

# Optimizing the Role of Internal Auditors as an Effort to Improve Financial Performance at Village Credit Institutions

## (Case Study in Pakraman Tukad Mungga Buleleng Village)

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### ABSTRACT

This study aims to determine the role of the internal auditor at the Village Credit Institution (LPD) in supervising financial management, prevention of non-performing loans and the efforts made to improve the quality of LPD performance. The type of research used is descriptive qualitative research. Instrument data in this study were conducted through interviews, observation, documentation and focus groups. In this study, the informants were the LPD Internal Supervisory Board, the LPD Chair and the management as the parties most aware of the LPD operational activities. The results of this study indicate that the success of LPD Tukad Mungga in maintaining its performance cannot be separated from the commitment of the management and also the role of the LPD's internal supervisory body which actively monitors the financial development of the LPD and also always cooperates with the Head of the LPD as the custodian of the institution. This is done as an effort to optimize the LPD's internal control. So from this internal control, it is hoped that the LPD's financial performance is getting better day by day. The management of the LPD will not succeed without the role of the internal supervisor as a party that also determines the direction of the development of the LPD in the future.

**Keywords:** Internal auditor, Financial performance, LPD.

### 1. INTRODUCTION

Traditional village is a traditional social organization. Traditional villages have economic rights in socio-economic terms which are the power to regulate relations between customary community groups and manage the wealth of traditional villages. Although a traditional village is an autonomous social institution, in designing and implementing a policy to protect, foster and realize an increase in the welfare of its people, the traditional village cannot be separated from the power of the government.

In Regional Regulation Number 8 of 2002 concerning Village Credit Institutions (LPD), it is stated that LPD is a village credit institution which is a savings and loan business entity owned by traditional villages. The purpose of establishing an LPD is to stimulate economic development of rural communities through savings and capital distribution, eradicating debt bondage and illegal pawning, as well as being able to generate equity and business opportunities for rural communities. In addition, the existence of LPD can increase purchasing power in

the form of smooth circulation of money in the village. LPD in its development is very instrumental for business development in the informal sector. In its development LPD can said to have been able to go beyond its initial goal of only financing religious and traditional activities. But now LPD has become one of the driving wheels of the economy in Bali. The family system full of simplicity that has been implemented in LPD management, shows flexibility in serving its customers. Un For this reason, LPD has been able to have a positive impact on empowerment in the Pakraman Village area in Bali.

Although LPDs are considered to have been able to provide welfare for village manners, on the other hand a number of LPDs have failed due to problems faced in carrying out their operational activities. The problems that are often faced by LPDs in carrying out operational activities to achieve goals in the economic sector are fraudulent actions in managing funds and the occurrence of bad loans. Basically, management for the advancement of the business of an institution engaged in banking such as LPD cannot be separated from the quality of its human resources in managing the company's finances itself. The

financial management of an institution is the most important thing that must be considered in realizing the company's goals, namely achieving optimal profits in accordance with the expected goals. To provide adequate assurance that the LPD's operational activities have been running as expected, the supervisory function is indispensable. In the LPD organizational structure, the LPD supervisory body is referred to as the Internal Supervisory Body. In Regional Regulation No. 3 of 2007 article 1 paragraph (11), what is meant by internal supervisor is a supervisory body formed by the village and tasked with supervising the management of the LPD.

LPD's efforts to realize conducive and effective internal control, the Bendesa Adat is given the power as chairman of the supervisory body who is believed to have authority and competence that is recognized in the Pakraman village environment. This will have an impact on the LPD's internal control will also be good. In addition to being required to know the overall operational activities of the LPD, Bendesa Adat is also expected to be able to provide managers with the information needed to carry out their responsibilities effectively. One of the roles of the Indigenous Bendesa in LPD operational activities is to participate in signing the customer loan application agreement (Sawyer, 2009)

Internal auditors have the authority as independent assessors to evaluate the operational activities of an organization by measuring and evaluating the adequacy of controls as well as the efficiency and effectiveness of the organization's performance. Internal auditors are parties who work in the company and have the main task of determining the appropriate policies and procedures set by top management, providing adequate protection of organizational assets, determining the efficiency and effectiveness of organizational activities procedures and determining the reliability of information, [1] . The role of internal auditors is very important in helping management achieve organizational performance and help improve organizational performance. This is an effort by management to achieve good performance by using a systematic procedure for evaluating, improving the effectiveness of internal control and taking notes on the findings of problems that occurred during the evaluation.

