike prior studies that focused primarily on structural or behavioral aspects in isolation, this research offers a holistic perspective that emphasizes the interconnectedness of these factors. Practically, the study highlights the importance of aligning governance systems with ethical values and ensuring that internal control mechanisms are flexible enough to adapt to evolving fraud risks. For managers and policymakers, the research suggests that fostering an ethical corporate culture and leveraging advanced technologies such as AI and blockchain are essential to building robust fraud prevention frameworks.

However, this study also has its limitations, which provide avenues for future research. One limitation is that the study relies solely on secondary data from existing literature, which may not fully capture the real-time complexities of governance failures in diverse organizational settings. Future research could benefit from empirical studies involving direct engagement with companies, such as interviews or case studies, to better understand how governance and internal controls operate. Additionally, while this study identified the role of advanced technologies in fraud prevention, further research is needed to explore the long-term impact and implementation challenges of these technologies in different industries. Future researchers should also investigate the role of emerging technologies in smaller organizations and explore how they can overcome resource limitations to enhance fraud prevention strategies.

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