

# THE ROLE OF INTERNAL AUDIT IN GOVERNANCE, RISK MANAGEMENT, AND CONTROLS FOR FRAUD PREVENTION AT PPATK

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## ABSTRACT

*Law Number 8 of 2010 concerning the Prevention and Eradication of Money Laundering has mandated the **Indonesian Financial Transaction Reports and Analysis Centre (INTRAC / PPATK)** to be the focal point of every effort made to combat money laundering in Indonesia. As a focal point, PPATK receives financial transaction reports from reporting parties, which include Financial Service Providers and Goods and Services Providers, where the data provided are considered to be highly confidential. This indicates that PPATK has become a strategic institution, and thereby it should be assured that its governance, risk management, and internal control are well maintained. **Government Internal Supervision Apparatus (APIP)** has become more strategic and keeps its pace according to the latest needs. APIP is expected to be the agent of change that could create added-values into the products or services made by the government agency. The activity of internal audit from APIP should contribute to increase the effectiveness and efficiency of governance, risk management, and control processes. In term of risk management, internal auditor should be able to evaluate the effectiveness and his contribution towards the improvement of the risk management process. Internal auditor should monitor the process through sustainable management, separated evaluation, or both. Internal auditor should be able to evaluate the potential occurrence of fraud and how the auditee manages the fraud risk. Meanwhile, in relation to internal control, the activity of internal auditor should evaluate the adequacy and effectiveness of internal control in handling the risks of the auditee's governance, operational, and information system.*

## 1. INTRODUCTION

Indonesian Financial Transaction Reports and Analysis Center (hereinafter referred to as PPATK) is the focal point which has the task of preventing and eradicating money

laundering. Universally, PPATK is a Financial Intelligence Unit (FIU) which has the duty and authority to receive financial transaction reports, conduct analysis of financial transaction reports, and continue the analysis to law enforcement agencies.

Based on Law No. 8 of 2010, the complainants, that is, financial service providers (FSPs) and goods and service providers, must submit the financial transaction reports to PPATK. According to statistical bulletin of anti-money laundering and terrorism financing of April 2016, from January 2003 to April 2016, PPATK received 270,586 Suspicious Financial Transaction Reports, 19,208,825 Cash Transaction Reports, 119,514 Goods and Services Provider Transaction Reports, 6,389 Cash Carriage Reports (LPUT), and 1,928,914 Financial Transaction Reports of Funds Transfer from / to Overseas. After receiving the report data, PPATK analyzes and / or examines the data, and submits the analysis reports to law enforcement officials.

The report data or information from the complainant and the reports on the results of analysis and / or reports on the results of the examination are strictly confidential because they involve financial transactions of a person that should be guarded by all employees of PPATK. The risk of information leakage and / or fraud may ruin the organization's reputation and has the implications for the criminal. The risk may come from all work units of PPATK. To prevent such occurrence, PPATK should run good governance, risk management and effective and efficient internal control. To

ensure that the governance, risk management, and control have been running well requires the role of Government Internal Supervisory Apparatus (hereinafter referred to as APIP) or internal audit.

## **2. REVIEW OF RELATED LITERATURE**

### **2.1 Internal Audit**

According to the Association of Internal Auditors of the Government of Indonesia (hereinafter referred to as *Asosiasi Auditor Intern Pemerintah Indonesia* or *AAIPI*) on the Internal Audit Standards, the internal audit is independent and objective activities, in the form of assurance activities and consulting activities, which are designed to add value and improve the operations of an organization (AAIPI, 2014). These activities help an organization accomplish its objectives by means of systematic and orderly approach to assess and improve the effectiveness of the risk management, control, and governance process.

Based on the above definitions, in its development, the audit concept has changed. In the past the internal auditor or APIP was merely as a supervisor of an organisasi whose work was just to seek faults, but at present the internal auditor can provide advice and input of the corrective actions on the existing systems. This shows that the role of APIP is increasingly strategic and moves in line with the needs of the time. APIP is expected to be an agent of change that can create added value in the products or services of government agencies. APIP as the government's internal watchdog is one of important elements of the government

management in order to realize good governance that leads to clean government / bureaucracy. Therefore, the internal auditor should always improve the knowledge both in auditing and in bisnis in order to provide advice and input of the corrective actions.