In the 2008 Bali Governor's Regulation concerning LPD Management and Supervisors, it is stated that a supervisory body is formed by the village to supervise the LPD management. In the regulation, it is also explained that the internal supervisory body in addition to overseeing the management of the LPD, is also tasked with providing advice and direction to the management, giving consideration and participating in solving LPD problems. In addition, the task of the supervisory body is also to socialize the existence of the LPD, conduct periodic performance appraisals of the management, compile and submit reports on the results of monitoring

during the village community. According to [2] the role of the internal supervisory body is very strategic. Apart from being an internal auditor, he is also a party that works together to work together to improve the progress of LPD management. The internal supervisory body dynamically oversees policies, operational implementation and accounting procedures as well as financial reporting procedures and if necessary can be a mediator between LPD management and external auditors. Research conducted by [3] states that internal auditors have a very important role in a company. This is because internal auditors have the ability to analyze problems that occur in financial management.

Supervision of LPD operational activities can be carried out by anyone who acts as an internal auditor in the Pakraman village regardless of the level and type of education. The scope of LPD supervision becomes wider and more complex when the number of assets owned by the LPD is greater, so that it directly requires adequate skills and insights. In connection with this, the role of the Bendesa Adat as an internal supervisory body in the existing organizational structure, must have clarity on the competencies possessed and a mindset that demonstrates its ability in the field of organizational governance, providing direction and advice, as well as full responsibility for the LPD. Research conducted by [4] internal auditors play a role in contributing to performance improvement. The same thing can also be seen from the results of research by [5], which states that internal auditors are an important part of corporate governance because they affect all stakeholders. The function of the internal auditor is believed to be very important for the growth of the company and the development of the country's economy.

Based on data on the health level of LPDs in Buleleng Regency in the Second Quarter of 2021 obtained from the [www.bulelengkab.go.id](http://www.bulelengkab.go.id) page, 169 LPDs spread across Buleleng Regency, 22 LPDs are in a "congested" position. Meanwhile, 84 LPDs are in a "healthy" position. One of the LPDs in Buleleng that has been able to maintain a good reputation and performance is the Tukad Mungga LPD. This LPD has the largest asset and is able to maintain its level of health. In addition, the Tukad Mungga LPD has a large number of employees compared to other LPDs, so of course the success of the LPD is due to the efforts made by the manager and the role of the LPD internal auditor who supports LPD operational activities. From the background described above, the researchers are interested in knowing and evaluating the optimization of the role of internal auditors in an effort to improve the financial performance of the Tukad Mungga Village Credit Institution.

## 2. LITERATURE REVIEW

### 2.1. Internal Auditor

[6] states that the definition of an internal auditor is an independent attitude that is able to provide adequate assurance that is intended to provide added value in an effort to improve the organization's operational activities. Internal auditors provide assurance that audit risk has been managed effectively and efficiently. [7] noted that fraud will be more easily detected if an organization has an internal auditor. [8] states that good internal control in an organization will be supported by a good internal auditor. Problems in independence, adequate expertise, professional attitude, scope of audit work, execution of work and management of the internal audit department are five general standards in auditing practices carried out by internal auditors.

### 2.2. Village Credit Institution

According to the Regional Regulation of the Province of Bali No. 3 of 2017, LPD is required to exist to ensure the realization of the welfare of the customary law community which is the Krama Desa Pakraman. LPD is a village economic body that has a function as a means to deposit funds, distribute credit, and become a source of funding in advancing village development in Bali [9]. LPD provides funds for operations and in order to achieve the goal of providing benefits to indigenous villagers.

