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THE ROLE OF INTERNAL AUDITORS FOR ACHIEVING AN EFFECTIVE INTERNAL CONTROL

THESIS



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ABSTRACT

This study is aimed to know about the function of internal audit, internal control, and the role of internal auditor for achieving an effective internal control in Bank Nagari. The writer using element of COSO Framework to review the internal control in Bank Nagari. The methodology used in this research is descriptive case study in order to get clear picture of the real situation in Bank Nagari. Both primary and secondary data is used, which are gathered from interviews with related parties, documentation of Bank Nagari, and study literatures that are related with the research. The results found in Bank Nagari shows that the internal audit function and implementation of internal control in Bank Nagari are effective. It seen from the position and function of internal auditor, and implementation of COSO Framework in Bank Nagari.

Keywords : Internal Audit, Position and Function of Internal Auditor, Independence, COSQ Framework



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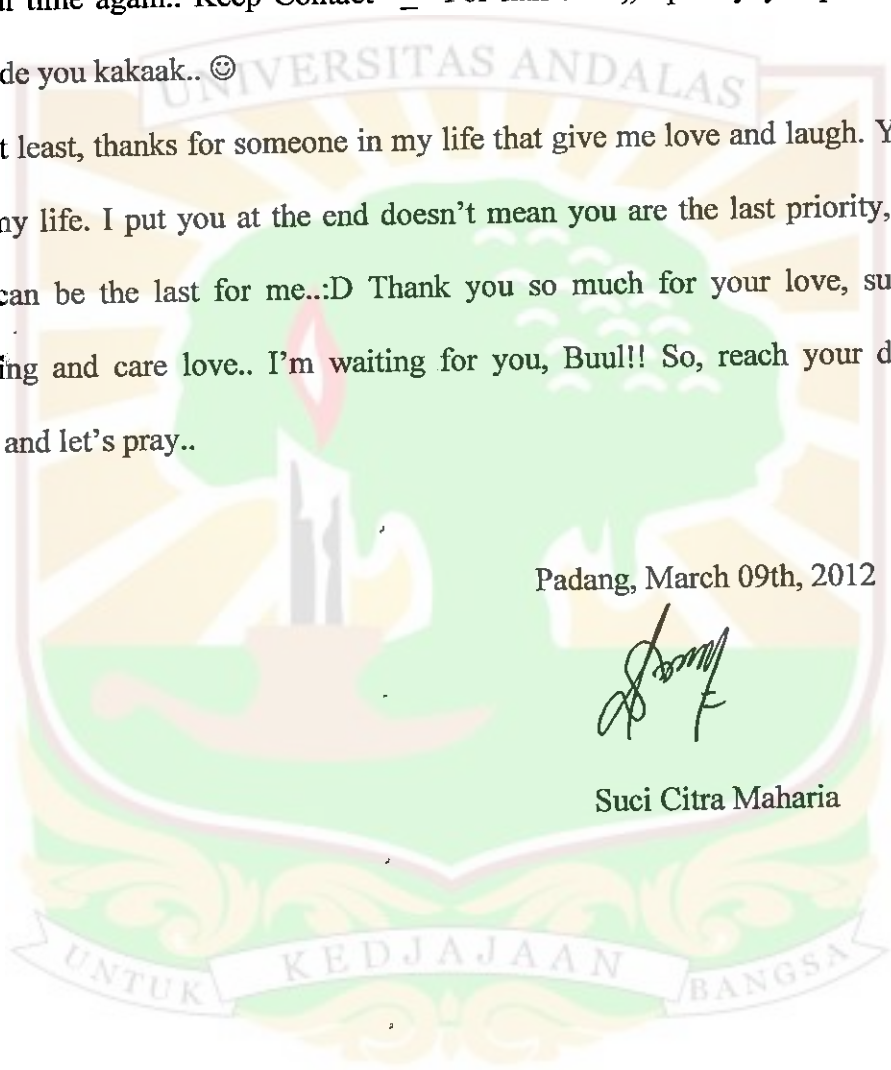
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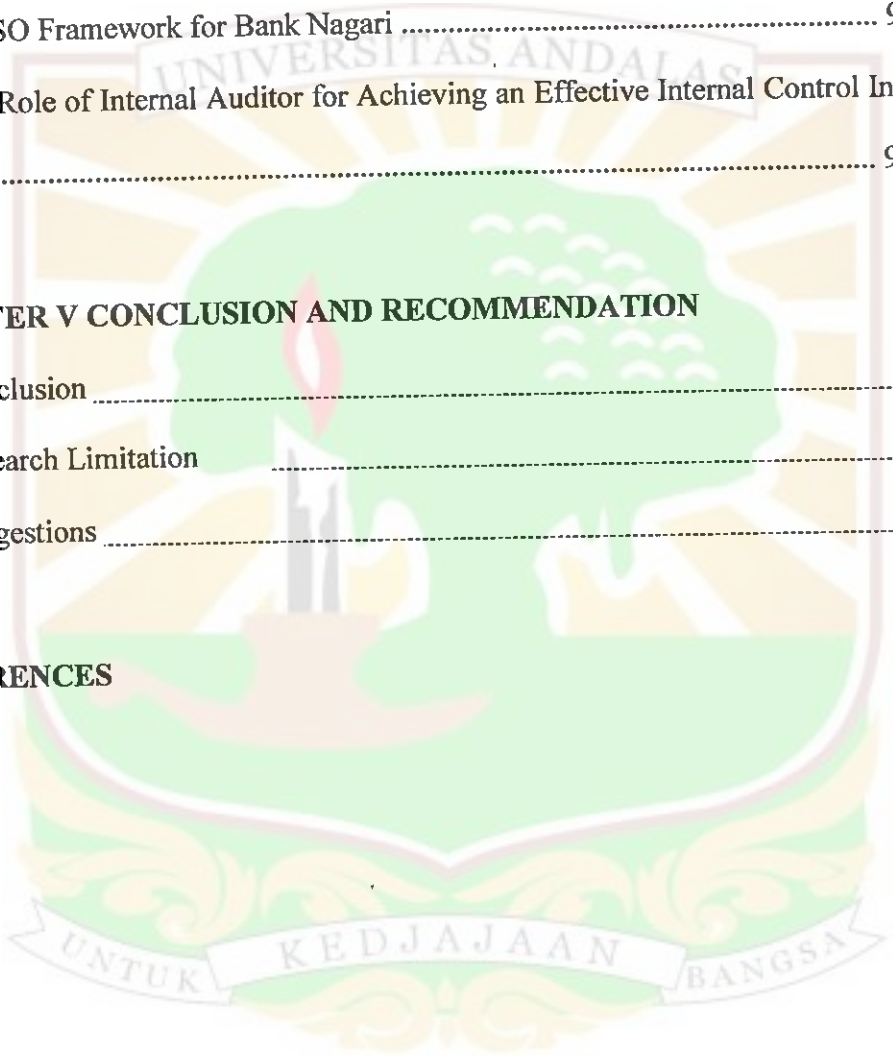
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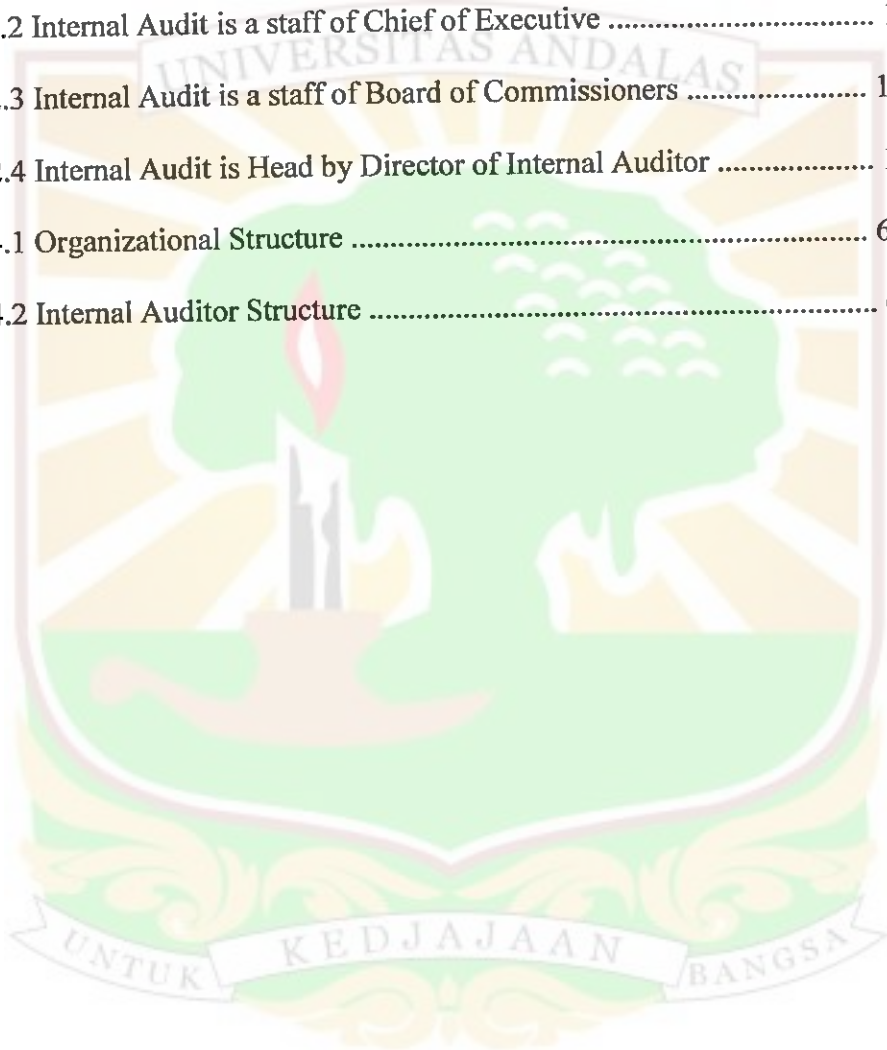
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CHAPTER 1

INTRODUCTION

1.1 BACKGROUND

Era globalization will sharpen rivalries that need more critical thinking on optimal utilization of various sources of funds and the use of existing resources. The increasing of complexity, the size of organization and the expansion in business operations is affecting the need for the complex control system, both control of financial and business operational that make the role of audit became important thing, especially the internal audit who has involved day to day operational of organization.

Internal audit role is about independent function that exists in an organization to test and evaluate the activities of organization. Internal auditor is required for its ability to provide the service according the need of the organization. The increasing effectiveness and efficiency of internal audit role in organization will result the good internal control in an organization.

Sawyer (2005) suggested that the internal audit function having turning point as a profession in 1941, namely with the formation of The Institute of Internal Auditors (IIA). In the 1950's internal audit function more focused on the review of financial statements (financial audit) and around the 1980's developing the internal audit function to assess the efficiency and effectiveness of company operations (operational audits). Since the arising case of Enron & Worldcom, the internal audit profession has developed significantly. Internal audit function

became widespread with the new concepts and rules that developed one of which the Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

According to IIA standard (2004), Internal auditing activities is an independent, objective, assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes. According to this standard the internal auditors have significant role in company and one of role is in internal control.

The needs for special internal control happen to all entities even the scale is bigger or smaller. The company arranges internal control is aimed to reach their goals effectively and efficiently. Internal control is obtained to give a guarantee for the validity and the appropriateness of financial information, describing the efficiency and the effectiveness of company management, and the loyalty of law and regulations. The main result of the recent years' globalization process is also affect the banking system as the vital need for a prudential supervision in order to maintain stability and confidence.

Banks are important institutions of intermediation function for flow of funds in an economy. Based on law UU No. 7 year 1992 about Perbankan as amendment by law UU No. 10 year 1998, " Bank is business entity which collects funds from public in form of savings and distribute it to the community in the

form of credit or other forms to improve the living standards of people". According to Bank Indonesia (1999), the role of internal audit in the banking industry and public companies, which are both associated with public funding is relied upon by the stakeholders are shareholders, directors, customers, management and government. Internal audit by the stakeholders are required to help them maintain the security of funds among other investors, ensuring the reliability of financial reporting, improve the effectiveness of internal control, and assist the audit committee to conduct supervision and encourage the organization comply with regulations and laws in force.

Indonesian Banking aims to support the implementation of national development in order to improve equity, economic growth, national stability towards improving the welfare of the people. If a bank has problems, the impact will spread rapidly, particularly to customers, investors or other parties and generally for the economic of the country. If the problem is not handled properly, it will create contagion effect, both domestically and internationally. In indonesia, for a state company (BUMN), the necessity to held internal control in COSO's framework based in regulated in article 22 of BUMN's Minister Discretionary, Number Kep-117/M-MBU/2002 about the application of good governance in state company. This article state that, the minister of BUMN have to maintain the internal control for the companies includes : Control Environment, Risk Assessment, Control Activities, Information, and Communication, and Monitoring.

Therefore, the need for effective internal control and efficient internal audit function is supported by good and effective for the banking company could develop in accordance with the development of business because one of the bank's internal audit functions is to safeguard and secure the business of banks. Internal control bring us to one conclusion that internal control is very important to keep company's assets. Whenever mistakes or irregularity happen, it is expected to be detected immediately.

Bank Nagari is a business entity which collects funds from public in the form of savings and distribute to the communities in the form of credit in order to improve the living standards for societies. Through its lending activities, banks are serving the financing needs and launching mechanism for all sectors of the economy. Bank Nagari in organizing their activities can not be separated from internal controls implemented by the internal audit unit who is responsible for all operational activities of the company.

In conclusion, Bank Nagari chosen because writer interested with the role of internal audit of Bank Nagari especially role in internal control. Additionally the writer interest with this research because research in banking finance company are still rare. Beside that, Bank is an institution that runs the business that has a unique character compared to other business.

Based on the background above, the writer is interested in doing research with the title:

"The Role of Internal Auditor For Achieving An Effective Internal Control, Case Study in Bank Nagari".

1.2 PROBLEM DEFINITION

Based on background above, existence internal audit function in a company is required to control the business activity so that the trust from community can be maintained. In order to implement the basic internal control components and to produce reliable information for company's stakeholders takes effectiveness role of internal auditors.

Based on the background above, the writer proposed the questions as follows :

1. How is internal audit function and practice in Bank Nagari?
2. How is Internal Control in Bank Nagari ?
3. How is the role of internal auditor for achieving an effective Internal Control in Bank Nagari ?

1.3 RESEARCH OBJECTIVE

The objective of this research are :

1. To describe the function of internal audit in Bank Nagari
2. To describe the internal control implementation in Bank Nagari

3. To describe and analyze the role of internal auditor for achieving an effective internal control in Bank Nagari

1.4 RESEARCH BENEFIT

The benefit that expected in this research are:

1. For writer, to get better understanding about the role of internal auditor in internal control within the organization.
2. For company, expected this research can be used as an input in improving the internal audit function in internal control for the future.
3. For accounting knowledge and next research, expected that this research can give input for accounting knowledge and inspiration for further research that more deeply in the future.

1.5 WRITING SYSTEMATICAL

The systematical of the research, is divided into five sections. Chapter One, describes the background of the problem, problem definition, research objective, research benefit, scope of research, and structure of thesis. Chapter Two includes the literature surveys of any related theories and opinions of the experts gathered from different sources, such as text books, the results from previous research, journals, and internet based content and information. Chapter Three, discusses the various kinds of research data, and describes the methods and techniques used to analyze the data and any information needed for the thesis.

Chapter Four, will describe the result of the research based on the data and information gathered related to the questions on problem definition and achieving the objective of the research by describing and analyzing the theories and implementation of subject in this company. And Chapter Five, will conclude all the result of research presented by the previous chapter and add feedback in from of suggestions, and also discuss the limitation of research.



CHAPTER 2

THEORETICAL FRAMEWORK

2.1 INTERNAL AUDIT

2.1.1 INTERNAL AUDIT DEFINITION

The increasing of complexity, the size of organization and the expansion in business operations is affecting the need for the complex control system, both control of financial and business operational. In the presence of these problems, management needs to delegate responsibility and authority to the available level of supervision. Thus, management is required to maintain the corporate property, prevent errors and fraud. Then, internal control is very useful for that matter.

To keep the internal control system works effectively, we need a special part in the company's that called internal audit department to conduct ongoing assessments of the company's internal control system. Internal audit department is expected to provide input information about things that need improvement in the internal control system; the following cited several definitions of internal auditing.

“Internal auditing is an independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization”, (Moeller and Witt: 1999). Internal auditing provides value to governing bodies and senior management as an objective source of independent advice.

Then, The Institute of Internal Auditors (IIA) (2004:3) has developed the globally accepted definition of internal auditor, as follows:

“Internal Auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes”.

This definition contains that internal auditing is an activity of a different assessment of accounting data and other activities performed by employees of the company itself in order to help management in the provision of information. The purpose of the internal auditing is to assist all members of management in carrying out their responsibilities effectively by providing them with analysis, assessment; recommendations and comments are objective about the activities being examined.