## 2.2 Governance

According to the Education and Training Center for Surveillance of Indonesian Financial and Development Supervisory Board (hereinafter referred to as **Pusdiklatwas BPKP**) (2014), multidimensional crisis that began with the financial crisis in 1997-1998, has pushed backflow demanding the reforms in state governance including the government bureaucracy. One of the causes of the multidimensional crisis experienced by the people of Indonesia was mismanagement in holding the governance (poor governance) indicated by several problems, among others are:

- domination of power by one party against the other parties, in which the monitoring becomes difficult;
- the occurrence of corruption, collusion and nepotism; and
- the low performance of the government apparatus including in the service to the public or society in various fields.

According to the Institute of Internal Auditors/IIA (2009), governance is a combination of several processes and structures implemented by board of directors to inform, direct, manage and monitor the activities of an organization in achieving its goals. Meanwhile, according to the United National Development

Planning (UNDP), good governance is a practical application of the management authority of various state affairs in the fields of politics, economic and administration at all levels. Based on the concept of the definition above, there are three important pillars of good governance, namely:

- People's welfare (*economic governance*)
- Decision-making Processes (*political governance*)
- The management of policy implementation (*administrative governance*)

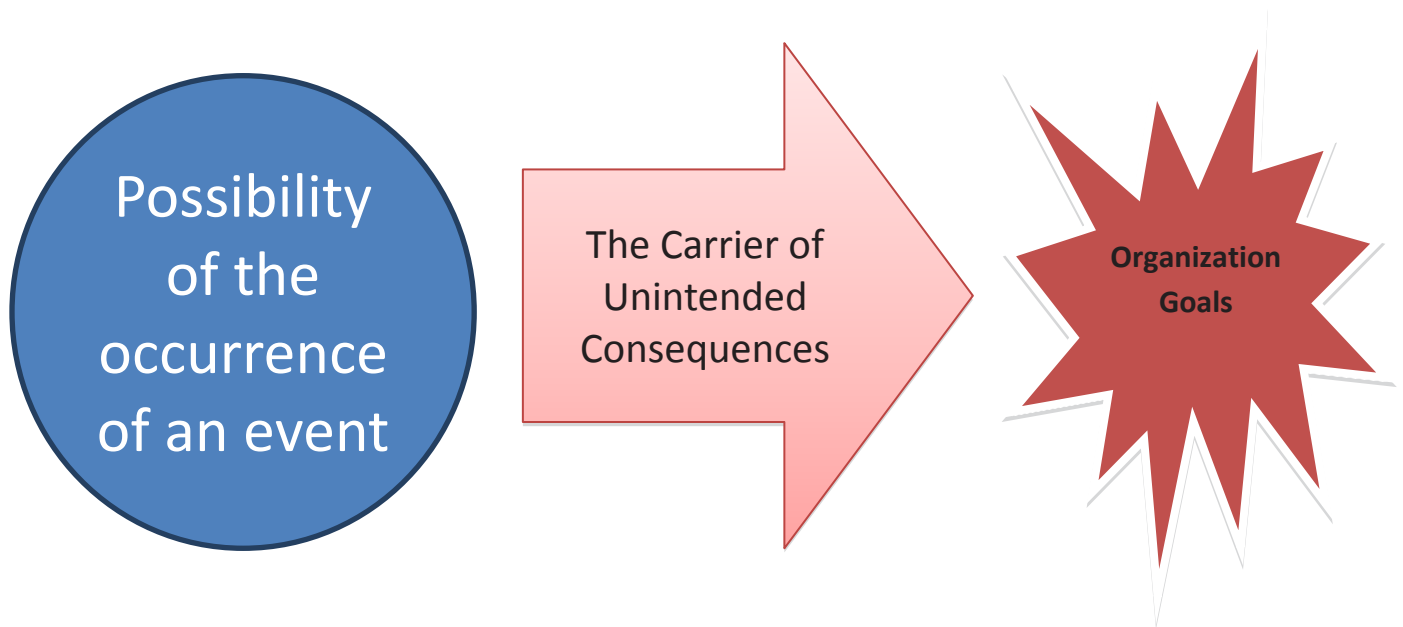
The good and bad governance can be judged when it is in contact with all the elements of the principles of good governance. The principles, according to UNDP, are participation, law enforcement, transparency, responsiveness, orientation on agreement, equality, effectiveness and efficiency, accountability and strategic vision

## 2.3 Risk Management

The demands for changes and an increase in the capability of the organization have raised the risks as well as opportunities for the organization. The risks are related to the possibility of failure and loss for the organization. Low-scale risk does not worry the organization. However, the large-scale risk could have an impact on not achieving the goal and mission of the organization.