In carrying out its business activities, LPD has the aim of obtaining profits generated from financial transactions. Efforts to support rural economic development, increase the habit of saving village manners and provide credit facilities to assist the small business sector are also one of the goals of establishing an LPD. Regional Regulation No. 2 of 2002, the Provincial Government of Bali stated that with the establishment of the LPD, forms of exploitation in providing credit could be eliminated. Equal opportunities for business activities at the village level as well as increasing the pace of the rural economy are expected to be achieved maximally.

An order for the objectives of the LPD to be achieved in carrying out its operational activities, the LPD requires sufficient capital, which is used to finance operational costs [10]. The function and purpose of the LPD is to provide business opportunities for local villagers, then to accommodate the existing workforce in the countryside, as well as facilitate the flow of money, as well as eliminate the existence of moneylenders [11]. Financial performance, which is reflected in the LPD's financial statements, is a tool that can be used to increase the level of trust of the traditional village on the performance of LPD management. Financial performance aims to determine the development of the organization in

carrying out its business in accordance with established procedures.

According to management theory, management functions in governance carried out by LPD management include planning, organizing, directing, coordinating, and controlling. All of these elements are believed to be able to support the achievement of organizational goals such as LPD [12]. The LPD as a village-owned financial organization gives the highest power to the Bendesa Adat as a reflection of the authority of the leadership of a Pakraman village manner.

To ensure that the authority for the existence of the LPD in Pakraman village is getting stronger, the government includes the Bendesa Adat as an internal supervisor in the management of the LPD. This internal supervisor is divided into core management and LPD staff. The LPD management consisting of the chairman, secretary and treasurer, has the task of coordinating the staff and is responsible for the management of the LPD. In addition, the LPD management through the internal auditor is also required to account for the management of the LPD as their duty to all village manners at the time of Paruman. The traditional leadership culture is still firmly held by LPD as a financial institution, in its operational activities by implementing modern banking management principles and management.

### 2.3. Financial performance

[13] states that financial performance is a study intended to measure the organization's achievement in carrying out its financial management procedures properly and correctly. Measurement of financial performance according to [14], as a report on government operational activities with the aim of assessing the financial performance of the organization effectively and efficiently and also monitoring actual cost activities with budgeted costs.

[15] mentions the elements of the company's financial performance as follows. Elements that are directly related to the measurement of company performance are presented in financial statements called profit and loss statements, net income is often used as a performance measure or as a basis for other measures. The main purpose of performance appraisal is to motivate employees in achieving organizational goals and in complying with predetermined standards of behavior in order to produce the desired results. The benefits of performance appraisal by management are:

- 1) Operational activities of the organization can be managed effectively and efficiently by increasing employee motivation to the maximum.
- 2) Decision-making can be taken with employees such as promotions, turnovers and dismissals.

- 3) Identifying employee training and development needs and providing selection criteria and evaluation of employee training programs.
- 4) Provide feedback to employees on how their superiors rate their performance.
- 5) Provide a basis for award distribution.

### **3. METHOD**

The type of research used in this research is descriptive qualitative research. The research used to examine the condition of natural objects where the researcher is the key instrument, the data collection technique is done by triangulation (combined), the data analysis is inductive, and the results of the study emphasize meaning rather than generalization [16]. Descriptive research by Moleong (2005) is defined as research that intends to understand the phenomenon of what is experienced by research subjects (eg behavior, perception, motivation, action) holistically and by means of description in the form of words and language, in a specific context. natural and by utilizing various natural methods. The research is directed at a detailed and in-depth description of the condition portrait of what is actually happening in the field. The data collected is in the form of words or pictures, so it does not emphasize numbers [16].

The research instrument is the means used to measure the data collection variables. In this study, the research instrument used was through unstructured interviews.

#### **1) Interview**

Interview is a form of communication between two people, involving someone who wants to get information from someone else by asking questions, based on a specific purpose [17]. Sugiyono (2007), interview is a meeting of two people to exchange information and ideas through question and answer, so that meaning can be constructed in a particular topic. Interviews were conducted to obtain information related to the role of internal auditors in LPD financial management as well as in efforts to prevent bad loans and fraud in LPD operational activities. In addition, to analyze the role of management in enforcing the provisions of the LPD legislation in the credit process starting from the stage of applying for credit from customers, assessing credit guarantees, processing credit approvals until the credit is disbursed, this is based on the Bali Governor Regulation of 2017 which clearly regulates how credit procedures at the LPD. In this study, interviews were conducted with the Bendesa adat as the LPD supervisory body in this case the LPD internal auditor and the LPD Chair.

