ISSN 1533-9211

DOI: 10.5281/zenodo.10071217

THE ROLE OF INTERNAL AUDIT ON INTERNAL CONTROL IN BANKING LENDING

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Abstract

This study aims to analyze the role of internal audit in internal control in providing bank credit. The research method used is qualitative. The results showed that internal audit is a monitoring element of the internal control structure in an organization, which is designed to monitor the effectiveness of elements of the internal control structure. The purpose of the audit carried out by the internal auditor is to assist all company leaders (management) in carrying out their responsibilities by providing analysis, assessment, suggestions and comments regarding the activities they examine. Seven main principles of internal control, namely: 1) Clear assignment of responsibilities, 2) Administration of company records, 3) Insurance of company assets and employees, 3) Separation of equipment and storage of assets, 4) Separation of responsibilities for related transactions, 5) Implementation independent inspection, 6) Use of mechanical equipment whenever possible.

Keywords: Role, Internal Auditor, Internal Control, Credit, Banking.

A. INTRODUCTION

Banking in Indonesia in conducting its business is based on the principle of economic democracy using the principle of prudence. The Bank itself has a function, namely as a collector and regulates public funds and aims to support the implementation of national development in order to increase equitable economic growth and national stability towards improving the welfare of many people.[1]

Banks need to provide an assessment of customers who apply for loan loans and feel confident that their customers are able to return the credit they receive. The issue of security of credit provided is an issue that must be considered by banks, because of the risks that arise in the lending system. This problem can be avoided by having an adequate internal control in the credit sector. In other words, an internal control is needed that can support the effectiveness of the lending system.

Law No. 10 of 1998 states that credit is the provision of money or bills that can be likened to it, based on an agreement or loan agreement between a bank and another party that requires the borrower to pay off its debt after a certain period of time with interest. Banks in conducting their business need to carry out a precautionary principle as stipulated in Article 2 of the Banking Law. To gain confidence and protect the bank as a creditor, the bank in this case must conduct a very good and thorough assessment of prospective debtor customers, known as the 5C principles, namely *Character*, *Capacity*, Capital, *Collateral* and Economic Condition of *the* prospective debtor.[2]

ISSN 1533-9211
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The need for adequate internal checks is needed for banks as the bank grows, besides that internal checks are also needed by banks in order to survive in the face of increasingly complex competition. Therefore, management needs someone else to conduct an internal audit conducted by the bank's internal audit, commonly referred to as internal audit.

According to the Board of Directors of the Institute of Internal Auditors (IIA) in 1999 defines internal audit as follows:

> "*Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. Its help an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes*.

Internal checks are testing activities that provide independent, objective, and consulting reliability or assurance activities designed to add value and make improvements to the organization's operations. These activities assist the organization in achieving its goals with a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and honest, clean, and good processes. The role of internal audits also has an impact on the banking sector. [3]

Bank Indonesia through Bank Indonesia Regulation No.2/6/PBI dated 21st February 2000 concerning "Bank Inspection Requirements and Procedures" regulates in detail the procedures for bank examinations, both by Bank Indonesia and other interested parties. Management has a role to carry out internal control by supervising in maintaining and securing company property so that it is not misused by both internal and external parties.

One of the things that management does to supervise is by internal inspection. Bank Indonesia (BI) has issued a standard regarding the role of internal audit, namely the Standard for the Implementation of the Bank's Internal Audit Function (SPFAIB) through Bank Indonesia Regulation No.1/6/PBI/1999 dated September 20, 1999. Although internal control has been carried out and internal audits have been carried out by internal auditors, it is not uncommon for fraud to still be found, especially fraud in the credit department.

Systems and procedures that can support the security of the process of running the internal control system for lending are through adequate forms, records and procedures that support the effectiveness of a credit management system. The bank must also pay attention to the elements of internal control of lending.