Government Regulation No. 60 of 2008 states that risk is an event that may happen, and if it happens, it will have a negative impact on the achievement of the goal. The definition of risk above is illustrated in Figure 2.1.

**Figure 2.1 The Understanding of Risk**



(Source: Pusdiklatwas BPKP, 2014, Governance, Risk Management, and Internal Control)

### **Definition of Risk Management**

The risk of not achieving the organization's goals and programs happens not only in the business sector, but also in the public sector. Therefore, the government agency needs to conduct risk management.

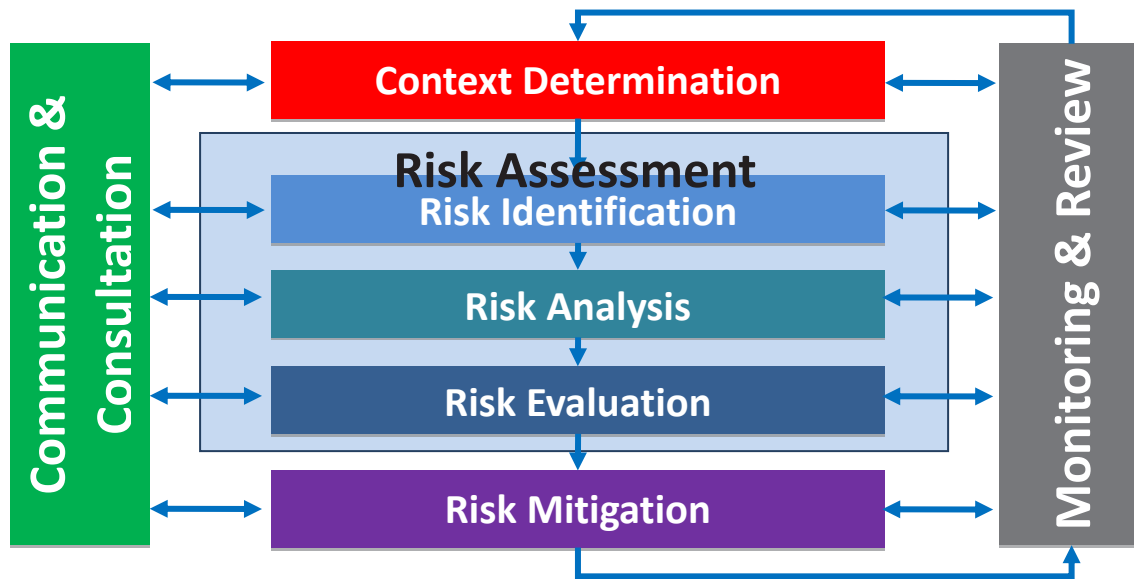
Risk Management, according to AS / NZ Standard 4360: 2004, is *"the culture, processes, and structures that are directed towards realizing potential opportunities while managing adverse effects."* Meanwhile, according to COSO, risk management can be defined as *"a process, effected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity,*

*manage risk to be within its risk appetite, and provide reasonable assurance regarding the achievement of entity objectives."*

### **Elements of Risk Management**

According to AS / NZS (2004), elements of risk management can be seen in Figure 2.2 that can be explained as follows:

Figure 2.2ERM AS/NZS Framework



(Source: AS/NZS 4360, 2004, *Australian/New Zealand Standard Risk Management*)