#### **2) Observation**

Observations or observations in this study consist of focusing attention on an object by using all the senses [18]. The observations made are immortalized in the form

of images through the camera so that what is observed is documented and the accuracy can be relied on. The observed aspects and their explanations are documented in the form of a manuscript which will be used as material for analysis.

#### **3) Documentation**

The researcher also conducted a documentation study, namely studying documents related to the role of internal auditors in the LPD. Documentation in this study was carried out by recording written regulations regarding the main duties and functions of each manager in the LPD organizational structure.

#### **4) Focus groups**

It is a technique that can be used where individuals are selected in groups and directed to discussions that focus on pre-specific topics (Rahayu, 2011). Focus groups will be conducted on internal auditors in LPD to obtain information related to optimizing the role of internal auditors in an effort to improve LPD financial performance.

## **4. RESULTS & DISCUSSION**

In an organization, the role of internal auditors is needed and becomes very important, because internal auditors are a monitoring element of the internal control structure in an organization that is made to monitor the effectiveness of every other part of the internal control structure. As a form of responsibility in carrying out their duties, internal auditors are required to be able to provide effective information required by management. Internal auditors can be independent assessors in conducting reviews of the organization's operations, measuring and assessing the implementation of effective and efficient internal controls so that internal auditors can evaluate the organization's financial performance. Internal auditors who are in the organization have the main task of determining the policies and procedures that have been set accordingly by management, finding out whether or not the protection of the organization's assets is good, determining the efficiency and effectiveness of activity procedures and determining the reliability of information [17].

Internal auditors in organizations such as the LPD, chaired by the Bendesa Adat, are required to fully understand the LPD's operations and the level of progress achieved. In the regulation of the Governor of Bali No.18 of 2008, it is explained about the SOP (Standard Operating Procedure) of the LPD Internal Supervisor which includes; supervise the management of the LPD, provide instructions to the LPD, provide advice, consideration and participate in solving problems, socialize the existence of the LPD, evaluate the performance of the management on a regular basis,

compile and submit a report on the results of supervision to the village community.

The results of the internal auditor's evaluation can be used as a benchmark for the organization's achievement of the established policy direction. Initially, the role of internal auditors was as management supervisor because management needed certainty regarding the implementation of policies that had been set to avoid fraudulent actions. However, over time, the role of internal auditors has shifted to become a consultant for the organization. In operational work units, internal auditors can help manage risk by identifying problems and providing suggestions for corrective actions that can add value as a stimulus in strengthening the organization. Thus, it functions to assist management in preventing, detecting and investigating fraud that occurs in an organization.

Internal auditors at the LPD function to provide oversight of the organization's operations and to monitor the effectiveness of the elements of the internal control structure. This is because the LPD really needs good management by the management and the supervisory body because the LPD is one of the assets and incomes owned by traditional villages. Prevention of abuse of authority and fraudulent practices that can harm the LPD must be carried out adequately and thoroughly. So that the course of the LPD's operational activities, especially in terms of lending which is the main business of the LPD, must always be monitored by the internal supervisory body.

#### **4.1. The Role of Internal Auditors in Supervising Financial Management**

As already mentioned, the role of the auditor in overseeing financial management and preventing fraud is very important to ensure that the LPD's internal control system is running well. From the results of interviews conducted with the internal auditors at LPD Tukad Mungga I Ketut Yasa, S.H, it is known that the internal auditors always carry out monitoring and evaluation and are directly involved in supervising the operational activities of the LPD. Especially if there are problems that arise, especially in the bookkeeping system. According to [2], the internal supervisory body dynamically synergizes and becomes a partner in efforts to advance the LPD. The supervisory body is expected to be able to actively monitor and evaluate policies, operations and accounting records and financial reporting as well as being able to become a liaison between LPD management and external auditors.

