
Internal Audit Function and Application of Good Corporate Governance at Public Indonesian Commercial Banks

R.A. Novatiani¹, N.N. Afiah², R. Soemantri³, H. Ritchi⁴

Abstract:

This study aims to analyze the internal audit function, analyze the application of good corporate governance and analyze the influence of the internal audit function on the implementation of good corporate governance. Deviations that occur in a company can be prevented by the implementation of good corporate governance adequately, and to achieve the application of good corporate governance, a quality internal audit is needed.

The method used in this research is descriptive verification method. The sample of this study was 60 respondents, consisting of leaders and audit teams from three government commercial banks. The sampling technique is Nonprobability sampling, namely census sampling by collecting data using questionnaires and interviews.

The results showed that the internal audit function was carried out adequately, the implementation of good corporate governance was carried out adequately and the internal audit function had an effect on the implementation of good corporate governance. To maximize the internal audit function in a government commercial bank (SOE's Bank), internal auditors must be able to provide property protection to the company, and to achieve the principles of good corporate governance in accordance with what has been outlined, employee competency is needed in accordance with the internal.

Keywords: *Internal Audit Functions, Good Corporate Governance, and Government Commercial Banks.*

JEL code: L30, L31.

¹Doctoral Candidate, Economics and Business Faculty, Padjajaran University, Indonesia; and Economics Faculty, Widyatama University, Indonesia, email: aitnovatiani@gmail.com; ilhamhasan77@yahoo.com

²Professor in Accounting, Economics and Business Faculty, Padjajaran University, Indonesia, email: nunuy@unpad.ac.id

³Lecturer Accounting Department, Economics and Business Faculty, Padjajaran University, Indonesia

⁴Lecturer Accounting Department, Economics and Business Faculty, Padjajaran University, Indonesia

1. Introduction

The purpose of establishing a company is to increase the value of the company by getting profits that have been set (Brigham and Houstonn, 2001). To achieve the objectives of the company, business people must anticipate the possibility of irregularities in their business such as the existence of nepotism, corruption and collusion, which will harm the company. Deviations that occur in a company can be prevented by the application of good corporate governance. The application of good corporate governance is an important alternative in overcoming various problems due to conflicts of interest from the parties involved (Zarkasyi, 2008).

The application of the principles of good corporate governance is the key to success in a company, so that the company is able to operate the company effectively and efficiently, transparently, professionally, and accountably (Suprayitno, 2005; Yadiati, 2017). In line with the results of research from MacMillan *et al.* (2004) stated that aspects of corporate governance controls are compliance, accountability, and transparency. In accordance with the decree of the Minister of State-Owned Enterprises No. 117/M-MBU/2002 concerning the application of the practice of good corporate governance in commercial banks (SOE's) which includes the existence of transparency, accountability, responsibility, independence and equality and fairness.

In order for good corporate governance to be implemented adequately, an effective internal audit function is needed, because the internal audit function can help directors and management in carrying out their responsibilities and duties in implementing good corporate governance (Tunggal, 2011; Yadiati, 2017). The effectiveness of internal audit is achieved when there is independence, sufficient resources, and support from management (Vinten, 1999). Internal audit must be carried out professionally which includes the existence of independence, scope of work, implementation of audit activities, internal audit section management and professional capabilities (Tugiman, 2006). The professional abilities of internal auditors include conformity with professional standards, knowledge and skills, human relations and communication, continuing education and professional accuracy (Novatiani, 2017).

Many studies have found that internal audit influences the implementation of good corporate governance, such as the research conducted by Yusriwati (2012); Yassin *et al.* (2012); Rezaee and Riley (2010); Ruud (2003); and Leung *et al.* (2002) which states that internal audits in carrying out their roles to improve corporate governance must have skills, abilities and knowledge. Thus, the role of internal auditors is becoming increasingly important in terms of creating a good corporate governance structure (Allegrini *et al.*, 2006; Carcell *et al.*, 2005; Nagy and Cenker, 2002). This study aims to examine the internal audit function in the application of the principles of good corporate governance in government commercial banks.