B. DISCUSSION

1. Bank Function in Lending

Bank comes from the Italian *word banca*, which means place to exchange money. In general, a bank is defined as a financial institution whose main business is to collect funds and distribute them to the public in the form of credit and provide services in payment traffic and money circulation. According to Law Number 10 of 1998 concerning Banking, banks are financial

ISSN 1533-9211
DOI: 10.5281/zenodo.10071217

institutions that collect funds from the public in the form of deposits and redistribute them in the form of loans (credit) and or other forms, with the aim of improving the standard of living of many people.

A bank is a business entity whose wealth is mainly in the form of *financial assets* and is motivated by profit and social, so it is not just profit (Hasibuan, 2013).

Then based on PSAK No. 31, the Bank is an institution that acts as a *financial intermediary* between parties who have excess funds (*Surplus* Unit) and parties who need funds (*Deficit Unit*), as well as an institution that functions to facilitate payment traffic. Its main activity is to collect funds from the community and redistribute these funds to the community and provide other bank services

Bank is a financial institution whose main business is to collect funds and redistribute these funds to the public in the form of credit and provide services in payment traffic and money circulation.

Therefore, in carrying out its daily business activities, banks must have funds in order to provide credit to the public. The funds can be obtained from bank owners (shareholders), the government, Bank Indonesia, parties abroad, and the domestic community.[4]

Kasmir defines a bank as follows: "A bank is a company engaged in finance, meaning that banking activities are always related to finance. Where the main activity is to collect funds from the community and redistribute these funds to the community and provide other bank services[5]. The Bank is a business entity in the financial sector whose main activities are to collect public funds (*funding*), distribute them in the form of credit (*lending*), and provide services to the community.

From some of the above understandings, it can be concluded that the Bank is a business entity in the financial sector whose main activities are to collect public funds (funding), distribute them in the form of credit (lending), and provide services to the community.

Division the types of banking today are viewed from various aspects as follows:[6]

1) Types of Banks in terms of their functions

According to the basic banking law number 14 of 1967, the types of banking according to their functions consist of: Commercial Banks, Development Banks, Savings Banks, Market Banks, Village Banks, and Employee Banks.

However, after the issuance of the Basic Banking Law number 7 of 1992 and reaffirmed by the issuance of Law of the Republic of Indonesia number 10 of 1998, the types of banking consist of: Commercial Banks and Rural Banks (BPR).

Where Development Banks and Savings Banks changed their functions to Commercial Banks while Village Banks, Market Banks and Employee Banks changed to People's Credit Banks (BPR).

ISSN 1533-9211
DOI: 10.5281/zenodo.10071217

2) Types of Banks in terms of ownership

In terms of ownership, it means who owns the bank. This ownership can be seen from the deed of establishment and control of shares owned by the bank concerned. The types of banks in terms of ownership are:

a) State-owned banks

Where the deed of establishment and capital are owned by the government, so that all profits of this bank are owned by the government as well. Examples: Bank Negara Indonesia (BNI), Bank Rakyat Indonesia (BRI), Bank Tabungan Negara (BTN).

b) National privately owned banks

This type of bank is partially or wholly owned by the national private sector and the deed of establishment was established by the private sector, as well as the distribution of profits for private profits as well. Examples: Bank Muamalat, Bank Central Asia, Bank Bumi Putra, Bank Danamon, Bank Duta, Bank Niaga.

c) Cooperative-owned banks

The ownership of shares of this bank is owned by companies incorporated as cooperatives. Example: Indonesian Cooperative Commercial Bank.

d) Foreign-owned banks

This type of bank is a branch of an existing bank abroad, a foreign private bank or a foreign government. Obviously the ownership is owned by foreign parties. Examples: ABN AMRO Bank, Deutsche Bank, American Express Bank, Hongkong Bank and Standard Charactered Bank.

e) Mixed-owned banks

Share ownership of mixed banks is owned by foreign parties and national private parties. Its majority share ownership is held by Indonesian citizens. Examples: Sumitomo Niaga Bank, Merincorp Bank, Swadarma Sakura Bank and so on

3) Types of Banks in terms of status

a) Foreign exchange banks

Is a bank that can carry out transactions abroad or related to foreign currencies as a whole, such as overseas transfers, *travelers-cheques*, bookkeeping and payment of letters of credit and other transactions.

b) Non-foreign exchange banks

It is a bank that does not have a license to carry out transactions as a foreign exchange bank, so it cannot carry out transactions like foreign exchange banks. So non-foreign exchange banks are the opposite of foreign exchange banks, where transactions carried out are still within national borders.