The purpose was achieved with:

- a. Examines whether the implementation of control systems in accounting, finance and operation of adequate and qualified.
- b. Assess whether policies, plans and procedures that have been determined already adhered to.
- c. Assessing the accuracy of accounting data and other data within the organization
- d. Assessing the quality of execution of tasks that have been given to each member of management.

An implementation or audit team function as stated above is called the *internal auditor*.



According to Holmes and Burns (2000:152), *"Internal auditing is an independent appraisal activity within an organization for review the operation as services provided to management"*.

Another definition according to Boynton and Kell Johnson (2003:491), *"Internal auditing is the activity giving confidence as well as consulting an independent and objective, which is designed to add value and improve the organization's operations"*.

From all definition, internal auditors define as a function of an independent assessment of activity in the audit. The role of internal audit not only in the financial but also in management functions, policies and procedures, efficiency and effectiveness through development and appraisals of risk management, control and governance processes.

2.1.2 INTERNAL AUDITOR DEFINITION

We need a part or a special department to conduct the examination to ensure the continuity of the activity of the company's operations runs as to plan. The control system should always be evaluated to improve efficiency and effectiveness of the company.

If it is seen from the sides that have done the audit, there are two groups of auditors, Internal Auditor and External Auditor. The position and responsibilities between the two groups of auditors is very different from each other. An Internal Auditor worked in companies, government agencies, or non-profit company, while

According to Holmes and Burns (2000:152). "Internal auditing is an independent appraisal activity within an organization for review the operation as services provided to management."

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the External Auditors worked on a Public Accounting Firm. Although the parties conducting the internal audit is a part of the audited organization itself, but the implementation of internal audit have to keep objective and independent of the activity being audited. Internal Auditor generally reported to Senior Managers or the Board of Directors, while the External Auditors have only a limited reporting structure to the firm where the auditor worked and third parties (creditors and investors).

According to Mulyadi (2002:29), states that: Internal Auditor is the auditor who worked in the company (state companies or private companies) whose task is to determine whether policies and procedures established by top management have been complied with, determine the efficiency and effectiveness of the procedures of the organization's activities, as well as determining reliability of the information generated by various parts of the organization.

From the definition above, an auditor is concerned with determining whether the policies and procedures have been followed or not as well as organizations concerned with the safeguarding of assets. The Internal Auditor is also involved in the review effectiveness and efficiency of the operation procedures and in determining the reliability of the information generated by the organization.

According to Arens (2008:482), Professional Institute of Internal Auditors provides a definition of internal auditing as follows: "Internal audit is a consulting activity and the objective and independent assurance designed to add value and improve the organization's operations. It helps organizations to achieve their goals by

conducting a systematic and disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance process.”

2.1.3 INTERNAL AUDIT FUNCTION

The formulation of the internal auditor function in a company usually involves management control system, obedience, disclosure of irregularities, the efficiency and effectiveness, risk management, and governance processes. Internal audit function is becoming increasingly important in line with the increasing complexity of corporate operations. Management may not be able to oversee all operations; therefore management was greatly assisted by the internal auditor's function to maintain the efficiency and effectiveness of activities.

Sawyer (2005:32) mentions the function of Internal Audit to management as follows: (1) Supervise the activities that can not be controlled solely by top management, (2) Identifying and minimizing risks, (3) Validating reports to senior management, (4) Assisting management in the technical fields, (5) Assist decision-making process, (6) Analyzing the future - not only to the past, (7) Helping managers to manage the company.

The purpose of the examination conducted by the internal auditor is to help all the company management in carrying out its responsibilities by providing analysis, assessment, advice and comments on the activities examined. To achieve these objectives, the internal auditor should conduct the following activities:

1. Reviewing and assessing the goodness, adequacy and implementation of management control systems, internal control, and other operational controls and to develop effective controls at a cost that is not too expensive.
2. Ensure compliance with policies, plans and procedures established by management.
3. Measure how far the company property accounted for and protected from the possibility of any form of theft, fraud and abuse.
4. Ensure that the management data developed within the organization can be trusted.
5. Assessing the quality of work in carrying out tasks assigned by management.
6. Suggests the operational improvements in order to improve efficiency and effectiveness.

2.1.4 POSITION OF INTERNAL AUDITOR

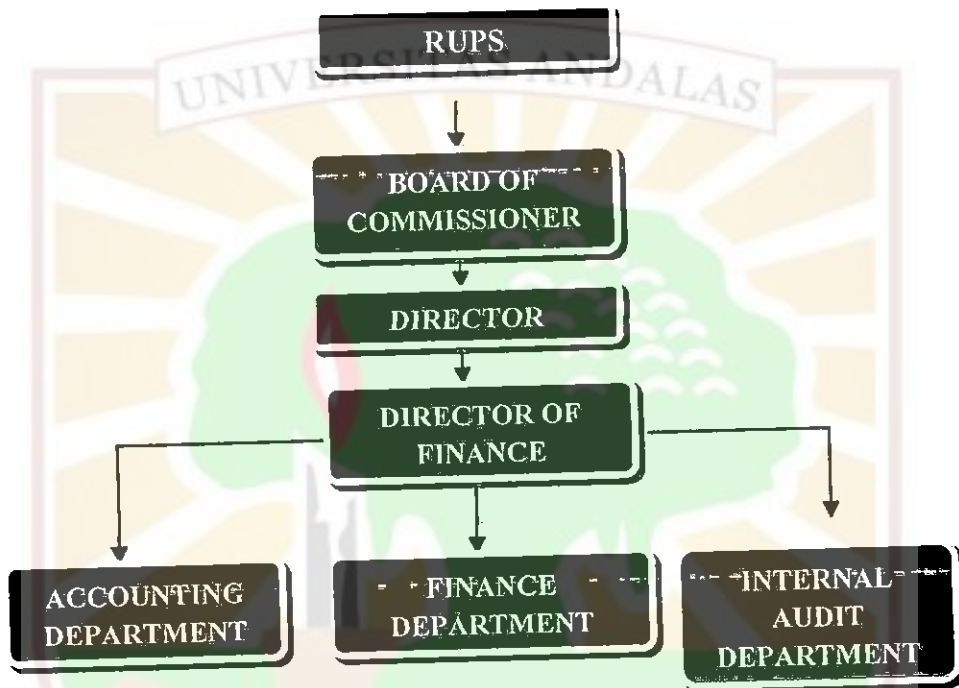
One of the things that must be taken to ensure that a company can have an effective internal audit department is an internal audit department should have an independent position in the organization. Freedom referred in this case is in a sense can be entered into every level of management that is examined. As part of management, the internal auditor must report their activities to higher authorities. The position of internal auditor in the company's organizational structure is not

necessarily the same with others, because this depends on the situation and condition of the enterprise and the goals to be achieved in the establishment of the internal auditor. The position of internal auditor within the organizational structure greatly affect the successful of his duties, so that the position allows internal auditors to conduct their functions well and can be worked flexibly within the meaning of independent and objective.

In determining the organizational structure of the internal auditor is clearly accompanied by a clear job description that will bring positive impact in the process of communication between the internal auditors with the manager. Otherwise placements that are not clearly will hamper the flow of the internal auditor reporting, because it is necessary to determine explicitly the position of internal auditor is. According Sukrisno Agoes (2004:243) there are four alternative internal auditor positions within the company/organization, namely:

1. Internal Audit under the Director of Finance (aligned with the accounting and finance).
2. Internal audit is the staff Director.
3. Internal audit is the staff the Board of Commissioners.
4. Internal audit headed by a Director of Internal Auditor

To better explain the position of the internal audit within the corporate organization and structure of the organization in its own internal audit unit, it can be shown following the picture below:

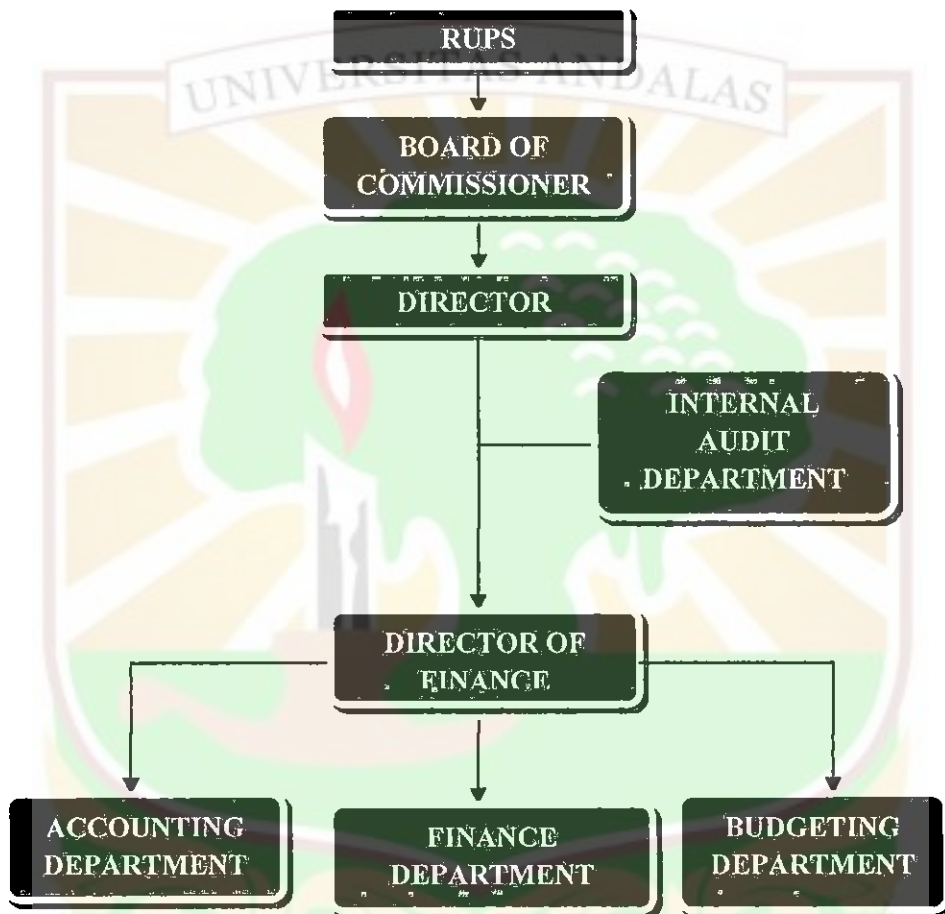


Soekrisno Agoes (2004)

Figure 1 : Internal Audit under the Director of Finance (aligned with the accounting and finance)

Description : In the picture above shows the internal audit is located parallel to the finance and accounting. Internal audit is fully responsible to the Director of Finance. The weakness of this position is that the scope of the Internal Auditor examination becomes narrow which only emphasized the control of the finances only. If it is

associated with its independency, then the degree of freedom from Internal Auditor will be small and narrow. The advantage of this position is the Internal Auditor reports can be readily to studied and responded.

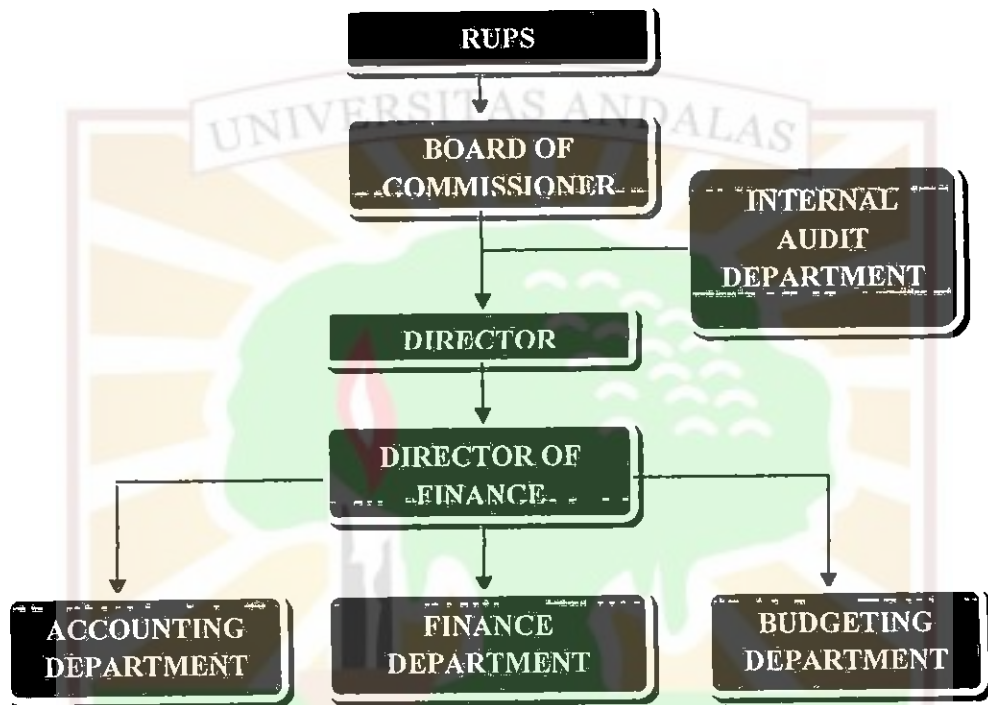


Soekrisno Agoes (2004)

Figure 2 : Internal audit is the staff Director/ Chief of Executive.

Description: In the picture above shows the position of Internal Auditor is a Staff Director. In this case, the Internal Auditor has a high level of independency because

Internal Auditor can be conduct investigation into all parts of the company except part of Director. Because of the high level of activities it make the director can not be studied audit in depth so the corrective action can not be done immediately.

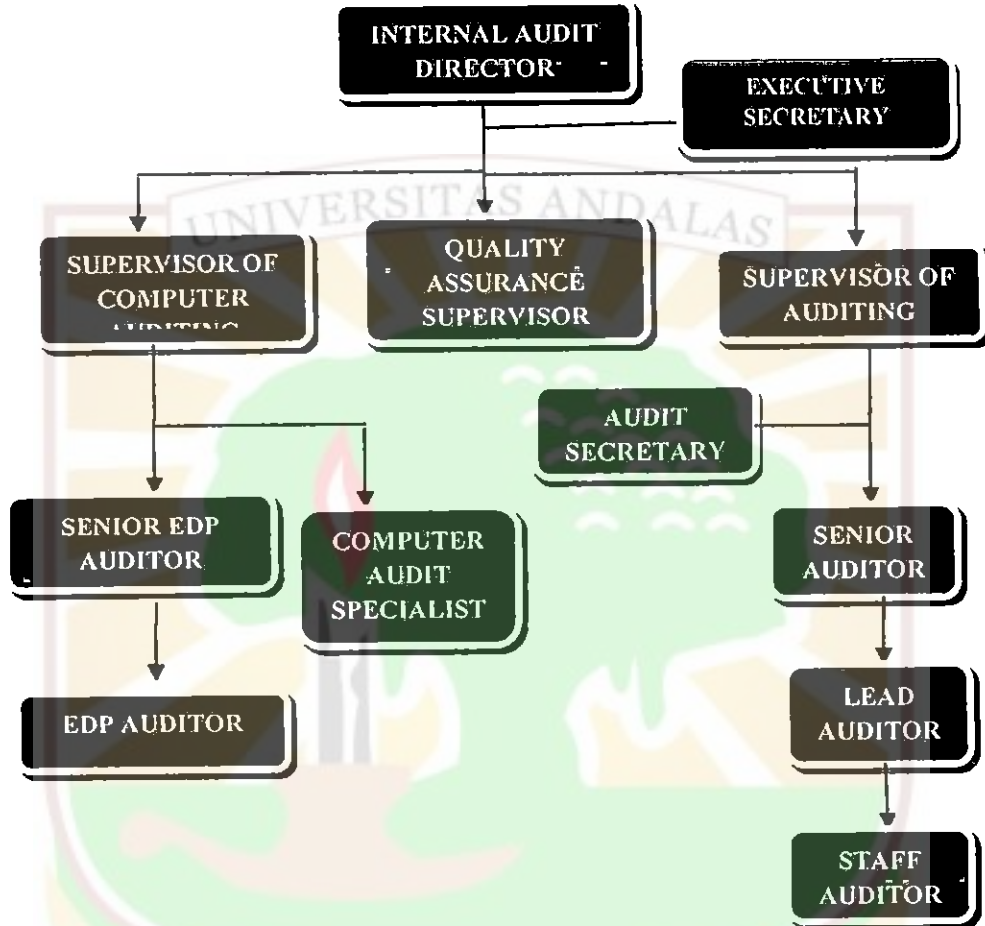


Soekrisno Agoes (2004)

Figure 3 : Internal audit is staff of Board of Commissioner.

Description: In the picture above shows that the Internal Auditor worked as a Staff of the Board of Commissioners and this position is above Director. These positions provide a higher level of independence because Internal Auditor can be examine all aspects of the organization. The weakness of this structure is the members of the Board of Commissioners can not be found at any time and also less mastered to solve

the problems of daily operations so it can not quickly take action or respond to prevention proposed by the Internal Auditor.