Internal audit must be carried out professionally which includes the existence of independence, scope of work, implementation of audit activities, internal audit section management and professional capabilities (Tugiman, 2006). The results of research conducted by Novatiani (2017) conclude that the professional abilities of internal auditors include the suitability of professional standards, knowledge and skills, human relations and communication, continuing education and professional accuracy. The results of Vinten's study (1999) state that the effectiveness of internal audits is achieved when there is independence, sufficient resources, and support from management.

2. Literatur Review and Hyphotesis Development

2.1 Internal Audit Function

The internal audit function is to provide a variety of services to the organization including performance audits and operational audits that will be able to assist senior management and the board of commissioners in monitoring the performance produced by management and personnel in the organization so that internal auditors can provide independent assessments of how well the organization is performing (Kurmiawan, 2012). The internal audit function can be carried out effectively, if the internal audit function is carried out professionally. Internal audit indicators function well if they carry out the elements according to Tugiman (2006) in Table 1 below.

Table 1. Indicator of the Effectiveness of the Internal Audit Function

Dimensi	Indikator
Independence	<ol style="list-style-type: none"> 1. Organizational Status 2. Objectivity
Professional Ability	<ol style="list-style-type: none"> 1. Compliance with professional standards 2. Knowledge and skills 3. Ability to develop good relationships and communication effectively 4. Continuous education 5. Professional accuracy
Scope of The Work	<ol style="list-style-type: none"> 1. Reliability of financial information 2. Compliance with policies, plans, procedures and regulations 3. Protection of property 4. The use resources economically and efficiently 5. Achievement of objectives
Execution of Inspection Activities	<ol style="list-style-type: none"> 1. Audit planning 2. Testing and evaluating information 3. Submission of examination results 4. Follow-up of examination results

Dimensi	Indikator
Audit Section Management	<ol style="list-style-type: none"> 1. Purpose, authority and responsibility 2. Planning for the implementation of the responsibilities of the internal audit section 3. Written policies and procedures 4. Development of human resources in the internal audit department 5. Coordination with internal auditors

2.2 Good Corporate Governance

According to FCGI (Forum for Corporate Governance in Indonesia, 2001) Good Corporate Governance is a set of rules that regulate relations between shareholders, company managers, creditors, government, employees and other internal and external stakeholders related to rights and obligations or in other words a system that regulates and controls the company. Good corporate governance is a system and a set of rules that regulate relations between various stakeholders (stakeholders), especially in the narrow sense of the relationship between the board of commissioners, the board of directors and shareholders in achieving company goals (Zarkasyi, 2008). The principles of good corporate governance can be seen in Table 2.

Table 2. *The good corporate governance principle*

Dimension	Indicator
<i>Transparency</i>	<ol style="list-style-type: none"> 1. Full disclosure for consistent material information 2. Transparent in providing relevant information 3. Interested parties can see and bring financial reports 4. Openness in decision making
<i>Accountability</i>	<ol style="list-style-type: none"> 1. Internal monitoring activities 2. The internal audit function is able to encourage the formation of an internal control system 3. Reporting on the company's financial use
<i>Responsibility</i>	<ol style="list-style-type: none"> 1. Adherence to the rule of law 2. Compliance with company internal regulations 3. Financial transactions based on generally accepted accounting principles
<i>Independency</i>	<ol style="list-style-type: none"> 1. The company is managed based on professional principles 2. There is no interference from outside parties that obscures the company's mission and vision 3. Each part is given the freedom to manage its unit to be responsible
<i>Fairness</i>	<ol style="list-style-type: none"> 1. There is justice in resolving conflicts between management 2. There is justice in providing a system of reward and punishment 3. The existence of equal rights among stakeholders

2.3 Effects of Internal Audit on the Principles of Good Corporate Governance

In the decision of the Minister of State-Owned Enterprises (SOE's) Number: Kep-117 / M-MBU / 2002, stated that Corporate Governance is a process and structure used by SOE's organs to increase business success and corporate accountability to realize shareholder value in the long term long by taking into account the interests of other stakeholders, based on laws and ethical values. Implementation of Corporate Governance in a company will affect the achievement of the company's success in establishing strategic policies in carrying out its business practices (Kristi, 2014). Companies that implement Good Corporate Governance will always carry out company activities effectively and efficiently to increase consumer confidence in the company and can improve company performance. Implementing GCG will also protect the interests of shareholders and related parties in managing the company. The company also believes that the implementation of GCG is another form of enforcement of business ethics and work ethics that have long been a company's commitment, and the implementation of GCG is related to improving the company's image (Purwani *et al.*, 2017).