- a. Communication and Consultation
- b. Communication and consultation process aims to obtain relevant information and to communicate each stage of risk management process so that those concerned can carry out their responsibilities well.
- c. Determination of Context
- d. Determination of context aims to identify and analyse organization as an environment where the risk management will be implemented. In this process, the parties most concerned with the process of the implementation of risk management, the scope and purpose of the process, the limiting conditions, and the expected results of the implementation of risk management are identified.
- e. Risk Identification
- f. Risk identification aims to identify all types of risks that could potentially obstruct, degrade or delay the achievement of objectives.
- g. Risk Analysis
- h. Risk analysis aims to determine the profiles and the maps of the risks existing in the organization and will be used in the evaluation process and risk management strategies.
- i. Risk Evaluation
- j. Risk evaluation aims to set priorities for the risks that have been identified and analysed. Risk evaluation is done so that the decision makers in the organization can consider whether to do further risk management and its priority handling
- k. Risk Management
- l. Risk management process aims to determine the type of effective and efficient treatment for such a risk. Risk management is done

by identifying the various risk management options available, deciding the best risk management option, and developing the risk mitigation plans

m. Monitoring and Reviewing

n. Monitoring and reviewing aims to anticipate sudden and persistent changes in the risk, both on the level of risk and on the risk direction which have a negative impact on the risk profile.

## 2.4 Internal Control

Internal controls are built to achieve organizational goals by utilizing all economically, efficiently, effectively and in accordance with the applicable provisions. Basically, internal control aims to identify the occurrence of deviation on the implementation of activities from the plan that has been set, so that corrective action can be done by the management. Internal control can include preventive controls in the form of a design of control system, or the detective to address the deviations that have occurred (Pusdiklatwas BPKP, 2014)

## 2.5 Indonesian Government Internal Audit Standards

According to AAIFI (2014), Indonesian Government Internal Audit Standards, hereinafter referred to as the Auditing Standards, is the criteria or measurement of minimum quality for conducting internal audits that shall be guided by the Indonesian government's internal auditors. The auditing standard consists of two main parts, namely:

### a. Attribute Standards

Attribute standards govern the common characteristics that include the responsibilities, attitudes, and actions of the internal audit assignment as well as the organizations and parties that conduct the internal audits, and these apply generally to all internal audit assignments. Attribute standards are divided into Basic Principles and General Standards.

### b. Performance Standards

Performance standards describe the specific nature of internal audit activities and provide criteria for assessing the performance of internal audit. Performance standards are divided into Internal Audit Implementation Standard and Internal Audit Communication Standard. The scope of activities regulated in the Performance Standards includes Quality Assurance Activities and Consulting Activities.

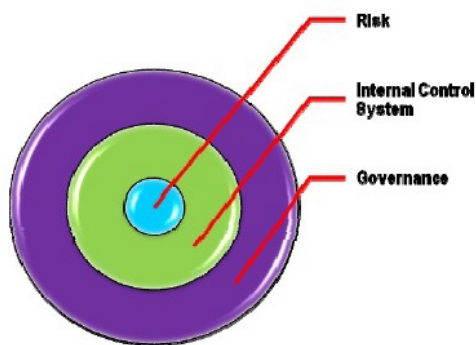
The role of internal audit activities in accordance with Internal Auditing Standards Paragraph 3110 is responsible for evaluating and developing public sector governance processes as part of the assurance function. In terms of risk management, the role of internal audit should be able to evaluate the effectiveness and contribute to the improvement of risk management processes. As for the internal control, internal audit activities should be able to assist the auditee in maintaining and improving the effective control by evaluating the effectiveness and efficiency and encouraging continuous improvement.

## 2.6 The Relationship among Governance, Risk Management, and Control (GRC)

As a combination of processes and structures implemented by management to inform, direct, manage, and monitor the activities of the organization in order to achieve the objectives, governance is not a set of processes and structures that stand alone, apart from other systems. Governance also has relevance to risk management and internal control (Pusdiklatwas BPKP, 2014)

According to Government Regulation No 60 of 2008, the relationship among governance, risk management, and internal control can be seen in Figure 2.3 as follows:

**Figure 2.3**  
**GRC Relationship according to Government Regulation No 60 of 2008**

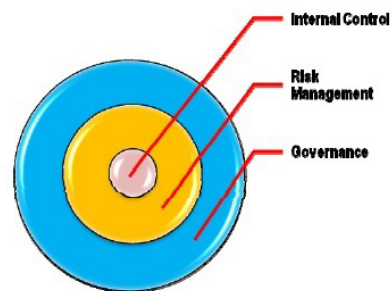


(Source: Pusdiklatwas BPKP, 2014, Governance, Risk Management, and Internal Control)

From the figure above it can be seen that risk is part of the internal control system, and the internal control system is an integral part of governance. Recent developments related to risk management give a new discourse on the relationship among governance, risk management, and control. According to the IIA

(2009), the relationship can be seen in Figure 2.4.