Supervision of LPD operational activities can be carried out by anyone who acts as an internal auditor in the Pakraman village regardless of the level and type of education. The scope of LPD supervision becomes wider and more complex when the number of assets owned by the LPD is greater, so that it directly requires adequate

skills and insights. In this regard, the role of the Adat Bendesa as an internal supervisory body in the existing organizational structure must have clarity, technical expertise and a mindset that demonstrates his ability in the field of governance, providing direction and advice, and full responsibility for the LPD.

The results of the interview concluded that the evaluation carried out by the supervisory body as an internal auditor on financial management, including the development of bad loans at the Tukad Mungga LPD, carried out through an integrated system, had a significant impact on the sustainability of the LPD. Supervision by internal auditors within the LPD is one form of the implementation of the internal control system as an effort to minimize business risk and can provide confidence that the standard operating procedures that have been established cannot be misused by various parties that can harm the LPD and village manners.

#### **4.2 The Influence of Internal Auditors in Efforts to Prevent Bad Loans**

In accordance with Perda No.3 of 2007 article 1 paragraph (11), the definition of internal supervisor is a supervisory body formed by the village and has the task of evaluating the management of the LPD. The head of the supervisory body held by the Bendesa Adat is intended to realize an effective and efficient internal control system.

From the results of interviews conducted by internal auditors as well as to the head of the LPD, it is known that the LPD implements an operating procedure system (SOP) set by the Bali Regional Development Bank. In six stages of loan collection to customers, LPD will carry out monitoring. If the customer does not heed the billing stages, the LPD will go to the customer to his house and ask for clarification and the possibility of granting an extension of the credit repayment period. However, if the policy is not implemented, the LPD will apply the final procedure, namely taking over the guarantee by deliberation so that the customer will understand the conditions and risks that occur due to the funds that are not returned. To ensure the continuity of the LPD, the LPD must dare to act and obey the applicable procedures, because even though the customer is the karma of the customary village, the provisions in carrying out LPD operational activities must still be carried out to prevent the LPD from collapsing due to the large number of uncollected loans.

Another thing related to the involvement of internal auditors in preventing bad loans is that the customary village heads are involved in the credit agreement. Because in applying for credit there is no difference in the procedures carried out. Regardless of the loan amount, the procedure will be the same. The steps that must be taken in applying for credit are making a credit application, then doing a credit analysis, credit

memorandum, credit decision letter, and finally an agreement. In applying for credit, the difference is the collateral used depending on the amount of credit submitted by the customer.

#### 4.3. What Efforts Are Taken By LPD In Improving The Quality Of Performance

The quality of LPD financial performance is a study conducted to determine the LPD's ability to carry out financial management procedures properly and correctly. Through evaluation of financial performance by the parties involved, such as traditional villages, administrators, customers and the LPD supervisory body, they can benefit from the information presented in the financial statements. This information can be used as a basis for assessing the health level of the LPD. Through this health rating, the development and capability of the LPD as a village financial institution can be known. Because the LPD is a village financial institution consisting of customers from the adat village itself, of course it cannot carry out its operational activities without the trust of the community.

From the interviews that have been conducted, it is concluded that in improving the performance of the LPD, the main thing that must be done is to always stick to the commitment to seriously manage and strive so that the LPD is able to survive in the midst of the rise of bankrupt LPDs. There is a need for cooperation between the Internal Auditor, the Chair and the Management to synergize, coordinate and monitor the movement of the LPD. In an effort to improve this performance, the LPD still feels the need to make improvements so that its financial management is supported by good and competent human resources. Useful trainings for administrators to prepare strategies that can maintain the continuity of the LPD in the future.

### 5. CONCLUSION

The role of internal auditors is very important in financial management and improving LPD performance. From the results of the research that has been carried out, it can be seen that the success of the Tukad Mungga LPD in maintaining its performance is inseparable from the commitment of the management and also the role of the LPD internal supervisory body which actively monitors the financial development of the LPD and also always coordinates with the LPD Chair as the leader at the institution. This is done as an effort to optimize the LPD's internal control. So from this internal control, it is hoped that the LPD's financial performance is getting better day by day. The management of the LPD will not succeed without the role of the internal supervisor as a party that determines the direction of the development of the LPD in the future.

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