To achieve good corporate governance, adequate supervision is needed, because supervision will support the company's goals. supervision referred to is internal audit. Many studies have found that internal audit influences the implementation of good corporate governance, where internal audits in carrying out their roles to improve corporate governance must have skills, abilities and knowledge (Yusriwati, 2012; Yassin *et al.*, 2012; Rezaee and Riley, 2010; Ruud, 2003; and Leung *et al.*, 2002). Thus, the role of internal auditors is becoming increasingly important in terms of creating a good corporate governance structure (Allegrini *et al.*, 2006; Carcell *et al.*, 2005; Nagy and Cenker, 2002). This study aims to examine the function of internal audit in the application of the principles of good corporate governance in government commercial banks.

Internal audit must be carried out professionally which includes the existence of independence, scope of work, implementation of audit activities, internal audit section management and professional capabilities (Tugiman, 2006). The results of research conducted by Novatiani (2017) concluded that the professional abilities of internal auditors include the existence of conformity with professional standards, knowledge and skills, human relations and communication, continuing education and professional accuracy. The results of Vinten's research (1999) state that the effectiveness of internal audits is achieved when there is independence, sufficient resources, and support from management.

3. Research Method

The method used in this research is descriptive verification method. According to Sugiyono (2012) descriptive method is a method used to describe or analyze the results of research but not used to make broader conclusions. In terms of verification, the causality between the internal audit function of good corporate governance will be seen. Data collection in this study using questionnaire

instruments distributed to 60 respondents from 3 government (SOE's) commercial banks. The sampling technique in this study was a census and analysis products using SPSS (statistical product and service solutions).

4. Results and Discussion: Influence of Internal Audit Function on Good Corporate Governance

Based on the results of statistical tests with the calculation of the t-test obtained t-count value of 7.640 while the t-table value is 2.001. This shows that the t-count is greater than t-table which is 7.640 greater than 2.001 which means that the internal audit function influences the implementation of good corporate governance. The results of this study prove that independence, scope of work, implementation of audit activities, management of the internal audit section and professional capabilities which are parts of the internal audit function can influence the existence of accountability, transparency, independence, equality and fairness and responsibility which are parts of good corporate governance. This is in accordance with what was stated by Tunggal (2011); Rezaee & Riley (2010); Yusriwati (2012); Ruud (2003); and Leung et al (2002) that the role of internal auditors is to help directors and management in carrying out their responsibilities and duties in implementing good corporate governance. Yadiati (2017) also said that internal auditors can assist company members in carrying out the duties and responsibilities of managing corporate governance effectively. The role of internal auditors is becoming increasingly important in terms of creating a good corporate governance structure (Yassin *et al.*, 2012; Allegrini *et al.*, 2006; Carcello *et al.*, 2005; Nagy and Cenker, 2002).

In general, corporate governance in commercial banks has adhered to the principles of good corporate governance, but the implementation is still not good. Respondents said that the company was still not professionally managed, this was because there were still external interference, so that the company's organs were affected by certain parties in terms of decision making. It was also found that in carrying out the duties and responsibilities of each company organ, there are still employees who carry out their duties not in harmony with the company's vision and mission, this is because there are employees who have competencies that are not in accordance with their roles, so that the bad impact is employees cannot hold on to business ethics and behavioral guidelines that have been made in the company.

If this condition still occurs, then the principle of good corporate governance will be difficult to achieve. Good corporate governance will be achieved must include the existence of accountability, transparency, independence, equality and fairness and responsibility (Yadiati, 2017; Zarkasyi, 2008). Furthermore, in line with Suprayitno (2005), the principles of good corporate governance are needed in supporting the management of companies effectively, transparently, efficiently, professionally and accountably. According to the results of the MacMillan *et al.*

(2004) study, it was concluded that aspects of corporate governance control included the notion of compliance, accountability, and transparency. Before the internal audit functioned effectively, companies must have a quality information system to achieve good corporate governance (Napitupulu *et al.*, 2017). In the information system, state-owned finance and banking sectors are included in the good category when compared to other sectors (Napitupulu and Aitungkir, 2016), so that the financial and banking sectors are able to quickly apply the principles of good corporate governance.