**Figure 2.4**  
**GRC Relationship according to IIA**

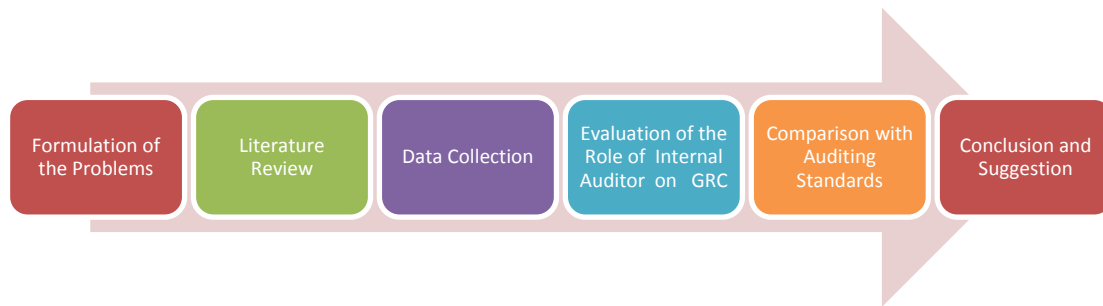


(Source: Pusdiklatwas BPKP, 2014, Governance, Risk Management, and Internal Control)

From the figure above, it can be seen that the internal control system is part of the risk management, and risk management is an integral part of governance.

## 3. METHODOLOGY

Research methodology is a systematic series of stages to complete and answer the research questions that have been determined. This study uses a quantitative and qualitative analysis with a series of stages as follows:



**Figure 3.1**  
**Research Methodology**

The above stages are explained as follows:

1. Formulation of the problems  
Outlining the problems that will be examined through this study and the output of this stage is the research question
2. Literature Review  
Sources of literature are from books, theses, document of the agency as the research object, document of legislation and other government regulations, and other sources from the internet
3. Data Collection  
Collecting data through interviews, field observation and literature study.
4. Evaluation of the Role of Auditor  
Evaluating the current state of the internal auditor's role in the governance, risk management and internal control.
5. Comparison with Auditing Standards  
Comparing the role of internal auditors with auditing standards issued by AAIPI. The result of this comparison is the gap that will be used as the conclusions and suggestions for future improvements

#### 6. Conclusion and Suggestion

Conclusion is obtained by inductive. Conclusion accommodates the overall research objectives. Suggestions are for improvement of APIP in the future.

#### 4. RESULTS AND DISCUSSION

The measurement of the internal auditor's role in the governance, risk management, and control is carried out by filling out a questionnaire to compare the activities of the existing internal auditors with the auditing standards. Filling out the questionnaire is conducted on focus group discussion (FGD). The questionnaire form for measuring the role of internal auditors in governance, risk, and control (GRC) can be seen in Table 4.1.