ISSN 1533-9211
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4) Types of banks in terms of how to determine prices

a) Banks based on conventional principles in seeking profits and determining prices to their customers, banks based on conventional principles use two methods, namely: determining interest as a price, both for savings products such as savings, deposits and current accounts.

b) **Banks based on sharia principles**

   Banks based on sharia principles have recently developed in Indonesia. But abroad, especially in Middle Eastern countries, banks based on sharia principles have been growing rapidly for a long time

Banks as financial institutions have the main function, namely as a collector of funds in the form of loans. But actually the function of banks can be explained more specifically as expressed by Y. Sri Susilo in the book "Banks and Other Financial Institutions", which is as follows:[7]

1) Agent of Trust

The main basis of banking activities is trust, both in terms of raising funds and distributing funds. The public believes that the money will not be misappropriated by the bank, and the bank believes that the debtor will not misuse the loan

2) Agent of Development

The economic activities of society in the monetary sector and in the real sector are inseparable. The two sectors always interact and influence each other. The real sector will not be able to work well if the monetary sector does not work well.

3) Agent of Service

In addition to collecting and distributing funds, the bank also offers other banking services to the public. The services offered by this bank are closely related to the economic activities of the community in general. These services can include money transfer services, valuables storage, bank guarantees, and bill settlement.

In the explanation contained in Law No. 10 of 1998 concerning Banking, banks have two functions, including:

1) Community Fund Collector Community fund collection can be in the form of deposits (time deposits), current accounts, savings, and others that are likened to it.
2) Disbursing Community Funds Distributing community funds can be in the form of credit or likened to it.

The Seybold REPORT

ISSN 1533-9211

DOI: 10.5281/zenodo.10071217

Banks as financial institutions have an important function, as a support for the economy of a country. The functions of banks in general are as follows:[8]

1) Bank as an intermediary body in credit

Banks function as recipients of credit or in the form of money entrusted by the public such as savings, current accounts and deposits.

2) Banks as money dealers

Banks as entities that have the ability to circulate money, both giral and fiat money.

3) Banks as *intermediary finance*

Banks as *intermediary finance* are intermediaries from parties who have excess funds with parties who need funds

2. The Role of Audit Internal in Internal Control in Banking Lending

According to Sukrisno, Agoes mentioned three types of auditing that are commonly carried out. The three types are: [9]

1. Operational Audit (Operational/Management Audit)

Operational or management audit is an examination of all or part of the operational procedures and methods of an organization to assess its efficiency, effectiveness, and economicalization. Operational audit can be an effective and efficient management tool to improve company performance.

The results of operational audits are in the form of recommendations for improvement recommendations for management so that this type of audit is more of a management consultation.

2. *Compliance* Audit

Compliance Audit is an examination to find out whether the procedures and rules set by the competent authority have been obeyed by personnel in the organization. Compliance Audit is usually assigned by the competent authority that has established procedures / regulations in the company so that the results of this type of audit are not for publication but for internal management.

3. *Financial* audit

Examination of financial statements is an evaluation of the fairness of financial statements presented by management as a whole compared to generally accepted financial accounting standards. In the sense of whether financial statements in general are exchangeable and verifiable information and have been presented in accordance with certain criteria.