Soekrisno Agoes (2004)

Figure 4 : Internal audit headed by a Director of Internal Auditor.

Description : In the picture above shows that the position of the Internal Auditor is headed by a Director of Internal Auditor. Director of Internal Auditor directs the personnel and activities of internal audit department and has responsibility for training and program the staff audit. Director of Internal Audit have free access to the

Board of Commissioners. The responsibility of the Director of Internal Audit is to prepare an annual plan for the examination of all units of the company and presenting the program for approval. Audit Supervisor assist the Director of Internal Audit in developing the annual audit program and assist in coordinating audit efforts with the Public Accountant to provide appropriate audit scope without duplication of effort. Senior Auditor received the audit program and instructions for assigned audit area from Audit Supervisor. Senior Auditor has audit staff in the audit field work. Staff Auditors carry out audits on-site audit. This structure has the weakness when the Director of Internal Audit can not manage the internal audit department well, so the task of audit can not meet the general purpose and the responsibilities that have been approved by management. Beside that, internal audit department resources are not used effectively and efficiently.

From the four placements above, shows that the freedom possessed by the Internal Auditor of one company by another company is not always the same. The higher position of internal auditor in the organization, then the greater freedom (independence) of internal auditor has to. However, the most effective placement of the Internal Auditor is depends on the objectives to be achieved.

As an independent appraisal of the adequacy of the company's internal control, the Internal Auditor is only put themselves as a resource in making the concept of corporate control. Parties who take full responsibility in the design and implementation of internal audit are the management and directors. Thus, the internal

audit assessments are still independence and objective to the control audit. Independence as a basic of auditor profession to being neutral to the entities, and it means it will be objective. Public can trust the audit function because the auditor recognize to be fair and wise.

2.1.5 INDEPENDENCE

The Institute of Internal Auditors (IIA) has developed the standard for professional practice of internal auditing. This standard serve both members of the internal auditor and the larger society served by internal auditor and provide benchmark against which to measure the level and quality of individual and overall internal auditing activities.

Moreover Institute of Internal Auditor (IIA) set the standards are recognized into five general standard covering major areas and function of internal auditor as follow: (Moeller & Witt 5th year)

1. Independence
2. Professional Proficiency
3. Scope of Work
4. Performance of Audit work
5. Management of Internal auditing development

Internal auditor has to have independency to do auditing and to give suggestion for improvement company's performance based on the profession standard that had by internal auditor. Independency is used to make sure the product and services produces have advantages for interest community and stakeholders. Internal auditor considered as independent if internal auditors do the responsibility and duties independence and objective.

Interpretation of Standard 1100 from the Standards for the Professional Practice of Internal Auditing Related Standard: 1100 – Independence and Objectivity

“The internal audit activity should be independent, and internal auditors should be objective in performing their work”.

This guidance is not intended to represent all the considerations that may be necessary when conducting an evaluation, but simply a recommended set of items that should be addressed. Compliance with Practice Advisories is optional. (The Institute of Internal Auditors : 2004)

Agoes Sukrisno (2004:227) suggests that the independence of internal auditors, among others, depends on:

- a. Position of Internal Audit Department in the organization, intention to whom the internal auditor responsible is. In a large company, the internal audit organization is headed by a Director who supervises the audit managers, audit

Supervisors, Senior Auditors, Auditors associate and Assistant Auditors (junior Auditors).

- b. To being independent, internal auditor should not be involved in the operations of the company. For example internal auditor should not participate in the activities of sales and marketing, preparation of accounting systems, the process of recording transactions and preparation of financial statements of the company.

As explained in the previous section regarding the internal auditor position, position of internal auditor within the company will determine the level of freedom in performing their duties as auditors. Position of internal auditors in an organization has influences on the extent of activity and level of independence in conducting their duties as a controller. So the position of the organization's internal auditors should be sufficient to complete the audit responsibilities. Internal auditors will be effective as desired if it is free from management activities on the audit. It will be achieved if the internal auditors have a position that allows him to develop independent attitudes toward other parts that must be examined.

2.1.6 AUDIT REPORT

The end result of the implementation of internal of audit set forth in a written report through the process of good preparation. The report results of an internal audit is an essential tool to deliver accountability to the management works that is as a medium of information to assess the extent to which the task assigned can be

implemented. Meanwhile the content or material internal of audit reports by Boynton et al (2003:494), namely:

- a. A written report signed by the audit should issue after the examination is completed. Internal report can be in written form or orally and can be delivered formally or informally.
- b. Internal auditors should discuss conclusions and recommendations on appropriate levels of management before issuing the final written report.
- c. The report must be objective, clear, concise, constructive and timely.
- d. The report should state the purpose, scope, and audit results, and if appropriate, the report must also contain a statement of opinion of the auditor.
- e. The report may include recommendations for potential improvement and recognizes performance as well as a satisfactory corrective action.
- f. The view auditee concerning of audit conclusions and recommendations can be included in the audit report.
- g. Director of internal auditing or designee should review and approve the final of audit report before publication and must decide to whom the report will be distributed.

According to Sawyer's (2005:36) code of ethics and standards of professional practice of Internal Audit of the Institute of Internal Auditors provides a mechanism

for the auditor to report the results audits, findings, opinions, or information obtained during the audit. These mechanisms are:

a. Authorized level of management reporting

b. Reporting to the audit committee

c. Reporting to the board of directors.

The purposes of of audit report are: (1) Auditor's report is the conclusion of the examination results, (2) Presents the findings of the examination that has been done, (3) As a basis for later action taken by management against deviations that occur.

To achieve these objectives the report submitted must have these elements:

a. Objective

Readers expecting a straight forward presentation of the results and based on facts. When auditors protect, or cover the important findings qualify the annoying readers will find the conclusions and recommendations.

b. Clear

The report prepared using clear language, does not cause misunderstanding for its users. Explain clearly and fully to be understood by those who use it.

c. Concise

Sentences are made about the important ideas must be clear and concise.

d. Constructive

Constructive report is a report that presented recommendations for action to the extent possible improvements that could be done to work on improving operations.

e. Timely

Value audit reports are directly related to the speed of information.

Before being forwarded to the user report, a review of the report is prudent to do an internal audit. It aims to further ensure the correctness and completeness. The audit report will be effective when there is a follow up to the implementation of audit process that totally provides benefits for the company. For the internal audit department tasked to monitor the implementation of follow-up, analyzing the adequacy of follow-up with the identification of barriers to implementation, and provide a report on the follow-up.

2.2 INTERNAL CONTROL

Many groups and organizations have published standards and guidelines on internal control and defined it in various ways. Internal control is focused on the achievement of the organization's mission. Therefore, it is essential that an organization have a clearly stated mission that is known and understood by everyone

in the organization. It is also important to understand that, while good internal control will provide "reasonable assurance" goals and objectives are met, good internal control cannot guarantee organizational success. However, goals and objectives are much less likely to be met if internal control is poor.

2.2.1 INTERNAL CONTROL DEFINITION

Alvins, Arens et al in Auditing and Assurance Service (2008) defines internal control as follows:

"A system of internal control consists of policies and procedures designed to provide management with the reasonable assurance that the company achieves its objective and goals. These policies and procedures are often called control, and collectively they comprise the entity's internal control".

According to Hamed Philee and Babak Jamshedy-Navid (2009) internal control is an accounting procedure or system designed to promote efficiency or assure the implementation of a policy or safeguard assets or avoid fraud and error. Internal control is a major part of managing an organization. It comprises the plans, methods, and procedures used to meet missions, goals, and objective and in doing so, support performance based management. Internal control which is equal with management control helps managers achieve desired result through effective stewardship of resources. They also stated that Internal Control is a combination of financial control and other control. Financial controls include: (1) controls for recording accounting

transaction properly, (2) controls for proper safeguarding company assets like cash stock bank debtor, etc, (3) Early detection and prevention of errors and frauds, (4) Properly and timely preparation of financial records, (5) to maximize profit and minimize cost. Other controls include the following Quality controls, control over raw material, control over finished product, marketing control, etc.

Moreover, Association of Internal Auditors (Institute of Internal Auditors - IIA), quoted by Sawyer (2005:59), defines internal control as follows: "... every action taken by management to increase the likelihood of achieving objectives and targets specified". Controls can be preventive that are designed to discourage errors or irregularities or detective that are designed to identify an error or irregularity after it has occurred According Tugiman Hiro (2004: 12) a good internal control means:

1. Activities effective and efficient organization
2. Financial statements or trustworthy information of organization
3. Management in the organization's compliance with laws and regulations applicable.

An effective system of internal control is a critical component of management and the basis for safe operations and healthy in a company. Internal control is a collection of various control components and integrated activities that are used by organizations to achieve its objectives.

2.2.2 INTERNAL CONTROL OBJECTIVES

The Organization which sponsored Treadway (COSO- Committee of the Sponsoring Organization) defined internal control is a process affected by an entity's board of directors, management, and other personnel designed to provide reasonable assurance of the achievement of operations, compliance with applicable laws and regulation, and reliability of company's financial reporting.

And also the Association of accountants Indonesia (2001:319.2) defines internal control is a process which is run by a board of commissioners, management and other personnel entity designed to provide reasonable assurance regarding the achievement of three classes of the following purposes: (a) reliability of financial reporting,(b) effectiveness and efficiency of operations, and (c) compliance with laws and regulations.

From the definition described earlier, it can be concluded that the purpose of the system of internal control are as follows:

- a. Safeguarding the company's assets
- b. Checking the accuracy and correctness of accounting data
- c. Improve efficiency in operations
- d. *Ensure that no deviating from the established policy of prior management.*

2.2.3 INTERNAL CONTROL COMPONENTS

Internal control system is not universally take place for all company but based on the some principle that directly help its function in the internal control system. All of principles only as a general guidance that can not guarantee there will be no fraud or irregularities happen eventhough all of the principles are run well. It causes by the limitation of internal control itself or other causes such as the internal control is not suitable for the development of the company nowadays.

In Indonesia, for a state company (BUMN), the necessity to held internal control in COSO's framework based in regulated in article 22 of BUMN A Minister discretionary, Number Kep-117/M-MBU/2002 about the application of good governance in state company (BUMN). This article state that, the minister of BUMN has to maintain the internal control for the companies includes: Control environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring.

Arens also cited the COSO framework in Auditing and Assurance Services that internal control divided into five elements above. All five internal control components must be present to conclude that internal control is effective. The implementation of internal control is affected by the level of complexity of the company, type of industry, management philosophy, and the culture of the company. All five component of internal control build the framework of the internal control

structure that can assured the good control can be implemented in the whole activities of company. A good internal control enables management to face a rapid change, competitions, the priorities and the movement of consumer demand, and also restructuring for future development. The five components of internal control are as follows:

1. Control environment

Control environment is action, policies, and procedures that reflect the overall attitude of top management, directors, and owners of an entity about internal control and its importance. The control environment has a pervasive influence on the decisions and activities of an organization, and provides the foundation for the overall system of internal control. If this foundation is not strong, if the control environment is not positive, the overall system of internal control will not be as effective as it should be. Environmental control is a very important component because the basis elements of the effectiveness of internal control to another. Influential factor in the control environment are:

- a. Integrity and ethical values. The company should be able to create the condusive environment in a good process of financial report. Because of that, the company decide the policies and procedures to became the standard of behaviour and responsibility all individu in the company. It is include management's actions to remove or reduce incentives and temptations that

might prompt personnel to engage in dishonest, illegal, or unethical acts. They also include the communication of entity values and behavioral standards to personnel through policy statements, code of conduct, and by example.

- b. **Commitment to competence** is the knowledge and skills necessary to accomplish tasks that define an individual's job. The company must be able to find and employ the employees with enough ability, skill and knowledge needed in order to complete the work well and they can give a good performance to the company.
- c. **Management philosophy and the operational style.** In each performing its duties and functions, the management believes in the importance of internal controls and tried to apply it effectively. Belief in the importance of the operational control will form a style that will communicate the sense of control.
- d. **Board of Directors and Audit Committee Participation.** An effective board of directors is independent of management, and its members stay involved in and scrutinize management's activities. An active and objective board can often effectively reduce the likelihood that management overrides existing controls. To assist the board in its oversight, the board creates an audit committee that is charged with oversight responsibility for the financial reporting process. The audit committee is also responsible in maintaining ongoing

communication with both external and internal auditors, including approval of the auditor or non audit services performed by auditors for public companies.

- e. **Organizational Structure.** The entity's organizational structure defines existing lines of responsibility and authority. By understanding the client's organizational structure, the auditor can learn the management and functional elements of the business and perceive how controls are implemented. It also being a formal framework in the company so we can see the part of internal control that have been implemented.
- f. **Assignment of authority and responsibility.** Authority is a right to give command to the lower level in the company. Responsibility is the duty of someone to doing the job and responsible for the result of their job. In order to create the effective and efficient work environment, its needed the clear classification of authority and responsibility.
- g. **Human resources policies and practices.** Basically, human resource is a key element in the implementation of control. A good employee, competent and truwtrworthy is needed to the successful of company. So, the methods by which persons are hired, evaluated, trained, promoted, and compensated are important part of internal control. It causes by the good process will able to find the professional and competent workers.

2. Risk Assessment

The risk assessment is the process of identifying and analyzing risks related to achieving an objectives entity, as the basis of risk management performed. Risk assessment process that can be done is to identify internal and external changes and related actions that may be required. Thus it can be evaluated the possibility of inappropriate operational implementation.

3. Control Activities

Control activities are the policies and procedures that can help management to ensure that management directives be implemented. Control activities have different objectives and applied according to the functions of each organization level. Control activities that can be done include: segregation of duties, control of information processing, physical control, and review work.

a. Adequate separation of duties

There are four general guidelines for adequate separation of duties to prevent both fraud and errors are of special significance to auditors:

- i. Separation of the custody of assets from accounting**
- ii. separation of the authorization of transactions from the custody of related assets**
- iii. Separation of operational responsibility from record keeping responsibility**

iv. Separation of IT duties from user departments

b. Proper authorization of transaction and activities

Authorization can be either general or specific. Under general authorization, management establishes policies for the organization to follow, and subordinates are instructed to implement this general authorization by approving all transactions within the limits set by the policy. Specific authorization applies to individual transaction.

c. Adequate documents and records

Documents and record are the physical objects upon which transaction are entered and summarized. They include such diverse items as sales invoice purchase orders, subsidiary records, sales journals, and employee time cards. Document and records should be:

- i. Prenumbered consecutively to facilitate control over missing documents and as an aid in locating documents when they are needed at later date**
- ii. Prepared at the time a transaction takes places, or as soon as possible thereafter**
- iii. Sufficiently simply to ensure that they are clearly understood**
- iv. Designed for multiple use, when possible, to minimize the number of different forms.**

d. Physical control over assets and record

To maintain adequate internal control, it is essential to protect assets and records. The most important types of protective measure for safeguarding assets and records are the use of physical precaution.

v. Independent checks on performance

The careful and continuous review of the other four called independent checks or internal verification. The need of this arises because internal control tends to change overtime unless there is a mechanism for frequent review.

d. Information and Communication

The information within the company should be identify, process, and communicate to the employee to help them to carry out their responsibilities. Information can be communicated verbally, in writing and electronically.

Information should travel in all directions to ensure that all members of the organization are informed and that decisions and actions of different units are communicated and coordinated. A good system of communication is essential for an organization to maintain an effective system of internal control. A communication system consists of methods and records established to identify, capture and exchange useful information. Information is useful when it is timely, sufficiently detailed and appropriate to the user.

Communication is not an isolated internal control component. It affects every aspect of an organization's operations and helps support its system of internal control. The feedback from this communication network can help management evaluate how well the various components of the system of internal control are working.

e. Monitoring

This component is the component that has function to assess and measure the quality level from the structure of internal control that have been implemented (ongoing monitoring activities or separate monitoring activities). If the changing happen in the environment of company, so the changing needed can conduct quickly and can not disturb the operational company.

2.2.4 LIMITATION OF INTERNAL CONTROL

Each control how well it has a weakness. The weakness itself is often used by the person who have a chance to make a fraud or actions that harm a company.

COSO identify the following inherent limitations that explain why internal control, no matter how well designed and operated, can provide only reasonable assurance regarding of achievement of an entity's control objectives (Boyton et al. 2003:327):

- **Mistakes in the judgment**

Occasionally, management and other personnel may exercise poor judgment in making business decision or in performing routine duties because of inadequate information, time constraints, or other procedures.

- **Breakdowns**

Breakdowns in established control may occur when personnel misunderstand instructions or make errors due to carelessness, distractions, or fatigue. Temporary or permanent changes in personnel or in systems may also contribute to breakdowns.

- **Collusion**

Individual acting together, such as an employee who performs important control acting with another employee, customer, or supplier may be able to perpetrate and conceal fraud so as to prevent its detection by internal control.

- **Management override**

Overriding practices include making deliberate misrepresentations to auditors and others.