The influence of the internal audit function on good corporate governance in government commercial banks is because the internal audit function is needed in every company activity, especially in banking companies. Although the internal audit function has an effect on the implementation of the principles of good corporate governance, it is still found that one element of the internal audit function in protecting corporate assets is still in the poor category. The function of internal audit includes independence, scope of work, implementation of audit activities, internal audit management and professional capabilities. Internal audit must be carried out professionally which includes the existence of independence, scope of work, implementation of audit activities, internal audit section management and professional capabilities (Tugiman, 2006; Vinten, 1999). The professional abilities of internal auditors include conformity with professional standards, knowledge and skills, human relations and communication, continuing education and professional accuracy (Novatiani, 2017).

5. Conclusion

The internal audit function influences the implementation of good corporate governance. These results indicate that there is independence, scope of work, implementation of audit activities, internal audit section management and professional capabilities which are parts of the internal audit function can influence the existence of accountability, transparency, independence, equality and fairness and responsibility which are parts of good corporate governance. To maximize the internal audit function in a government commercial bank (SOE's Bank), internal auditors must be able to provide property protection to the company, and to achieve the principles of good corporate governance in accordance with what has been outlined, employee competency is needed in accordance with the internal.

References:

- Allegrini, M., D'Onza, G., Paape, L., Melville, R., Sarens, G. 2006. The European literature review on internal auditing. *Managerial Auditing Journal*, 21, 8, 845-853.
- Brigham. E.F., Gapenski, 1996. *Intermediate Financial Management*, Fifth Edition, Dryden.
- Carcello, J.V., Hermanson, D.R., Raghunandan, K. 2005. Changes in internal auditing during the time of the major US accounting scandals. *International Journal of Auditing*, 9, 2, 117- 127.

- Kurniawan, A. 2012. *Audit Internal Added Value for Organizations*. BPFE Yogyakarta.
- Leung, P., Barry, J.C., Robertson, P. 2002. *The rule of internal audit in corporation governance and management*. The Institute of Internal Auditor.
- MacMillan, K., Money, K., Downing, S., Hillenbrad, C. 2004. *Giving Your Organization SPIRIT: An Overview and Call to Action for Directors on Issues of Corporate Governance*. *Journal of General Management*, 30, 15-42.
- Nagy, A.L., Cenker, W.J. 2002. *An assessment of the newly defined internal audit function*. *Managerial Auditing Journal*, 17, 3, 130-137.
- Napitupulu, I.H., Situngkir, A. 2016. *Integrated Management Accounting Systems For Competitive Advantage: The Case in State-Owned Enterprises of Indonesia*. *International Business Management*, 10, 23, 5643-5650.
- Novatiani, RA, 2017. *Analysis Ability Professional Internal Auditor (In The Three State-Owned Company In Bandung)*. *International Journal of Scientific & Technology Research*, 06, 03, ISSN 2277-8616.
- Rezaee and Riley. 2010. *Financial Statement Fraud: Prevention and Detection*. John Wiley and Sons New Jersey, Canada.
- Ruud, T.F. 2003. *The Internal Audit Function on Integral Part of Organizational Governance*. Jakarta, Harvariado.
- Sugiyono. 2012. *Business Research Methodology*, 16th edition. Bandung: PT. Alfabeta.
- Tunggal, A.W. 2009. *Audit Internal*. Jakarta, Harvarindo.
- Vinten, G. 1999. *Audit independence in the UK - the state of the art*. *Managerial Auditing Journal*, 14, 8, 408-437.
- Yassin, N., Ghanem, M., Rustom, L. 2012. *The role of internal auditfunction corporate governance: An empirical study on commercial banks in Lebanon*. *Proceedings of the academic and business research institute conference*, Orlando.
- Zarkasyi, Moh. W. 2008. *Good Corporate Governance in Manufacturing, Banking and Other Financial Services Business Entities*. Bandung: CV, Alfabeta.