Generally, the criteria in question are generally accepted accounting standards such as generally accepted accounting principles. The audit results of financial statements are auditors' opinions, namely Unqualified Opinion, Qualified Opinion, Disclaimer Opinion and Adverse Opinion.

ISSN 1533-9211
DOI: 10.5281/zenodo.10071217

Based on the breadth of examination, the types of audits can be distinguished as follows:[10]

1. General Audit, which is a general examination of financial statements conducted by an independent Public Accounting Firm (KAP) with the aim of providing an opinion on the fairness of the financial statements as a whole.
2. *Special Audit*, which is a form of examination that is only limited to auditee requests carried out by the Public Accounting Firm (KAP) by providing opinions on parts of the audited financial statements, such as an examination of the company's cash receipts.

Meanwhile, based on the group or executor of the audit, the audit is divided into 4 types as follows:

1) External Auditor

External / independent auditors work for public accounting firms whose status is outside the structure of the company they audit. External auditors produce reports on financial audits.

2) Internal Auditor

Internal auditors work for the companies they audit. Management audit reports are generally useful for the management of the company being audited. Therefore, the task of internal auditors is usually a management audit which is a type of *compliance audit*.

3) Tax Auditor

The tax auditor is tasked with checking the compliance of the audited taxpayer with applicable tax laws.

4) Government Auditor

The task of government auditors is to assess the fairness of financial information compiled by government agencies. In addition, audits are also conducted to assess the efficiency, effectiveness and economicalization of program operations and the use of government property. Audits carried out by the government can be carried out by the Audit Board (BPK) or the Audit Board for Finance and Development (BPKP).

Internal audit is a monitoring element of the internal control structure in an organization, which is created to monitor the effectiveness of other elements of the internal control structure. Internal auditing is an independent assessment function in an organization to test and evaluate the activities of the organization carried out.[11] Audit intern is an auditor working in a company (state company or private company) whose main task is to determine whether the policies and procedures set by top management have been adhered to, determine whether or not the safeguarding of the organization's wealth, determine the efficiency and effectiveness of the organization's activity procedures, and determine the reliability of information produced by various parts of the organization. According to Sawyer, internal audit is an independent assessment function established within a company to examine and evaluate its activities as services provided to the company.[12, 13] Internal audit is an examination carried out by the

The Seybold REPORT
ISSN 1533-9211
DOI: 10.5281/zenodo.10071217

company's internal audit department, both on the company's financial statements and accounting records, as well as compliance with predetermined peak management policies and compliance with the government and the provisions of the applicable professional association.[14]

Internal Audit according to The Institute of Internal Audit (2012) as follows:

> "Internal auditing is an independent appraisal activity established within an organization as a service to the organization. It is a control which functions by examining and evaluating the adequacy and effectiveness of other controls. The objective of internal auditing is to assist members of the organization in the effective discharge of their responsibilities. To this end, internal auditing furnishes them with analyses, appraisals, recommendations, counsel, and information concerning the activities reviewed. The audit objective includes promoting effective control at reasonable cost."

Internal audit is an independent assessment activity formed in an organization as a service to the organization. Which serves as a control to check and evaluate the adequacy and effectiveness of other controls in the organization. The purpose of internal audit is to assist members of the organization in carrying out responsibilities effectively. On the basis of this goal, internal auditors equip the organization with analysis, assessment, recommendations, advice and information regarding the organization's activities. The objectives of such audits include promoting effective controls at reasonable costs.

So it can be concluded that internal audit is an activity carried out by an organization that is intended to assist management in providing information, in the hope that it can add value to the company. The implementation of internal audit must be carried out independently and objectively which means that it is not influenced by any party and is not involved in the implementation of the audited activities.