- **Cost vs benefits**

The cost of an entity's internal control should not exceed the benefits that are expected to ensue. Because precise measurement both cost and benefits usually is

not possible, management must make both quantitative and qualitative estimates and judgments in evaluating the cost benefit relationship.

The limitations or weaknesses of internal control above is a constraint to the achievement of adequate and effective internal controls. The responsibilities of internal control guidance delegated to the chairman because of how good internal control is very easy to be broken by the leadership. When discussed in deeply, the main element of the cause of the weakness of internal control is a human being executor. Humans as an element of internal control is a more important role than other elements such as procedures and records.

2.3. THE ROLE OF INTERNAL AUDITOR FOR ACHIEVING AN EFFECTIVE INTERNAL CONTROL

Internal auditors have a very important role in achieving company objectives. The need for the concept of internal audit because the company increased the extent of the company's scope. Therefore, the larger a company, the more extensive range of control that carried by the leadership, so management must create an effective control to achieve an optimal management to consider the benefits and costs.

Because of limitations in controlling activities of management, the company requires an internal auditor who will assist management in determining whether the plan of operations, finance, policies and procedures performed in accordance with the

conditions determined. So that audits are conducted within a firm is on the assessment and verification procedures. The data was recorded based on company policies and plans, as one of the functions in an effort to supervise their activities.

The basic theories and concepts of audit has been responded that the existence of audit in a company aimed to improve the company's performance. A function may take the form of a company division, department, section, business unit, business function, business processes, information service, system or project. If the action succeeded in improving the performance audit of the company it means support towards the improvement of overall performance.

According to Arens, Elder, and Beasley (2008:482) "The role of internal auditors has grown dramatically, especially with the increasing size and complexity of many companies."

The statement can be understood because of the internal auditors spend all their time inside one company, they have more knowledge about the company's operations and internal controls as compared with the external auditors. This type of knowledge can be important for effective corporate governance.

Internal auditors are expected to provide value to the organization through improved operating effectiveness, while at the same time also perform traditional responsibilities, such as:

1. Reviewing the reliability and integrity of information

2. Ensuring compliance with policies and regulations
3. Custody of assets (assets)

According Soekrisno agoes (2004:226) Some indicators that could be do by an internal auditor in achieving effective control are:

- a. Internal audit department should have an independent position within the company organization
- b. Internal audit department should have a job description
- c. Internal audit department should have an internal audit manual
- d. There should be strong support from top management to the internal audit department
- e. Internal audit department should have people who are professional, capable, able to be objective and have high integrity and loyalty
- f. Internal auditors should be working with the public accountant

A system of effective internal controls is a critical component of management and a foundation for safe and sound operation of organizations. Moreover, it is appreciated as essential to the prudent operations of organization and the most important of all, to promoting stability in the financial system as a whole.

2.4 REVIEW OF THE PREVIOUS RESEARCH

To support this research, the writer also uses the information from other researcher. The first review is the research conducted by Susi Susanty (2010), which is closely related to the subject discuss in this thesis. The title of her thesis is “ The Role of Internal Auditor for Achieving an Effective Control in PT Bank Tabungan Negara (BTN) Medan. She review the function of internal auditor and analyzes whether the role of internal auditors are appropriate with the position and function of internal auditor itself in order to achieve effective control. This research is a guidance for the writer to describe and analyze the role of internal auditor in internal control system in the author region, Padang. But, to make it different, the writer using the COSO framework as a tool to examine the effectiveness of internal control system.

Another research that closely related to the internal control system is held in PERUM Pegadaian Branch Office of Terendam Padang that conduct by Hanie Syifa (2010) about the Evaluation of Internal Control Implementation Over Credit Pawn Transactions where in this thesis there are several consideration that have being evaluated in the element of internal control below :

1. Control Environment

a. Integrity and ethical values

The employee of this bank has an adequate integrity, it can be seen in their obedience in worship to God, honest attitude, responsible and positively thinking.

b. Commitment to competence

Commitment support by education and training for all employees, especially for new employees in order to getting professionalism in doing their work. And also the company using reward and heavy punishment for irregularities.

c. Management's philosophy and operating style

The operating style of management is mostly centralized for discretionary in terms of company. But for transaction and decision making for credit approval in Tarandam Padang branch office is decentralized, held by groups, not dominated by one party.

d. Board of director or audit committee participation

Board of directors are responsible for ensuring that internal controls are established and functioning to achieve the mission and objectives of the whole unit. And the management should identify what controls currently exist or should be established to reasonably assure the achievement of each specific objective for those unit. And also having internal monitoring

unit team as internal auditor to make the progress report and being the consultant for the whole company.

e. **Organizational structure**

The organizational structure in Perum Pegadaian Tarandam branch office Padang is organized within two levels : the central level and representative level.

f. **Assignment of Authority and Responsibility**

Some of the same responsibility might be handled by more than two employee since the lack of human resources on this branch. But other critical responsibility like verification, only handled by the manager of branch (full verification).

g. **Human resource policies and practices**

Human resources policies and practices toward hiring a competent personnel and for assign personnel to higher position is designed in special mechanism. There are centralized mechanism of recruitment and promotion.

2. **Risk Assessment**

An entity's risk assessment for financial reporting purposes is its identification, analysis, and management of risks relevant to the preparation of

financial statements that are fairly presented in conformity with generally accepted accounting principles.

3. Control Activities

Control activities are a set of policy and procedures to ensure that any correction action has been taken or the expected duties have already conducted.

4. Information and Communication

Information and communication are essential to effect control. For PERUM Pegadaian Tarandam Padang, the design of accounting information system and communication for credit transaction is determined with special guiding principles.

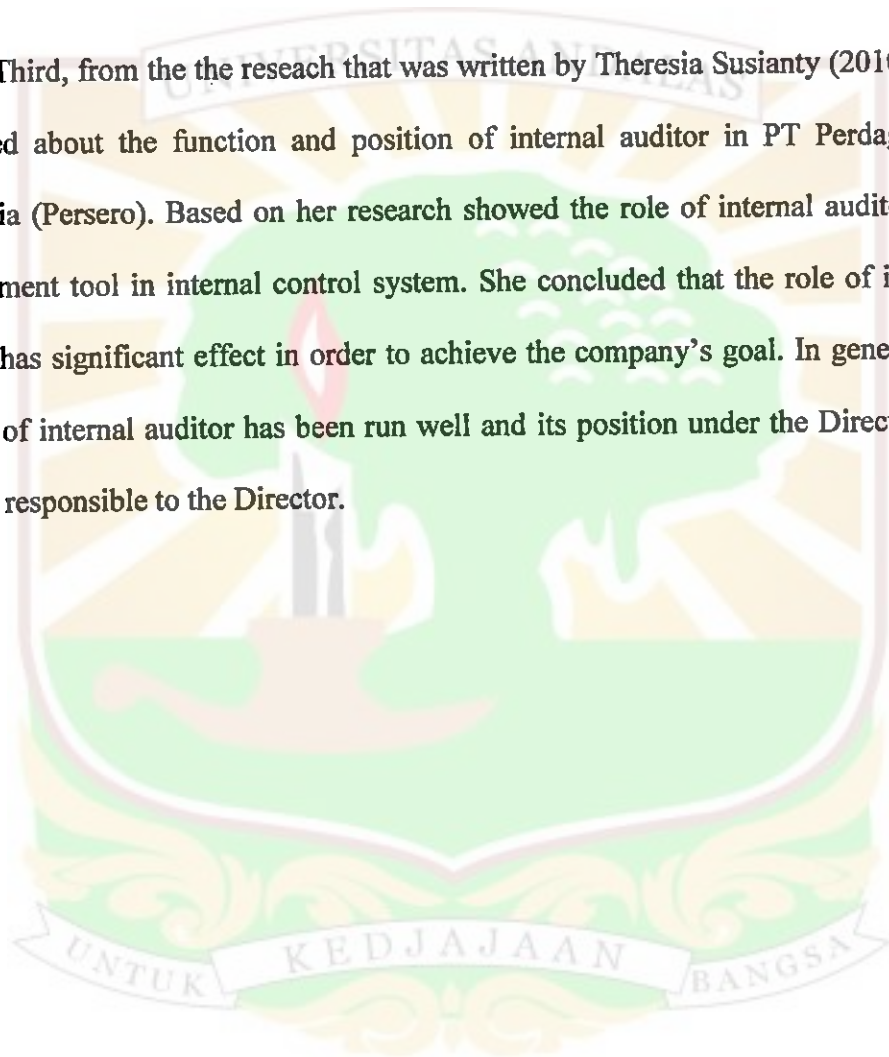
5. Monitoring

Monitoring in this company is accomplished by ongoing monitoring activities and by separate evaluations of internal control such as self assessments, peer reviews, and internal audits.

In conclusions, the internal control in credit pawn transaction in PERUM Pegadaian Tarandam Padang is effective. And we also conclude that the implementation of internal control for credit transaction procedures in this company

is already conducted in the right manner and effective for almost of the whole procedures credit. Using this pattern of internal control evaluation by this research, the writer then build the writer own result by describing the internal control implementation generally in Bank Nagari.

Third, from the the reseach that was written by Theresia Susianty (2010). She discussed about the function and position of internal auditor in PT Perdagangan Indonesia (Persero). Based on her research showed the role of internal auditor as a management tool in internal control system. She concluded that the role of internal auditor has significant effect in order to achieve the company's goal. In general, the funtion of internal auditor has been run well and its position under the Director that directly responsible to the Director.



CHAPTER 3

RESEARCH METHODOLOGY

Research is a form of scientific activities to obtain knowledge and truth. To discover the truth of the logical and supported by the facts we should do some research first. That is the nature of research as a scientific activity. In scientific research, one of element is the scientific method that used to solve the problem research. To present the research report that can be utilized so in this research use scientific method that includes the following:

3.1. Object of The Research

Object of the Research described where the object study taken place. This research conducted at Bank Nagari Center Office.

3.2 Scope of The Research

There are two types of financing served by this company, conventional system and syaria system. This research will be limited to the conventional type of Bank Nagari, and hence, only discuss the product served by the conventional company. Writer focus on the role of internal auditor for achieving an effective internal control in Bank Nagari. The result of the research is descriptive which explains about the internal auditor's role in achieving effective internal control in Bank Nagari.

3.3 Research Design

The research is accomplished by using a case study. According to Indriantoro and Supomo (1999), case study research is research with characteristic problems associated with the background and current condition of the subject studied, and its interaction with the environment. The object of study can be individuals, groups, institutions, or certain communities with the aim to investigate in depth about a particular subject and provide complete picture of on the subject.

The method used in this research is descriptive and qualitative analysis, which aims to provide a clear picture of the real situation regarding the research object. The data will be analyzed by considering the result got from the company and compared with existing theoretical foundation so that in the end of the research it can be concluded. According to Sekaran (2003) case studies that are qualitative in nature are useful in understanding certain phenomena and gathering further theories for empirical testing. So, in this research the method that use is descriptive qualitative analysis research in term of case study. On case study research design and methods, Yin (2003), said that, “case study research method is empirical inquiry that:

1. Investigates a contemporary phenomenon within its real life context;
2. The boundaries between phenomenon and context are not clearly evident and in which multiple sources of evidence are used.

According to Yin (2003), the case study is a suitable strategy when the principal questions of study regarding the questions how or why, if the researcher had little opportunity to control the events that will be investigated, and where the

research focus lies in the contemporary phenomenon in real life. So, this case study method is chosen by the writer because there are some strengths of case study. For example, it enables the researcher to gain a direct view of a certain phenomenon or series of events and can provide a complete picture since many sources of evidence were used.

This research instrument that will be used during the process is an interview guideline, documentation of related literatures and references. This guideline is build based on the research objective, by focusing on the function of internal auditor for achieving an effective internal control. The respondent of interview, or the interviewees selected on the basis of the researcher's individual judgment where permitted on the ground that they could provide the necessary information needed for the research.

3.4 Data and Data Collection Method

3.4.1 Data Source

This study did not use the sample because of the object under study or data obtained only from one company. Types of data used in this research are qualitative data which data that is not expressed with numbers.

This research is done by collecting data and documentation in Bank Nagari which consists of primary and secondary data. The primary data is the data that writer collect directly from the main source and self-analyzed by writer such as from direct observations, interview, and documentation. The secondary data will be in form of

study literature related to the theoretical background that support the writer with the steps in identifying any observed data, and also used in analyzing data to generate result conclusion.

3.4.2 Data Collection Method

In order to analyze the problem faced in this research, we need a set of relevant data that could give a description of the condition to be investigated. For this data collection method in this paper is as follows:

1. Interview

That is the way collecting the data by conducting question and answer directly with interested parties. In this case is division of supervision of Bank Nagari. This interview can be done with one-on-one or a small group. Interviews can be used throughout the data gathering process. Although the process is time-consuming, interview is useful because we can gather specific information and ask follow-up questions to get more detail on items of particular interest. It is done to get clear and complete information about the research. The interviews were tape-recorded and get note to secure an accurate account of the conversations and avoid of loosing data since not everything can be written down during interview.

2. Literature Study

Namely how to obtain the data by reading literature related to the problem so it can be theoretical basis to solve the problem. The data is gathered by using and analysing any literature such journal, accounting book, article and internet based on topic discussed. These data used in theoretical framework which related to the internal auditor role and internal control. These data is used to support and strengthen the theory to any previous research, any update information to the role of internal auditor for achieving an effective internal control in Bank Nagari.

3. Documentation

That is the way collecting the data by looking at data and documents on the object being studied and recorded for purposes related to the issues being investigated. For example internal audit charter, annual report, audit program, etc.

3.4.3 Data Needed

In conducting this research, the steps that author do to analyze the research problem that is collecting that data related to:

1. Organizational Structure

The author need organization structure in this research because it's describe how the flow of responsibility in Bank Nagari

2. Internal Audit scope in Bank Nagari

The scope internal audit consists of Vision, Mission and functions of internal audit in Bank Nagari.

3. **The Internal Control structure in Bank Nagari**

It consist which element that affect the internal control in Bank Nagari

4. **Audit guidelines on Bank Nagari**

These data will be analyzed and will be matching with interview result to evaluation the role of internal audit in achieving an effective internal control and giving recommendations that needed to Bank Nagari.

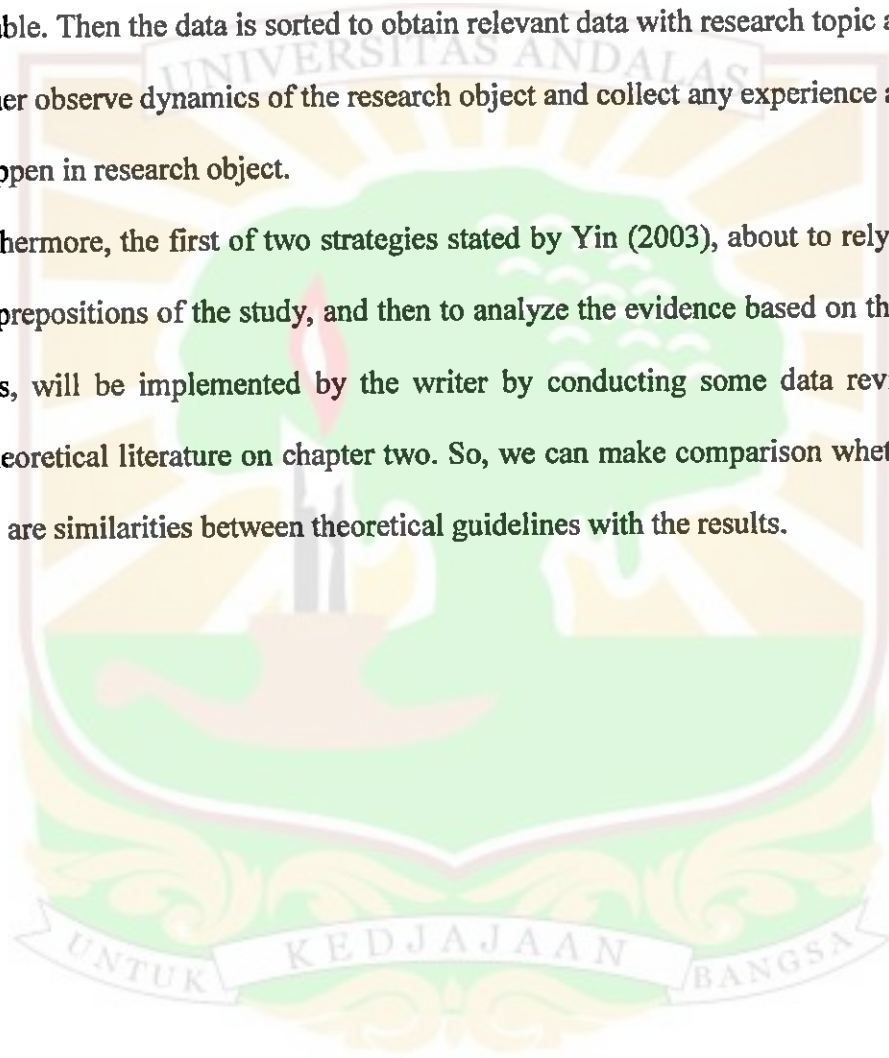
3.5 Data Analyzing Method

This aspect is the last and most difficult step in case study methodology. Miles and Huberman (1984) suggested analytic techniques such as rearranging the array, placing the evidence in a matrix of categories, creating flowcharts or data displays, tabulating the frequency of different events, using means, variances and cross tabulations to examine the relationship between variables and other such techniques to facilitate analysis. Beside that, Yin (2003) presented two strategies for general use : One is to rely on theoretical propositions of the study, and then to analyze the evidence based on those propositions and the other technique is to develop a case description, which would be a framework for organizing the case study.