**Table 4.1**  
**Measurement Form of Internal Auditor’s Role on GRC**

No	Statement Description	Answer choice		
		Yes	Partly	No
1	Our supervisory activities include assessment of the efficiency and effectiveness of the governance, risk management, and control.			
2	The internal audit activity has assessed whether the organization’s information technology governance has supported the strategy and objectives of the organization			
3	We already have an internal audit charter which expresses the nature of assurance services which can be provided by APIP at this time, that is, the value for money audit (audit of economic, efficiency, effectiveness (3e) / evaluation of program / policy evaluation).			
4	Our supervision has contributed to the improvement. We have given the influence of changes in increasing the effectiveness, efficiency, and improved organizational performance.			
5	Our monitoring activities have reduced the scale / exposure of the organization’s risk that may occur.			
6	We have assignment supervision for the provision of advisory services without taking over management responsibilities (including: training, review of development system, Control Self Assessment / CSA), independent performance assessment, counselling and advisory).			
7	We already have an internal audit charter that expresses the nature of advisory services that can be provided by APIP at this time, and lists the types of advisory services that can be done by APIP at this time.			
8	Our advisory services provide added value to the organization			
9	We have carried out practices that ensure that our independence and objectivity are not marred at the time of providing advisory services.			
10	We have carried out an audit on the (enterprise wide risk.			
11	We have carried out attestation to the fairness of management assertion on the effectiveness governance, risk management and control process.			
12	We already have an internal audit charter which shows the authority to give an opinion on the overall organization (the effectiveness of governance, risk management, and control process).			
13	We have carried out the planning for risk-based supervision			
14	Our institution leaders (Ministry / Institution / Local Government) and our stakeholders have confidence that the organization’s governance, risk management, and control process have provided reasonable assurance that the organization’s objectives to be achieved			
15	Our supervisory activities have been able to provide adequate assurance and advisory services including audit coverage in the areas of governance, entity level controls, fraud, new strategy proposal, and business programs or practices needed by the organization.			
16	We have an updated the internal audit charter that includes the expansion of the role and scope of surveillance activities.			

17	We have had a developed leadership and professionalism capacity so that we can act as a catalyst, a change agent, and able to provide future predictions to drive positive change for the organization			
18	We have used the overall enterprise risk management as an integral part of the APIP strategy.			
19	The focus of our strategy is emphasized on innovation, service to stakeholders, and the provision of value			
20	We are the key players in contributing to the determination of the organization's vision in responding to both internal and external need of the organization.			

From the table above, there are three (3) possible answers with the following criteria:

- a. Answer “yes” is selected on the assumption that the APIP unit has supporting documents or relevant evidence, and with the condition that the APIP unit concerned has implemented the entire document continuously and repeatedly.
- b. Answer “partly” is selected on the assumption that APIP unit has less complete supporting documents or evidence, and with the condition that the APIP unit concerned only implements part of the document uncontinuously and unrepeatedly.
- c. Answer “no” is selected with the assumption that the APIP unit does not have document, so that nothing is implemented in the APIP unit.

After comparing the role of internal auditors of INTRAC (PPATK) with the auditing standards issued by AAPII, it is obtained the results of the suitability of the role of internal auditors with auditing standards related to GRC by 52.50% or there is a gap of 47.50%.

## 5. CONCLUSION

Based on the discussion of the measurement process conducted, the role of internal auditor in the governance, risk management, and control can be deduced as follows:

1. There is a gap of 47.50% between the role of internal auditors and the auditing standards
2. Suitability between the role of internal auditors and auditing standards related to GRC is 52.5%
3. The internal auditor has not carried out an audit on the risk management on the entirely scope of the organization
4. The internal auditor has not updated the internal audit charter that includes the expansion of the role and scope of surveillance activities
5. The internal auditor has implemented practices that ensure that the independence and objectivity of the auditor is not marred as providing advisory services.
6. The monitoring activities have not fully promoted the improvement of governance, risk management, and control.

7. The infrastructure (document, policy) related to the improvement of governance, risk management, and control has not been completely available.

## 6. SUGGESTION

Some suggestions that can be used by the Internal Auditor of INTRAC (PPATK) are as follows:

1. Conducting *self-assessment* on the capability of the auditor to determine the auditor position level.
2. Measuring all existing auditing standards both general standards and implementation standards, because at present the measurement of the auditor's role is just limited to governance, risk management, and control.
3. Preparing documents or policies that support activities related to the supervision of governance, risk management, and control
4. Encouraging the immediate implementation of risk management at INTRAC
5. Evaluating and providing suitable recommendations to improve the process of public sector governance in the fulfillment of the following objectives:
  - encouraging the enforcement of ethics and values in the auditee organization;
  - ensuring the accountability and effective performance of the auditee management;
  - communicating risk and control

information to areas of the proper auditee organization; and

- coordinating the activities and communicating the information among the leaders / ministry / institution / local government, external and internal auditors, as well as audit management

6. Evaluating the potential for the occurrence of fraud and how the auditee manages the risk of fraud
7. Evaluating the adequacy and effectiveness of the government's internal control in response to the risk of auditee's governance, operations, and information systems

## 7. REFERENCES

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