According to Robert Tampubolon that: "the internal audit function functions more as eyes and ears for management , because management needs assurance that all policies that have been determined will not be implemented deviantly".[15] Thepurpose of internal audit is to help members of the organization carry out their responsibilities effectively. For this reason, the internal audit will conduct analysis, assessment, and submit suggestions. The purpose of the examination also includes the development of effective supervision at a reasonable cost.[16]

Thepurpose of the audit carried out by the internal auditor is to assist all company leaders (management) in carrying out their responsibilities by providing analysis, assessment, advice and comments on the activities they examine.[17]

The Seybold Report
ISSN 1533-9211
DOI: 10.5281/zenodo.10071217

To achieve this goal, the internal auditor must perform the following activities:

1) Review and assess the goodness, adequacy or inadequacy and application of management control systems, internal control and other operational controls and develop effective controls at a cost that is not too expensive.
2) Ensure compliance with policies, plans and procedures established by management.
3) Ensuring how far the company's assets are accounted for and protected from the possibility of all forms of theft, fraud and abuse.
4) Ensure that the management of data developed within the organization can be trusted.
5) Assess the quality of work of each part in carrying out the tasks assigned by management.
6) Suggest operational improvements in order to improve efficiency and effectiveness

Haryono put forward seven main principles of internal control, namely:

1) Clear assignment of responsibilities.
2) Implementation of company registration.
3) Insuring of wealth and employees of the company
4) Equipment separation and asset storage.
5) Separation of liability for related transactions.
6) Independent conduct of examinations.
7) Use of mechanical equipment whenever possible.

C. CONCLUSION

Internal audit is a monitoring element of the internal control structure in an organization, which is created to monitor the effectiveness of other elements of the internal control structure. Internal auditing is an independent assessment function in an organization to test and evaluate the activities of the organization carried out.

Internal auditors work for the companies they audit. Management audit reports are generally useful for the management of the company being audited. Therefore, the task of internal auditors is usually a management audit which is a type of *compliance audit*. The purpose of the audit carried out by the internal auditor is to assist all company leaders (management) in carrying out their responsibilities by providing analysis, assessment, advice and comments about the activities they inspect Seven basic internal control principles, namely: 1) Determination of responsibilities clearly, 2) Implementation of company records, 3) Insurance of company assets and employees, 3) Separation of equipment and asset storage, 4) Separation of responsibility for related transactions, 5) Implementation of independent examinations., 6) Use of mechanical equipment whenever possible.

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Foot Notes

1) Article 2,3,4 of the Banking Act of 1998
2) Cashmere Banking Basics (Jakarta: PT Raja Grafindo Persada, 2012). p. 112
3) Akmal, Internal Audit Approach Internal Audit Management, Edition. 2 (Jakarta: PT. Index, 2009). p. 12
4) Mudrajad Kuncoro, Easy to understand and analyze economic indicators (Yogyakarta: UPP STIM YKPN, 2013). p. 28
5) Cashmere Banking Basics.p. 23
6) Ibid, p. 25
7) Y. Sri Susilo Totok, Budi Santoso, Sigit Triandari, Banks and institutions. Other Finance (Jakarta: Salemba Empat, 2006). p. 9
8) Cashmere Banking Basics.p. 32
9) Sukrisno Agoes, Tax Accounting, 3rd Edition (Jakarta: Salemba Empat, 2014). p. 38
10) Ibid
11) Hiro Tugiman, a New View of Internal Auditing (Yogyakarta: Kanisius, 2014). p. 13
12) Mulyadi, Accounting System, 3rd Edition, 5th Print (Jakarta: Salemba Empat, 2010). p. 29
13) Lawrence B Sawyer's, Internal Auditing, Volume 1, 5th Ed (Jakarta: Salemba Empat, 2010). p. 8
14) Sukrisno Agoes, Auditing: Practical Instructions for Accountant Examination by. Public Accountant. Volume 1, Issue 4 (Jakarta: Salemba Empat, 2012). p. 221
15) Robert Tampubolon, Risk and System-Based Internal Auditing (Jakarta: Harvarindo, 2005). p.1
16) Tugiman, A New View of Internal Auditing.p 11
17) Agoes, Tax Accounting, 3rd Edition.p. 222

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