Data analysis methods used in this research is to combine the multiple qualitative data analysis techniques to process the data that consists of several stages. First, based on Miles and Huberman (1984), is about to rearranging the array, placing the evidence in a matrix categories, and creating the flowcharts or data displays. The

writer do not use tabulating frequency of different events, using means, variances and cross tabulation to examine the relationship between variables techniques since this is a qualitative research. So, according to these techniques, the writer would like to convert all the collected data into writings form to make it easier to be processed and understandable. Then the data is sorted to obtain relevant data with research topic and the researcher observe dynamics of the research object and collect any experience and problem happen in research object.

Furthermore, the first of two strategies stated by Yin (2003), about to rely on theoretical prepositions of the study, and then to analyze the evidence based on those propositions, will be implemented by the writer by conducting some data review based on theoretical literature on chapter two. So, we can make comparison whether or not there are similarities between theoretical guidelines with the results.



CHAPTER 4

RESEARCH RESULT AND DISCUSSION

4.1 COMPANY PROFILE

4.1.1 The History of Bank Nagari

Bank Pembangunan Daerah Sumatera Barat was officially established on March 12, 1962 under the name "PT. Bank Pembangunan Daerah Sumatera Barat" which was passed through a notary act Hasan Qalbi in Padang. The establishment was pioneered by the local government and public figures and private enterprises in West Sumatra, who are equally aware that in order to make local infrastructure moving being faster in West Sumatra, it is needed a financial institution in the form of a bank that specifically assist the government in implementing infrastructure in the local. On April 25, 1962 by the First Deputy Minister for Finance of the Republic of Indonesia issued a business license of PT. Bank Pembangunan Daerah Sumatera Barat through Decree No. BUM/9-44/II to start PT. Bank Pembangunan Daerah Sumatera Barat to do business with the position in Padang.

Under the Law No. 13 of 1962 of the Basic Provisions for Bank Pembangunan Daerah, establishment of Bank Pembangunan Daerah Sumatera Barat should be replaced by regional regulation of West Sumatra Province No.4

of 1973. Because of this law, PT. Bank Pembangunan Daerah Sumatera Barat converted into Bank Pembangunan Daerah Sumatera Barat.

In order to improve the public service, especially overseas transactions, it is based on the Decree of Bank Indonesia No.23/60/KEP/DIR January 17, 1991 Bank Pembangunan Daerah Sumatera Barat is being a foreign exchange bank. To improve the performance of the company, in 1992 issued Regional Regulation of the Province of West Sumatra No. 15 Years in 1992 which approved by the Minister of the Interior No.584.23-407 dated March 23, 1993 and promulgated in No. 3 Series D.1 of 1993. Under Regulation No. 15 of 1992, the investment bank's capital from third parties is possible with the provision of at least 51% of paid in capital represents the investment from the Local Government Level I and Level II.

In order to anticipate an era of globalization and free trade, Bank Pembangunan Daerah Sumatera Barat as a tool of regional autonomy is necessary to increase the competitive ability among foreign exchange banks by expanding the operation area to other regions of West Sumatra in accordance with prevailing regulations, by publishing the Regional Provincial Regulation Level I West Sumatra No. 2 of 1996 which among other things, about the mentioning of changes or calling name of Bank Pembangunan Daerah Sumatera Barat to be Bank Nagari with a view to better known, build brand image as well as implement the system arrangement of government in West Sumatra.

In accordance with the development and more flexibility in running the business, August 16, 2006 Legal status of Bank Pembangunan Daerah Sumatera

Barat changed from the Regional Company (PD) to be Limited Liability Company (PT) that was established under the law of Incorporation No. 1 On February 1, 2007 in front of Notary H. Final Hendri, SH and approved by the Minister of Justice and Human Rights Republic of Indonesia by Decree No. W3-00 074-TH.2007 HT.01.01 April 4. Then, January 25, 2007 there is an endorsement of basic budget about the changes of Bank Law Statutory from the Regional Company (PD) to be Limited Liability Company (PT).

At the date of October 11, 2007 in accordance Decree of Indonesia Bank Governor Deputy No.9/20/KEP.DpG/2007, PT. Bank Pembangunan Daerah Sumatera Barat have get permission to operate as foreign exchange bank.

Currently, Bank Nagari continued to strengthen its tradition of good corporate governance, full compliance with regulations, better risk management and commitment to customers and is ready to continue to expand market share and participate in improving the function of financial intermediation in an effort to support national economic growth. The top changes Bank Nagari in West Sumatra, was marked by launching a new logo along with a new vision and mission of the Regional Development Banks on November 27, 2008.

Today the Bank Nagari has status as a Foreign Exchange Bank and already have Sharia Division. Bank Nagari is also first Regional Development Bank that opens branch office in the Outer Region.

4.1.2 Vision And Mission

Bank Nagari Vision :

“ Being a Regional Development Bank of the leading and most trusted in Indonesia”.

Based on the vision of Bank Nagari to be well known and prominent in Indonesia for the future, Bank Nagari will maintain their reputation and continues to expand the business. Bank Nagari will maintain the belief by running the principles of good corporate governance, providing a satisfactory service and regulatory compliance with the truth.

Bank Nagari Mission :

1. Giving contribution in promoting economic growth and public welfare

Reflect the basis or background which mandated the establishment of the Bank according to the deed of establishment, which helped to build a strong economic activity to improve the economic welfare.

2. Satisfy and maintain the importance of stakeholders consistent and balanced.

It means that the bank will always run with the principle to fulfill that responsibility to the owner, customers, employees and communities.

- Keeping these Banks to grow and develop properly and healthy
- Provide excellent service
- Provide adequate profits for shareholders
- Provide maximum benefit to the society

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4.1.3 The Product Served

In daily operation, there are so many products served by Bank Nagari, there are conventional product and sharia product. But since the topic of this thesis only related to the conventional bank, so the author only explain about the conventional product of Bank Nagari as follows :

1. Conventional Savings
 - SIKOCI Savings
 - TABUNGAN HAJI (TAHARI MABRUR)
 - Current Account
 - Time Deposito
 - Time Deposito Certificate
 - Deposit on call
 - Simpeda Savings
 - Tabanas Savings
2. Conventional Lending
 - Kredit Modal Kerja Kontraktor/ KMKK (Working Capital Loan Contractor)
 - Kredit Kepada BPR (The Rural Credit)
 - KPR MULTIGUNA (Mortgage Multipurpose)
 - Kredit Modal Kerja Multi Guna/ KMKMG (Working Capital Loan Multipurpose)

- Kredit Investasi Multi Guna / KIMG (Multi Use Investment Credit)
- Kredit Rekening Koran/ KRK (Credit Account)
- Kredit Usaha Kecil Informal/ KUKI (Small Business Loan Informal)
- Kredit Usaha Rakyat/ KUR (Society Business Credit)

3. Services

- Remittance
- Collection/Inkaso
- Western Union Money Transfers
- Bank References
- Safe Deposit Box
- SMS Banking
- ATM Card Bank Nagari
- BPD net online
- Bill payment of electricity, water, telkom, fax
- Salary payment
- School payment
- New Student registration
- Halo Card payment

4.1.4 Corporate Culture of Bank Nagari

The corporate culture developed from the Core Value of Bank Nagari which is abbreviated as "NAGARI", namely: Good Intentions, Appreciation,

Ideas, Accuracy, Responsible and Integrity. Value is the value of life and complied by the Bank Nagari of human values inherent in the form of Corporate Culture Bank Nagari as follows:

1. Bank Nagari is a bank that focuses on customer service.
2. Bank Nagari is a bank which has a working climate that encourages the appearance, creativity, motivation and high spirit.

Corporate Culture covers corporate liabilities against to its people and liabilities of people against the company. Corporate liabilities to the people is to develop skills and appreciate the dedication people on the basis of performance. Conversely liabilities of people to the company is loyalty, discipline, reliable, creative - innovative, initiative and able to cooperate in the implementation of tasks.

The Philosophy of Work Culture are as follows:

1. Dedication: Human of Bank works solely for the benefit of the bank.
2. Work: Human of Bank working for the progress of the Bank.
3. Ethics: Human of Bank has good manners.
4. Prosperous: Human of Bank has a decent life.

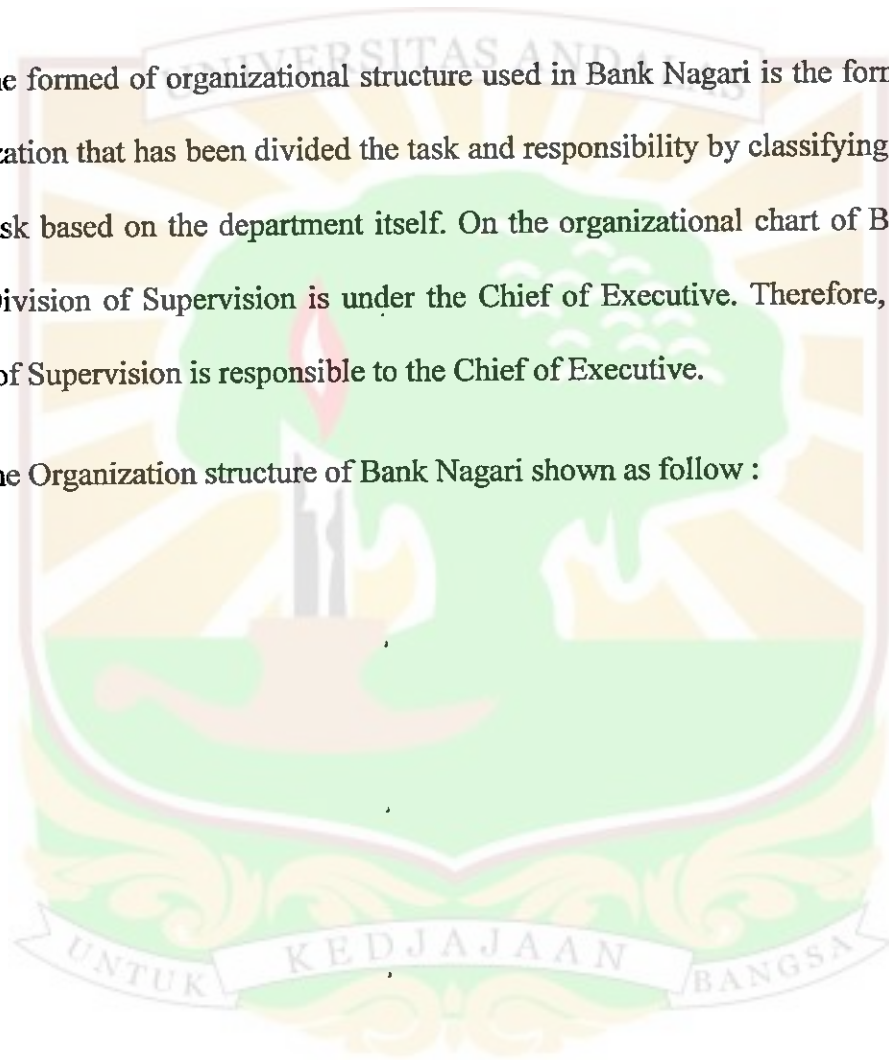
For the effective implementation of corporate culture as a commitment to conduct the work on everyone, to be evaluated periodically to measure and assess how far the quality and quantity of application of Work Culture in the human environment of the Bank.

4.1.5 Organizational Structure

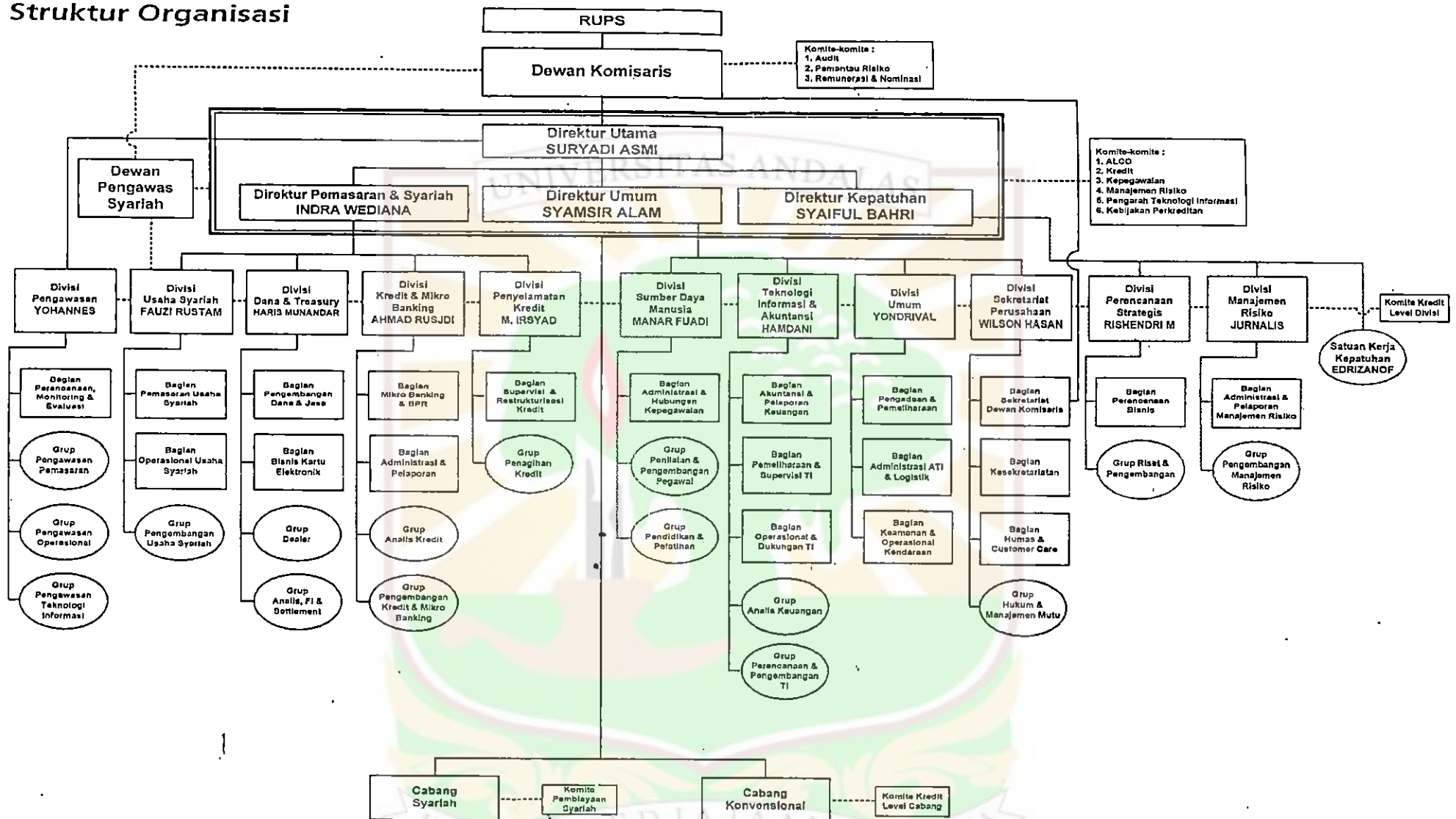
Organization structure is the structure that gives description in determination and limitation of job duties, responsible, authorization and describes the relationship between organization units and makes organization unit work together to achieve organization vision and mission.

The formed of organizational structure used in Bank Nagari is the formed of organization that has been divided the task and responsibility by classifying the type of task based on the department itself. On the organizational chart of Bank Nagari, Division of Supervision is under the Chief of Executive. Therefore, the Division of Supervision is responsible to the Chief of Executive.

The Organization structure of Bank Nagari shown as follow :



Struktur Organisasi



Keterangan:
 - - - - - Garis Komando
 Garis Koordinasi

Lampiran Surat Keputusan Direksi PT. Bank Pembangunan Daerah Sumatera Barat nomor : SK/107/DIR/09-2010, tanggal 1 September 2010

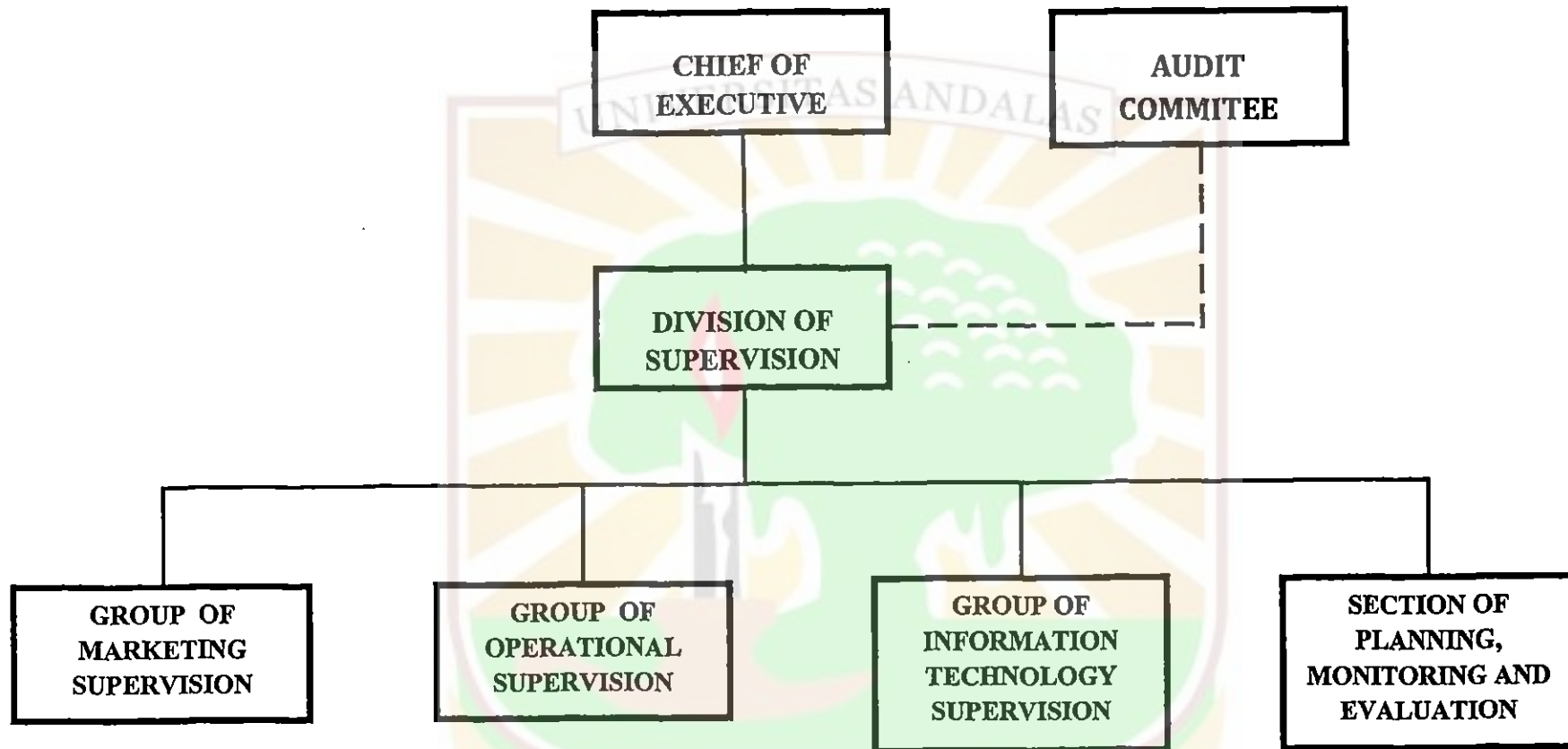


Figure 4.2

Source: Bank Nagari's Internal Data

4.2 SCOPE AND CONDITION OF INTERNAL AUDIT IN BANK NAGARI

4.2.1 Vision and Function Internal Audit in Bank Nagari

Vission

Vission of Division of Supervision is to become effective and efficient division in doing their function based on the Code of Ethic Profession in order to giving maximum contribution in achieving the Vission of Bank Nagari as the of community pride and the host in their own country, which can develop naturally and healthy to support growth and original revenue of West Sumatra itself.

Function

Help the management to conduct the management control system or internal control system within the function and activities as follows :

1. Monitoring the adequate and effectiveness internal control system with risk management basis for all aspect of unit bank activities
2. Monitor compliance to the provisions of the government banks, Indonesian banks and others associated with the implementation of the bank's business activities
3. Conduct general audit through the division units in Office Center and Branch Office to ensure the compliance with applicable rules and regulations and the activities or operations that have been implemented effectively, efficiently and economically to achieve organizational goals

4. Conduct the special audit (audit investigation) of deviations that lead to banking crimes (fraud) in the operational units of central office and branch based on the general audit reports, reports the relevant work units and other
5. Be functioning as a partner for all work units both in the central office and in branches, provide recommendations, opinions, or suggestions for implementation of activities or operational more effectively, efficiently and economically
6. Representing the management and being a working partners of external auditors such as public accountants, Bank Indonesia, BPK who conducting an audit in Bank Nagari.

4.2.2 Position and Structure Of Internal Audit

Based on the organizational structure of Bank Nagari, Division of Supervision is under the Chief of Executive of Bank Nagari. This is in accordance with the guidelines set forth in the Internal Audit Function Standard Bank (SPFAIB). Related to the organizational structure, Division of Supervision oversight audit results are directly accountable to the Chief of Executive, and then it will be forwarded to the Board of Commisioners.

Division of Supervision has conducting independent monitoring function with an adequate coverage of and in accordance with the plan, implementation and monitoring of audit results, has performed the task includes assessing the adequacy of internal control systems, the effectiveness of internal control systems,

and quality of performance. In addition Division of Supervision has reported findings based on the results of the examination regulations.

The function of internal Audit conducted by the Division of Supervision where the position are set as follows:

- a. Director of Division of Supervision are appointed and dismissed by the board of directors with the approval of the board of commissioners and reported to the Bank Indonesia.
- b. Director of division of supervision is responsible to the Chief of Executive. To support the independence and ensure the smooth working, Director of division of supervision can communicate directly with the Board of Commissioners to inform the various matters relating to the inspection work by reporting to the director and forward to the Director of Compliance Officer in advance
- c. In this report, the Director of Division of supervision :
 - Prepare inspection reports to the Chief of Executive and the board of commissioners with a copy to the director of compliance
 - Prepare a report on the implementation and results of the examination subjects that will be submitted to Bank Indonesia every semester after being signed by the Chief of Executive and the board of commissioners
 - Immediately prepare a report on any audit findings that may interfere with survival of a bank. The report should be submitted to the Bank Indonesia by Chief of Executive and board of commissioners.

4.2.3 Scope of Work Internal Audit

The scope of the Division of Supervision works or activities are as follows:

- a. Testing and assessment of the adequacy and effectiveness of internal control systems in the various activities of banks, including all processes and assets that directly or indirectly related to information technology in the bank, whether held by banks and held by third parties relating
- b. Evaluation of compliance with all applicable regulations and policies both internally and externally
- c. Testing the effectiveness of the implementation of policies and procedures and provide recommendations for improvement needed
- d. Reviewing the effectiveness of financial management and financial information systems including electronic data management systems and review for the accuracy and reliability of accounting records and financial statements
- e. Reviewing the effectiveness of management procedures and risk assessment methodologies at different levels of activity of banks
- f. Testing of procedures and policies and compliance with the provisions of Bank Indonesia and other regulatory provisions
- g. Conduct investigations and special investigation commissioned by the Chief of Executive and board of commissioners or upon request

h. Assess existing resources, whether the possession has been done economically, used effectively, and adequately protected and recommend to the board of directors for the possible use of resources is more economic, efficient and effective

i. Monitoring the follow-up examination results

4.2.4 Authority and Responsibility of Internal Audit Division

Division of Supervision has the authority to:

- a. perform unlimited access to all work units and the central offices which include operational activities, record keeping, information, property, and relevant personnel in the implementation of the audit function
- b. defining the scope of the examination and application of audit techniques required to achieve the objectives of the audit
- c. inviting leaders in the environmental division of the Bank Nagari to confirm anything related to the implementation of internal control and risk management as well as the findings of the examination in the division, branches and other work units
- d. obtain the necessary assistance of personnel from various units of work associated with conducting audits, and special assistance / professional is required both from external and internal

e. In exercising its authority, the internal auditor is guaranteed by the directors to be able to accomplish their duties independently and the safety that arising from the implementation of his duty.

Division has oversight responsibilities as follows:

a. Formulate an audit plan consulted with the Board of Commissioners and Chief of Executive

b. Implement an annual audit plan that includes the determination of audit and special audit tasks requested by the board of directors

c. Add his or her professional capacity as an auditor with knowledge, skills, and adequate work experience of banking operations and other disciplines knowledge that relevant to the duties to be able to perform the internal audit charter

d. Provide consulting services for all parties in the neighborhood bank

e. Perform investigation audits on activities suspected of containing fraud and report the results of the examination to the board of directors

f. Provide assurance that the internal auditor in expressing his views and thoughts always refer to the examination of generally accepted norms

g. Report all activities of examination to the president directors regularly.

4.2.5 Independency

In standard of internal auditor mention that internal auditor activity must be independent, and internal auditors must be objective in performing their work.

Internal auditor should have independence in conducting audit and express views and thoughts accordance with the profession and applicable audit standards. Independence is very important to services that given for all stakeholders, internal auditor must be independent in the examined activities. And also independent as code ethic of internal audit profession.

In the implementation of tasks and functions, the Division of Supervision must be professional, independent and objective and directly responsible to the Chief of Executive. To maintain an attitude of independency, Division of Supervision should not perform the operational activities of the bank and in expressing their views and thoughts should always refer to the examination of generally accepted norms. Beside that, Division of Supervision should always be to avoid the conflict of interest in the activities of the audited object, so that the objectivity of the auditor's attitude can always be maintained.

To improve their quality, the supervisory division maintains the quality assurance improvement program consistently and sustainable as well as perform periodic assessments, both the internal (self assessment) and assessment of external parties and an independent professional.

4.2.6 Code of Ethics of Internal Auditor

As a profession, the main characteristic of the internal audit is a willingness to accept responsibility for the interests of those who served. In order to carry out this responsibility effectively, the auditor needs to maintain high

standards of behavior. Therefore, the chief of executive hereby establish the code of ethics for internal auditors.

Code of conduct includes the behavior as a guide for internal auditors. Standards of conduct established the basic principles in audit practice. The auditor shall perform professional responsibilities with wisdom, dignity and honor. In applying this code auditors should pay attention to laws and regulations. Violations of standards of conduct set forth in this code penalized accordance to the applicable regulations.

The standards of conduct of internal auditors are:

1. Behave honestly, politely, objectively and sincerity in carrying out duties and fulfilling the professional responsibilities
2. Demonstrate loyalty to the organization or to the party served. But should not be consciously involved in deviation or unlawful activities
3. Refrain from activities that cause the conflict with the interests of the organization
4. Did not receive any compensation from employees, clients, customers, suppliers or business partners of the organization, so it can affect their professional considerations
5. Maintain confidentiality in accordance with the principles, policies and regulations

6. Be careful and judicious to use the information obtained in the implementation of duties, internal auditors can not use confidential information.

7. In reporting results, work, disclose all important facts are known, namely that if the facts are not disclosed to (1) distort the performance of activities in the review, or (2) cover up the existence of practices that violate the law

8. Constantly improve the skills and the effectiveness and quality of implementation of his duty. Internal auditors are obliged to follow and continuing professional education seminars or workshops related to the implementation of audit work.

4.2.7 Internal Audit Work plan

The activities of internal auditor should be based on planning. Director of Divison of Supervision responsible to make a plan to conduct the audit. These plan should be consistent with Internal Audit Charter, the objective of Bank, assigned by Chief of Executive and report to the Board of Commisioners. The planning process are as follows :

1. Deciding the objective of Audit

The audit goals should be measured and based on the planning and budget of the Bank Nagari

2. Deciding the work schedule of Audit

The work schedule including the activities being audit, the start date and the time needed considering with the scope of audit and audit result that

has been done by the previous auditor. In making a work schedule, there are several things that should be given attention :

- a. Past audit findings
- b. Risk evaluation that including liquidity risk, market risk, credit risk, interest rate risk, operational risk. This evaluation aimed to identify the material or significant effect from the audit.

3. Human resource and budget planning

In Human resource and budget planning, Bank should consider the total of auditor needed to conduct the audit, the qualification needed, and the training needed for development beside the administrative activities.

4. Audit Reports

The audit reports should be informed to the Chief of Executive and Board of Commissioners with copying by Director of Compliance. This report must describe the comparison between the achievement of audit result with the target that has been decided previously, and also the realization cost and budget, the deviations causes and the action taking to complete it.

Bank Nagari has three types of audits. There are routine audit, passive audits and special audits. Routine audits are audits conducted once a year where the planning is made once a year in the form of Annual Work Plan (RKT). However, RKT may change according to the conditions and circumstances before performing the audit. Passive audit is audit conducted from the office or call "behind the desk". That is, the audit is conducted when there are reports from employees such as through the mail. Audit is conducted by checking the truth

without going to the location. Special audit is audit conducted when there is a particular case that requires quick action. This audit is usually a special order and report directly to the Chief of Executive.

The annual planning stage is performed by the director of Division of Supervision and the director of other divisions and the group leader in Division of Supervision. Before any routine audit activity and special audit carried out, it takes approximately 2 (two) weeks for the preparation phase. Each member will be given the audit plan made by the director of the group on the basis of the annual audit plan and the latest issues. From the description of the audit plan, each group member will be assigned in accordance with their capabilities and expertise. In addition, determine the number of members who will conduct the audit. Audit planning is prepared under the conditions of past performance and current conditions as well, especially if there are subsequent events.

4.3 INTERNAL CONTROL IN BANK NAGARI

Internal control is a control mechanism applied by the bank management on an ongoing basis in order to:

- a. Safeguard and secure the bank's assets
- b. Ensuring the availability of more accurate reporting
- c. Improving compliance with the applicable provisions
- d. Reduce the financial impact or loss of irregularities including fraud, and violations of prudential aspects

The existence of the internal control system aimed at proficiency level:

- Ensure that all business activities of the Bank have been conducted in accordance with the provisions and regulations applicable, whether provisions issued by the government, banks and supervisory authorities of policy, regulations, and procedures established by the bank's internal
- Availability of financial and management information are true, complete and timely, and relevant decision-making is required in order that appropriate and accountable
- Improve the effectiveness and efficiency in the use of assets and other resources in order to protect the bank from the risk of loss.
- Improve organizational effectiveness and improve cost efficiency.

4.3.1 The Components of Effective Internal Control in Bank Nagari

In Bank Nagari, there are BI regulation as a guidance for Bank Nagari in running their function to achieve the vision and mission. Surat Edaran Bank Indonesia (SEBI) 5/22/DPNP/2003 about the guidance of internal control system for Bank state that main element for internal control system in bank are as follows : Management Oversight and Control Culture, Risk Recognition and Assessment, Control activities and separation of duties, Accountancy, information and communication, Monitoring Activities and Correcting Deficiencies. It's similar with the COSO's framework where the main elements of internal controls system

are : Control environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring.

1. The Company Control Environment

Control environment is action, policies, and procedures that reflect the overall attitude of top management, directors, and owners of an entity about internal control and its importance. It is the foundation for all other components of internal control, providing discipline and structure. The following is the result of observation and study literatures about the control environment of Bank Nagari :

a. Integrity and ethical values

This company has already establish since the early sixties until now. As well as the changes of the entire system, so does its ethical values and the principles of management attitude in leading company. Being a centralized company, this company create and build its values in form of several point of the company culture. The company culture is actualized the form of symbol or yell or jargon that called "NAGARI" (Good Intentions, Appreciation, Ideas, Accuracy, Responsible and Integrity). All this values is communicate from the top management in central company to the lowest function by distribute the values to all of the branches of Bank Nagari and also through several occation in terms of socialization, workshop, training and the most important one using the leaders as the role model of good ethical act for the entire company. Board of Commisioners and board of directors must be a role model to all of the employee for developing a healthy bank.

As a role model to the employees, in terms of maintain the company values as it supposed to be, the Board of Commissioners and Board of Director must increase the awareness all employees about the importance of effectiveness in doing the task and duties and then communicate to the management about all the problem happened in the operational bank.

All of the board of commissioners and board of director has been signed the Integrity Fact (Facta Integritas) and all parties involve in Bank Nagari has been signed the Statement of Compliance to the Code of Ethic as a committment proof. This statement always update annually, in way the all parties involve in Bank Nagari, in writing restated the Compliance to the Code of Ethics. The Statement of Compliance Year is a requirement to continuing the relationship work with Bank Nagari. If irregularities happen, Bank employee required to notify Human Resources Division or their leaders as soon as possible for any errors or suspicion of prohibition of the code of conduct. Human Resource Division is responsible to monitor compliance of Code of Conduct and give report to Audit Committee and make prohibition notes , either potential or that has actually occured. Human Resource Division makes "List of Prohibition" and responsible to give to the party who have authority for every prohibition that happens for a certain time. Then, the division of supervision periodically review the development of core values and make recommendations about core values revision. The punishment depends on the weight of action, it could be the cut of salaries, mutation, and even firing with no references based on the applicable law and regulation.

b. Commitment to Competence

The company culture also describes the expectation of the company over the qualities of its employee. In essence, the code of conduct of Bank Nagari contain the responsibilities and its prohibition as a description implementation of good corporate governance for all parties in Bank Nagari. Code of Ethic can create morale and spiritual intellegency to guide people to do the job as the portion and responsibilities themself. Bank Nagari employee firstly expected to be an integrated person with good performance, creative, high motivated and high of spirit togetherness. There are no fixed procedure in recruit the new employee, but the management have the power to decide it. For selection internal audit staff, there are no specific or special characteristics in selection the new employees. There will be educational program sertification at Yayasan Pendidikan Internal Auditor (YPIA). To ensure it practiced the Bank adopt a policy doing by several programs for developing the competency of employee which focused on increasing the understanding about bank, skills, intelligent process, manajerial ability, services, loyalitas, compliance and supervise. Related with these things, Bank has been realization the educational program and training in forms of in house training, out house training, workshop, seminar and socialization. And also Bank Nagari giving the equal opportunities to all the employees without underestimate act through the religion, ethnic, culture, physical characteristics, educational background, level of authority, and gender. But the board of director should ensure that a proper position of employee is in place to the skill, knowledge, and the behavior.

c. Board of Directors or audit committee participation

To ensure that the Bank has been conduct the regulation and procedure of internal control that became the guidance in operational has been run well to give the additional value to the bank, so the Board of Directors and Board of Commissioners should ensure that the internal control system has been good implemented. Board of directors are responsible for ensuring that internal controls are established and functioning to achieve the mission and objectives of the whole unit. Board of Commissioners are responsible to monitor the internal control system that has been decided by Board of Directors. And Audit Committee as intermediary between the board of director and internal auditor or external auditor.

Then management should identify what control currently exist (or should be established) to reasonably assure the achievement of each specific objective for this unitl. Since the board is responsible to ensure adequate procedures are in place and effectively implemented, Bank Nagari formed the division of supervision to make the progress report and being the consultant for the whole company. Periodically, division of supervision give the report about the effectivenss of internal control system to Audit Committe who has responsibility to keep the standard and adequacy scope of monitoring, result and effectiveness of audit process, and also ensure that division of supervision has enough resources to meet his independency. Division of Supervision oversight audit results are directly accountable to the Chief of Executive, and then it will be forwarded to the Audit Committee and Board of Commissioners.

d. Management's philosophy and operating style

This stated that management need to take action that push down to the importance of control to give the positive effect to the successful of company. The management of Bank Nagari has provided clear signals to employees about the important of importance of internal control through several activities. Not only being as good role model, but also establish the code of conduct to all of employees and individual involved in the company. All of the policy and and way of conduct is determined centralized.

e. Organizational structure and job descriptions

The organizational structure should reflect the adequate separation of duties and authority and also the clear reporting. In Bank Nagari has been shown the adequate of separation of duties and authority. The organizational structure should clearly regulate aspects relating to distribution of work between Auditor, grouping Auditor and range control and delegation of authority from the Director of Internal Audit. In the assignment of the Internal Auditor, it should be possible presence the rotation periodically so it can provide an opportunity for an Internal Auditor to increase knowledge and abilities.

Internal auditor in Bank Nagari are classified as group of marketing control, group of operational control, group of information technology control, group of planning, monitoring and evaluation. Each of group have clear job description.

1. Group of Marketing Control

- a. Actively Supervise the managing of marketing activities in the Office Center and Branches Office based on the planning of supervision guidance.
- b. Passively Supervise the marketing activities in the office center, branches, support branches, and Cash Center
- c. Doing the special and limited audit for the irregularities or mistake in the managing of marketing activities that have significant risk in Bank
- d. Manage the regulation, procedures, and policies that related with the marketing activities
- e. Discuss with the Auditee when doing the supervision and exit meeting to increase the understanding about the implementation of internal control of marketing activities Bank
- f. Doing the assessment and evaluation to the marketing control activities
- g. Doing the assessment or other technique audits that needed to record and report the managing of marketing control activities
- h. Collect the information that develop in marketing control activities and have potential to arise risk for bank in order to analysis and report to the management of bank
- i. Collect the information about the competitor's product to be analyze and give suggestion to development of product bank
- j. Prepare the recommendations or opinion of Division of Supervision from other unit work in internal Bank in order to development of system, procedures and policies in marketing control activities

k. Prepare the reports that are related to the implementation of task and responsibility of Group of marketing control activities

l. Documentation the supervision report and other reports related to the implementation of task and responsibility of group of marketing control activities and report to the group of planning, monitoring and evaluation to be continues managed

m. Prepare the policies and procedures that related with the implementation of task and responsibility of group of marketing control activities

2. Group of Operational Control

a. Actively Supervise the managing of operational activities in the Office Center and Branches Office based on the planning of supervision guidance.

b. Passively Supervise the operational activities in the office center, branches, support branches, and Cash Center

c. Doing the special and limited audit for the irregularities or mistake in the managing of operational activities that have significant risk in Bank

d. Manage the regulation, procedures, and policies that related with the operational activities

e. Discuss with the Auditee when doing the supervision and exit meeting to increase the understanding about the implementation of internal control of operational activities Bank

f. Doing the assessment and evaluation to the performance of implementation operational activities

- g. Doing the assessment or other technique audits that needed to record and report the managing of operational control activities
- h. Collect the other information that develop in operational control activities and have potential to arise risk for bank in order to analysis and report to the management of bank
- i. Prepare the recommendations or opinion of Division of Supervision from other unit work in internal Bank in order to development of system, procedures and policies in operational control activities
- j. Documentation the supervision report and other reports related to the implementation of task and responsibility of group of operational control activities and report to the group of planning, monitoring and evaluation to be continues managed
- k. Prepare the policies and procedures that related with the implementation of task and responsibility of group of operational control activities

3. Group of Information and Technology Control

- a. Actively Supervise the managing of information and technology activities in the Office Center and Branches Office based on the planning of supervision guidance.
- b. Passively Supervise the information and technology activities in the office center, branches, support branches, and Cash Center
- c. Manage the regulation, procedures, and policies that related with the information and technology activities

- d. Discuss with the Auditee when doing the supervision and exit meeting to increase the understanding about the implementation of internal control of information and technology activities Bank
- e. Supervise with the external auditor to the application of special technology
- f. Doing the assessment and evaluation to the performance of implementation information technology activities
- g. Doing the assessment or other technique audits that needed to record and report the managing of information technology control activities
- h. Doing the special and limited audit for the irregularities or mistake in the managing of information technology that have significant risk in Bank
- i. Collect the other information that develop in information technology control activities and have potential to arise risk for bank in order to analysis and report to the management of bank
- j. Collect the information that are related to the implementation of information technology to be analyzed and give the suggestion to development of implementation of information technology bank
- k. Documentation the supervision report and other reports related to the implementation of task and responsibility of group of operational control activities and report to the group of planning, monitoring and evaluation to be continues managed

4. Section of Planning, Monitoring and Evaluation

- a. Prepare the schedule of supervise planning that contain the object of supervise planning, planning team and member and the needed of day to day supervision
- b. Manage the task of supervision that will conduct by Supervision team
- c. Supervise the implementation of planning, work program and action plan of division of supervision
- d. Make a report about the audit finding to be reported to the Bank Indonesia and other parties in the internal environment bank that will be end at first semester and second semester every year
- e. Make a report of responsibility about the implementation of work planning of division of supervision
- f. Send the code of ethics of Auditor and internal audit charter to the auditee to increase the knowledge of auditee
- g. Prepare the formulation of action as a reward and punishment to the AUditee to the continuing action of audit finding and report to the board of directors to be the policies in bank
- h. Coordinates with human resource division to formulate the action in empowering the executive level and report to the board of directors to be a policy in bank
- i. Make a letters of conduct to be informed to the unit operational that doing the irregularities or mistake or will be punish by Bank Indonesia

- j. Coordinate and communicate with the Auditee in order to continuing action of audit finding
- k. Manage the development program of human resources of division of supervision based on the planning
- l. Manage the examination by the eksternal parties such as Bank Indonesia, Public Accountant, Badan Pusat Keuangan (BPK), and others.
- m. Documentation the policies and procedures of bank's operational, accept and documentation the summary of regulation, policy, and procedure that made by Groups of Supervision and then manage them into current and permanent file
- n. Prepare the report that related with the examine activities to the Bank Indonesia and other parties
- o. Manage the key performance indikator of division of supervision based on the regulation in every month
- p. Prepare the letters that comes from internal or eksternal banks
- q. Prepare the policies and procedrues that related with the implementation of task and responsibility of group of planning, monitoring and evaluation
- f. Assignment of authority and responsibility

Authority is a right to give command to the lower level in the company. Responsibility is the duty of someone to doing the job and responsible for the result of their job. In order to create the effective and efficient work environment, its needed the clear classification of authority and responsibility.

Usually the organizational structure, written memorandum, written procedure, procedure manual are used to indicate the assignment of authority and responsibility.

Bank Nagari reflect the authority from the frame of organizational structure Bank Nagari that give the clear line of command from the top to lower level and also there are clear of job description for every level in organizational structure.

f. Human resource policies and practices

The most important aspect of internal control is personnel. Because of that, the method by which persons are hired, evaluated, trained, promoted, and compensated being important part of internal control in order to get the competent and trustworthy personnel in providing effective internal control. Human resources policies and practices toward hiring a competent personnel and for assign personnel to higher position is designed in a special mechanism. Bank Nagari has human resource division to regulate the selection and recruitment the new employee. Normally, Bank Nagari did not have special requirements for obtaining new employee and bank nagari give a freedom to perform a selection for obtaining a new employee, but management have a power to intervent those selection through determines the criteria of the employee required and the last decision whether this newbee will be placed in what position, still depend on management.

2. The Company Risk Assessment

An entity's risk assessment for financial reporting purposes is its identification, analysis, and management of risks relevant to the preparation of financial statements that are fairly presented in conformity with general accepted accounting principles.

At the beginning, the Risk Management Division along with other relevant Division's leaders have been made and set the company's risk profile. Company's risk profile is then used as a basic assessment of the risks facing the company. Risk profile is a list of risks that had been identify by Division of Risk Management. Risk profile has information about risks from credit, market, operational, etc. There are eight types of risks in Bank Nagari described in Circular Letter of Bank Indonesia No.5/21/DPNP/2003 that aid to the Bank Nagari's internal auditors to determine the risks which will be the priorities in the audit. This will affect the system of internal control in setting the audit plan and report the results of those planning to the Chief of Executive and Audit Committee.

The implementation of a risk assessment in Bank Nagari carried out once every three months by the Risk Management Division and the Chief of each division and then submitted to the Division of Supervision. Then the data is further verified by the Division of Supervision both with quantitative and qualitative data will then be a risk profile of the Bank Nagari. The risk profile will be one reference to determine the priority risks to be audited.

3. The Company Information and Communication Style

Information and communication are essential to effect control. Information about an organization's plans, control environment, risks, control activities, and performance must be communicated up, down, and across an organization. The information required must be identified, captured and communicated in a form and timeframe that enable personnel to carry out their responsibilities. The information can be financial or operational, from internal or external sources.

For Bank Nagari, the design of accounting information system and communication is determined with special guiding principles. Examples, for regulatory reporting, the Bank adopted the accounting policy in accordance with accounting principles generally accepted in Indonesia. The financial statements for the year ended 31 december 2010 were prepared in accordance with accounting principles generally accepted in Indonesia, including the Indonesian Banking Accounting Guidelines (PAPI) 2008 and where appropriate with regulation No. VIII G.7 concerning Guidelines for the Preparation of Financial Statements issued by the Bapepam-LK and the letter of Bapepam-LK No. SE-02/BL/2008 dated 31 january 2008 concerning Guidelines for Presentation and Disclosure of Financial Statement of Public Companies General mining, oil and Gas, and Banking. Beside that, the company using manual to communicate the procedure and also by directly informed to the employee about the procedure or information (oral). To be accountable, the financial reporting are informed to the newspaper twice a year.

4. The Company Control Activities

a. Adequate separation of duties

Duties are segregated among different people to reduce the risk of error or inappropriate action. Normally, responsibilities for authorizing transactions, recording transactions (accounting), and handling the related asset (custody) are divided or separated among employees. Based on Surat Edaran Bank Indonesia SEBI 5/22/ DPNP/2003, the principle of separation must be obeyed in order to avoid the opportunities of the employee to do fraud, crime or deviations and it aimed to avoid the conflict of interest. This principle is called "Four Eyes Principle". But if it is needed, because of the changes characteristics of business activities and transaction and also the organization of Bank, the Board of Director should decide the authority or procedure including the list of worker who can access a transaction or high risk activities.

b. Proper authorization of transaction and activities

Authorization is the delegation of authority; it may be general or specific. Bank Nagari uses two kinds of authorization for the transactions, general and specific authorization. Under general authorization, Bank Nagari follows the policy established by the Bank Nagari within the limits set by the policy. And for the specific authorization applies to individual transaction. Management authorizes employees to perform certain activities and to execute certain transactions within limited parameters. In addition, management specifies those activities or transactions that need supervisory approval before they are performed or executed by employees. A supervisor's approval (manual or electronic) implies

that he or she has verified and validated that the activity or transaction conforms to established policies and procedures.

c. Adequate documents and records

There are some important documents exist at this company everyday. Such as credit approvals, credit invoices, cash in flow, cash outflow, etc. The documents must be updated regularly to describe the operations of the Bank actually, and should be informed to officials and employees. Upon a request, the document should always be available for the benefit of internal auditors, accountants Public and Bank Indonesia supervisory authority. The accuracy and availability of the document must be assessed by internal auditors when conducting routine and non-audit routine.

d. Physical control over assets and records

This control used to assure the implementation of control physical to keep the bank's asset. These activities include are safeguard the asset, record and access process of the computer and data file, and checking the asset periodically.

e. Independent checks and performance

Reviewing reports, statements, reconciliations, and other information by management is an important control activity; management should review such information for consistency and reasonableness. Reviews of performance provide a basis for detecting problems. Management should compare information about current performance to budgets, forecasts, prior periods or other benchmarks to measure the extent to which goals and objectives are being achieved and to identify unexpected results or unusual conditions which

require follow-up. Management's review of reports, statements, reconciliations, and other information should be documented as well as the resolution of items noted for follow-up.

5. Monitoring

Monitoring in this company is accomplished by ongoing monitoring activities and by separate evaluations of internal control such as self assessments, peer review, and internal audits. The internal control in Bank Nagari requires several actions consists of reasonable assurance, supportive attitude, competent personnel, control objectives, control techniques and continuous monitoring. So, the monitoring activities is performed by three parties, the management and division of supervision as the internal part of the company, and by the independent parties like external auditor annually.

The Bank shall conduct continuous monitoring on the effectiveness of the overall implementation internal control. Monitoring of key risk Banks should be prioritized and serves as part Bank of daily activities including the evaluation periodically, either by operational units or by the Division of Supervision. The Bank shall monitor and evaluate the adequacy Internal Control System is continuously relating to internal conditions and changes externally and should increase the system capacity effectiveness of internal control in order to be improved.

improved

increase the system capacity, effectiveness of internal control in order to be continuously relating to internal conditions and changes externally and should Bank shall monitor and evaluate the adequacy internal Control system is periodically either by operational unit or by the Division of Supervision. The prioritized and solves as part Bank of daily activities including the evaluation overall implementation internal control. Monitoring of Regulatory Banks should be

The Bank shall conduct continuous monitoring on the effectiveness of the

independent parties the external auditor annually.

division of supervision as the internal part of the company, and by the the monitoring activities is performed by three parties, the management and all self-administration control objectives and continuous monitoring for progress, control objectives control disciplines and continuous monitoring level actions consist of reasonable assurance, supportive attitude, competent personnel and internal audit. The internal control in Bank Negeri requires activities and by separate evaluations of internal control such as self assessment.

Monitoring in this company is accomplished by ongoing monitoring

2. Monitoring

noted for follow-up.

and other information should be disclosed as well as the resolution of the Bank and management review of reports, statements reconciliations, and follow-up

THE COSO FRAMEWORK FOR BANK NAGARI INTERNAL CONTROL

COMPONENT	DESCRIPTION OF COMPONENT	SUBDIVISION	IMPLEMENTATION BY BANK NAGARI
Control Environment	Action, policies, and procedures that reflect the overall attitude of top management, directors, and owners of an entity about internal control and its importance	a. Integrity and Ethical values	Implementing "Nagari" values namely : Good intentions, appreciation, ideas, accuracy, responsible, and integrity.
		b. Commitment to Competence	There are no specific characteristics for selection new staff or employees. Because all of the employees has equal opportunities. For internal auditor it will be educational program at YPIA.
		c. Board of Director and Audit Committee Participation	Division of Supervision oversight audit results are directly accountable to the Chief of Executive, and then it will be forwarded to the Board of Commissioners and Audit Committee.
		d. Management Philosophy and operating style	The management of Bank Nagari has provided clear signals to employees about the important of importance of internal control through several activities. Not only being as good role model, but also establish the code of conduct to all of employees and individual involved in the company.
		e. Organizational Structure	There is clear line of hierarchy and function.
		f. Assignment of Authority and Responsibility	There is clear assignment of authority and responsibility that reflect in organizational structure
		g. Human Resource Policies and Procedures	Bank Nagari has Human Resource division to regulate about the personnel. Normally, in obtaining new employee there s no special requirments but the management have power to decided.
		Risk Assessment	the process of identifying and analyzing risks related to achieving an objectives entity, as the basis of risk management performed

COMPONENT	DESCRIPTION OF COMPONENT	SUBDIVISION	IMPLEMENTATION BY BANK NAGARI
		2. Assess significance of risks and likelihood of occurrence	Perform by risk management committee
		3. Determine Actions necessary to manage risks	Approved by board of management
Control Activities	Policies and procedures that can help management to ensure that management directives be implemented	Type of specific control activities : a. Adequate Separation of Duties	Implemented. If needed, it based on the Board of Director authority
		b. Proper Authorization of transaction and activities	Implemented
		c. Adequate documents and records	Implemented
		d. Physical control over asset and records	Implemented
		5. Independent Checks on Performance	Implemented
Information and Communication	The information within the company should be identify, process, and communicate to the employee to help them to carry out their responsibilities		The design of accounting of information system and communication is determined with special guiding principles such as manual procedure, directly informed (oral), etc
Monitoring	Management ongoing and periodic assessment of internal control quality performance to determine whether controls are operating as intended and modified when needed	Not applicable	Monitoring is Conduct by Division of Supervision

4.4 The Roles Of Internal Auditor in Internal Control

Internal audit is part of the internal control structure and are all forms of activities related to audits and reporting audit results regarding the implementation of a coordinated control structure at every level of bank management. Transparency and clarity is something that is very important in the management of the bank so that the Internal Audit policies relating to authority and level of independence should be stated in a written document from the Director of the bank with the approval of the Board of Commissioners, called the Internal Audit Charter. Periodically, the Internal Audit Charter needs to be assessed for adequacy by the chief of executive and the Board of Commissioners that the conduct of Internal Audit always be at its optimal level.

Accordance to internal audit charter division of supervision in Bank Nagari, the roles of internal audit are to be supervisor, consultant, and also expected the new role of internal auditor as a strategic business partner. As a supervisor, Division of supervision help chief of executive to supervise deviation from rules that occurs in company. As a consultant, division of supervision should give recommendation or suggestion related to the procedure or system to ensure that the procedure and system has been include the components of internal control in order in its implementation, can achieve the objective effectively and efficiently. From those rules, the main role of internal supervisory units of Bank Nagari is to be supervisor, because the base role of internal auditor as supervisor. Therefore the dominant role of internal supervisory units is to be supervisor of business activity of Bank Nagari.

Based on the internal control guidance of Bank Nagari, division of supervision does not involved in designing the internal control system but the division of supervision involve in reviewing and supervising the effectiveness of internal control system for all unit of activities in Bank Nagari. Division of supervision ensure whether the internal control system effective or not and give the recommendation if improvement needed. In addition, to help the company to accomplish the vission and mission.

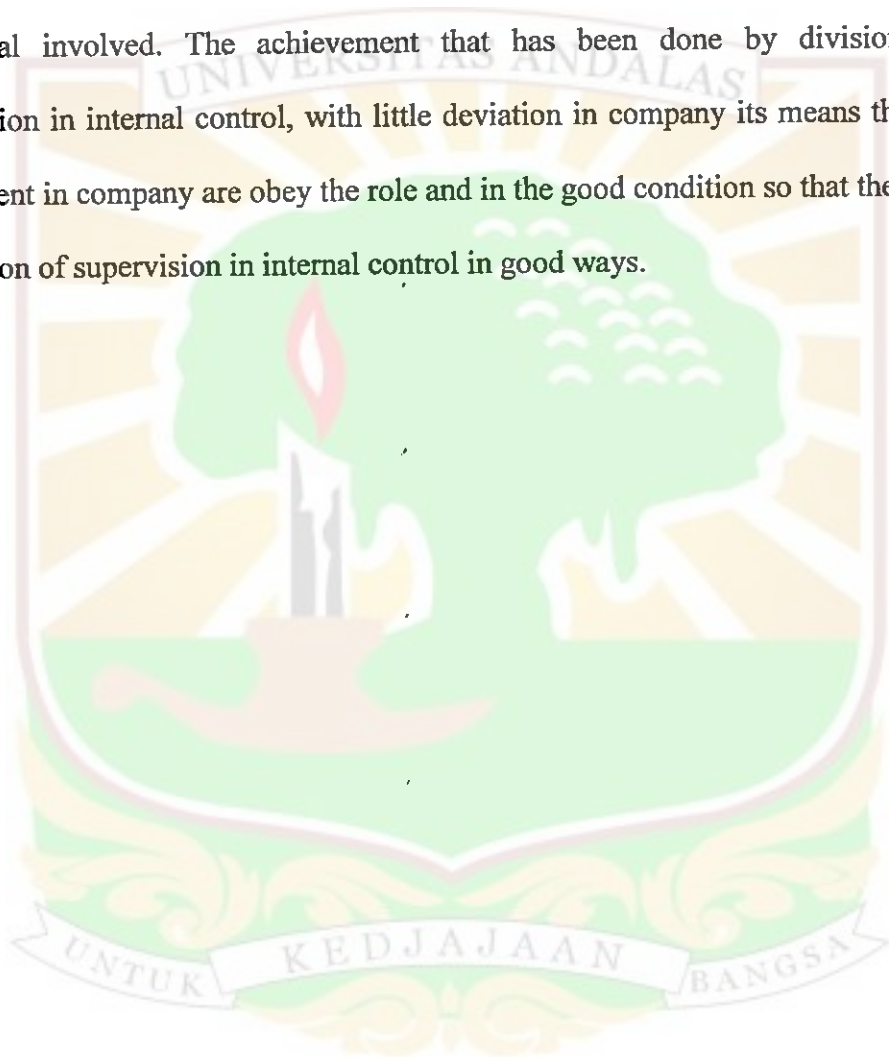
Accordance with the independency, internal auditor position in organization should be quite possible to carrying out its responsible in auditing so that they able to express their view and thoughts without any influence from management and other parties within the company. Director of division of supervision is responsible to the Chief of Executive. To support the independence and ensure the smooth working, Director of division of supervision can communicate directly with the Board of Commissioners to inform the various matters relating to the inspection work by reporting to the director and forward to the Director of Compliance Officer in advance

Position of division of supervision in Bank Nagari structure is below the Chief of Executive. To coordination the division of supervision activities, Director of division of supervision report the all findings to Chief of Executive and forwarded to the board of commissioners and audit committee before submitted to the Bank Indonesia.

The involvement of division of supervision in implementation effective internal control in Bank Nagari is to supervise and ensure the effectiveness of

internal control system, if the problem occur in implementation of internal control system, the division of supervision will be recommended solution to the problem to make it appropriate with the company.

Internal controls will be performing well if the support of all elements in the company, from directors, executive officers, internal audit and all of the individual involved. The achievement that has been done by division of supervision in internal control, with little deviation in company its means the all component in company are obey the role and in the good condition so that the role of division of supervision in internal control in good ways.



CHAPTER 5

CONCLUSION, LIMITATION, AND SUGGESTION

The objective of this research is to know about function of internal audit, internal control and the role of internal auditor in achieving an effective internal control system in Bank Nagari, where the object of this research at the Central Office of Bank Nagari.

Based on the result of research that discuss in previous chapter, there are conclusion, limitation, and suggestions as follow.

5.1 Conclusion

This research reviews the main standard and principle of internal audit and internal control. Describe the relevant information about condition of internal auditor and the role of internal audit in achieving an effective internal control for one type of banking company. Based of the result of the author's research, shows that the internal audit function and implementation of internal control in Bank Nagari are effective. It describe as follow:

1. Based on the position, the Position of Internal auditor in Bank Nagari is Independent, this can be seen from the organization structure of Bank Nagari that under chief of executive and it means the internal auditor directly responsible to the Chief of Executive. This can be proven by the

explanation in theory, where beside directly responsible to the Chief of Executive and not directly responsible to the Board of Commissioners as the independent party, but to support the independence in Bank Nagari, Director of division of supervision can communicate directly with the Board of Commissioners to inform the various matters relating to the inspection work by reporting to the director and forward to the Director of Compliance Officer in advance .

2. The role and function of internal audit in Bank Nagari is good, it can be proven in audit guidance of Bank Nagari that become a guidance for Internal Auditor in doing their job. The guidance explain about the code of ethics, audit procedure, audit work plan, and other procedures to be guideline of division of supervision.
3. Internal audit in Bank Nagari not only act as supervisory but also act as consultant. This can be known from vision and function of internal auditor of Bank Nagari,. The division of supervision helping the Chief of Executive in monitoring the implementation of internal control whether its effective or not, act as consultant and give recommendation for follow-up audit's findings.
4. The writer assess that the function of internal auditor is already effective, because the internal auditor in Bank Nagari have independent position, clear job description, get support from the leader, etc.
5. The internal control system in Bank Nagari can be said effective enough. It is can be seen from the accomplishment of almost all the five element of

COSO' Internal Control as discussed in the previous chapter eventhough there's a requirement of GAAS has not been completely fulfilled.

6. Internal control can be expected to provide only *reasonable assurance*, not absolute assurance, to an entity's management and board. As cited in the theory, an effective system is not a guarantee that the organization will be successful. Internal control is not an absolute assurance to management and the board about the organization's achievement of its objectives. It can only provide reasonable assurance, due to limitations inherent in all internal control systems.
7. The internal auditor already involve in internal control as supervise and consultant of the implementation and performance to achieve an effective internal control. The role of internal auditor has been running well.

5.2 Research Limitation

This study has limitations that may cause interference bias on research results:

1. This study only reviews the role internal auditor in internal control generally. Because the broad area of internal control make the writer difficult to figure out.
2. The restriction on access in the collection of data needed by the writer, thus it caused the limitation in describing.
3. Limited of understanding and the number of subjects of research on internal control system raises limitations in analyzing.

4. The extent of the problems that arise in a company's activities cause the writer is aware of the limitations of time, ability and knowledge the writer.

4.3 Suggestion

Based on the conclusions above, some suggestions could be given for Bank Nagari, including :

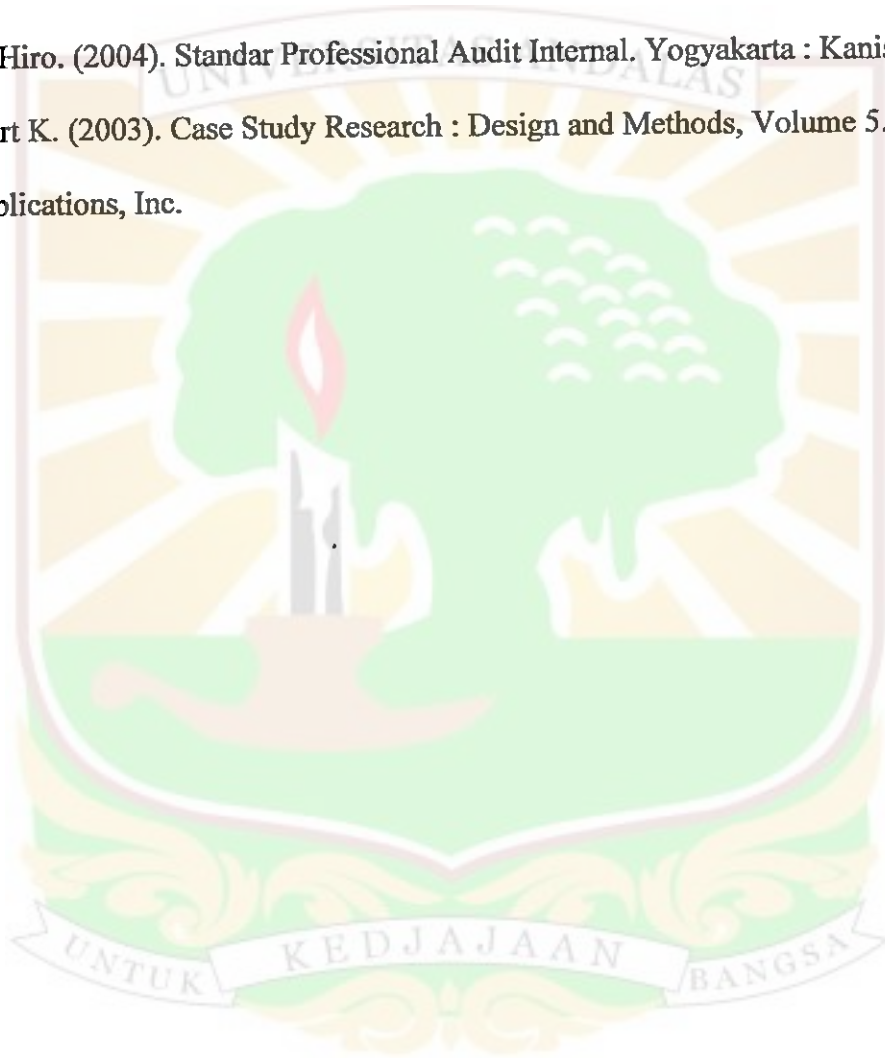
Generally, the division of supervision has been conduct the audit by independency with the adequate scope of audit. And also has been conduct the audit that including the assessment of adequate internal control system, the effectiveness of internal control system and the quality of performance. And the quality of internal control system has been enough satisfied. It can be seen From all five elements of internal control, in general Bank Nagari has implemented all of those elements effectively and accordance with the principles.

Therefore, Bank Nagari needs to more improve the quality of internal audit staff to make sure that they have enough understanding through the consistency and implementation of internal control system or make standardization for internal audit. And also to keep the development of ability, skill and knowledge from the staff of internal auditor, individual or group with the increasing the continuity of training, practice, course, seminar, and so on to be updated about the development of business world so that the internal auditor have enough knowledge to doing the job.

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LIST OF INTERVIEW QUESTION

A. Internal Auditing

1. Does Bank Nagari has an internal auditing function? If does, what is the name of this function?
2. Where is the position of internal audit team (Internal Audit) of PT. Bank Nagari in the organizational structure of the company?
3. What is the vision and mission of internal audit in Bank Nagari?
4. How does the independency act that become principle for internal auditor?
5. To whom does the internal auditor report their work?
6. Does internal auditor in Bank Nagari have the internal audit charter?
7. How does the structure of internal audit and the task of each internal auditor?
8. How is the mechanism of assigning or resigning the chief of internal auditor?
9. Does the director of internal auditor have periodically meeting with the board of management to discuss the auditing results? How frequent of those meeting?
10. What is the scope of internal auditing activity in Bank Nagari?
11. What kind of the auditing program that Bank Nagari has?
12. Do all the auditing program has been being approved before its executed?
13. How many types of audit in Bank Nagari? How long PT. Bank Nagari need to conduct the audit?
14. When the audit planning process is conducted?
15. Does every process of preparing the audit planning performed at the same time?
16. What party involved in preparing the audit planning?

17. What are the required data needs from the auditee (department to be audited)? Please describe the function and purpose of collecting individual data.
18. How is the way to cover up if the audit were found the deviations?
19. Does audit report is accompanied with recommendations?
20. Does the internal auditing has special criterion in choosing the staff auditing ?
21. Does the internal auditing department has special program for its internal auditor advance education?
22. Does the performance of each internal auditor is evaluated periodically?
23. What indicators show that the auditing internal function has been accomplished in Bank Nagari

B. Internal Control COSO Framework

24. What the purpose of internal auditor in Bank Nagari?
25. Does Bank Nagari conduct a risk assessment? When a risk assessment done? Please explain the process.
26. How many kinds level of risks in Bank Nagari?
27. What kind of accounting information that allowed to be distribute to the whole company?
28. Does the accounting system in this company has been designed to certain that all transactions is recorded and documented properly?
29. Do those transactions and documentation has been recorded in the financial statement on the right time?
30. Is there any system created to avoid the duplication of recording over the transactions components if the transaction is canceled?

31. Is there any action from management to avoid or to regulate the irregularities of employee? IF any, what kind of action taken?
32. How is the process of values communication within the company? Is it conducted through the statement of discretionary, code of conduct or through examples?
33. What are the consideration used by management to determined whether an individual is right for certain position in organization structure and the job description?
34. How is the internal control is implemented as usual? It overally from the top command for all function and assignment, or it is communicated first to each of representative leader and then distributed to their lower subordinates?
35. What kind of method used in Bank Nagari in selecting, promoting, training, and compensating the employees?

