

Top Management Commitment as a Potential Variable to Explain Successful Implementation of Risk Based Internal Audit

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The approach to conducting audits has changed, but local governments in Indonesia have not yet implemented a risk-based audit approach. There are many potential benefits to local government, if internal auditors use this approach. Among them is being able to overcome the relatively small number of internal auditors compared to organizational units and the risk of fraud. There are several factors that are thought to influence the successful implementation of risk based internal audits. These factors include communication, the role of the internal audit function, training, commitment and the application of risk management. This research was conducted in several local governments in the province of North Sumatra and the target population comprises internal auditors in the local government. To answer research questions, data analysis uses the PLS application with a structural approach. The results show that communication, the role of the internal auditor function and the application of risk management significantly influence the successful implementation of risk based internal audit. Whereas the training and commitment from the peak pipeline did not have significant effect. The training conducted so far has not provided effective results and there are even indications that the process is a waste of state money. Training models such as in house training and ongoing training should be established. Continuing professional development is needed to improve the quality of internal auditors.

Key words: *Risk based internal audit, risk management, internal auditor role, leadership commitment.*

Introduction

In recent years, the level of fraud committed by both local and central government officials has increased. This can be seen with some officials who have been named as suspects and are currently undergoing litigation. This fraud would be detected early if the internal auditor performed its functions appropriately. There are several obstacles to the detection of fraud by internal auditors, including because the number of internal auditors is relatively low compared to the objects they have to monitor, so their workload is too high. In addition, the number of certified internal auditors is also relatively small, so it is suspected that, when in conducting examinations, the quality of their work is also relatively low. The question is whether the local government internal auditors are able to develop the audit task within various existing constraints which include: limited audit staff with an accounting background; lack of training; high transfer of audit personnel to other agencies and the limited understanding of leadership itself.

There is an audit approach that can be applied in local governments within these existing various limitations for local government internal auditors; the risk-based audit approach which is often known as the risk-based internal audit. This approach is a risk-based audit that links internal audit with the organization's overall risk management framework. Through the Risk Based Internal Audit method, internal auditors ensure that all organizational risk management processes are carried out effectively. Conducting a risk-based audit approach, is expected to identify the risk of failure, error, and fraud. A potential benefit for internal auditors when using a risk-based audit approach is improved efficiency and effect in conducting audits so as to improve the performance of internal auditors.

The phenomenon that is currently occurring is that the quality of district / municipal auditor's internal work is still relatively low in achieving its supervisory function. This can be seen from the results of the examination of the Supreme Audit Agency (SAA) on the implementation of the management of the Regional Government Budget (RGB) in the District / city Government in North Sumatra Province where frauds were identified that had not been found by the City Regency internal auditors. The SAA's findings indicate that internal auditors have not been able to carry out their roles and functions and indicate the inability of internal auditors to detect and assess potential fraud.

In recent years, there has been a shift in the auditing approach, namely from a system based audit to a process based audit and the current approach is a risk based audit. With this shift in the auditing approach, a lot of research related to Risk Based Internal Audit (RBIA) has been generated (Eshikhati (2012), Kirogo et.al (2014), Nyarombe et.al (2015). Eshikhati examined the factors that influence the adoption of public sector risk based audits in Kenya. RBIA was found to be a complex process that tended to continue for several years. Successful

implementation of RBIA requires careful design and implementation. For RBIA to be adopted successfully, managers have a large role to play because they must ensure that resources are available for the internal audit function. Human resources support is very important because in implementing the RBIA process and the availability of resources must be ensured because it makes auditor work easier and accelerates their implementation.

This study is a follow-up study conducted by Erlina et.al in 2018, the results of their research concluded that what was crucial in the successful implementation of RBIA was top management commitment. Without top management commitment, quality human resources and a good regulatory framework, the application of Risk Based Internal Auditing will not succeed. Using the RBIA approach is needed to focus on the application and effectiveness of risk management procedures, risk assessment methodologies, critical evaluation of the adequacy and effectiveness of internal control systems. The role of the auditor will change in that they will suggest steps to reduce risk and identify potential risk areas.

Literature Review

Agency Theory

Agency theory explains the agency relationship that arises from the contract between the agent and the principal, where the agent performs tasks for the benefit of the manager. Differences in interests between agents as company management and capital owners / shareholders can occur in the implementation of agency relationships. Shareholders / owners of capital give the mandate or authority to the agent to carry out and make decisions for the company's operational activities based on agreements or contracts that have been agreed on by both parties. Mandates are given to agents to carry out company operations in accordance with specified limits. To ensure effective company operational activities, control from shareholders / owners of capital is needed because the agent will seek personal gain for his work. As the principal also has an interest in the company's operations, the relationship between the agent and the principal often creates a conflict of interest. This conflict occurs because each individual tries to obtain their own benefits, which can lead to information asymmetry; the difference in information between the interests of agents and principal interests.

Financial statements prepared by management as agents cause information asymmetry due to differences in interests. Therefore, an independent third party is needed, so that financial reporting is fair and responsible, as well as in the process of implementing Risk Based Internal Audit. Agency theory that explains the relationship between principals and agents is rooted in economic theory, decision theory, sociology, and organizational theory. Agency theory analyzes the contractual arrangement between two or more individuals, groups or organizations. One party makes a contract, implicitly or explicitly, with the other party

(agent) with the hope that the agent will act / do the work as desired by the principal (in this case the delegation of authority occurs). Lupia & McCubbins (2000) state that delegation occurs when one person or group, a principal, select another person or group, an agent, to act on the principal's behalf.

Agreements are formed in institutional structures at various levels, such as behavioural norms and contract concepts. The institutional environment also influences the formal rules that apply, legislation (which regulates institutional responsibilities and competencies), budget procedures, and governance structures in which the budget process is carried out, and transactions are negotiated, monitored and enforced.

The economic and political perspective of Waterman and Meier (1998) criticize the assumptions that pose problems with conventional agency relationship models, namely conflicts of interest and asymmetric information. They develop assumptions of problems within a broader theoretical framework from a political, bureaucratic and budgetary perspective. Meanwhile, other researchers such as Mitnick (1973), Thompson and Jones (1986), McCubbins et al., (1987), Christensen (1992), Fozzard (2001), Lupia (2001), and Shapiro (2005) looked at agency relationship models as an alternative to the control system analysis in formulating and executing budgets.

Risk Based Internal Audit

The Risk Based Internal Audit approach is a method used by the auditor to determine the audit procedures to be carried out; that is based on risk; or an indication that there is a greater likelihood that a transaction or level of transaction, account or balance, and / or disclosure of misstatements, so that the auditor can achieve the audit objectives. Risk-Based Audit, which focuses on recorded and unrecorded risks, increases financial statement guarantees and the financial reporting process. The higher the risk area, the more audit time and client control are needed. In addition to focusing on the level of risk, risk-based methods help to evaluate and build value into the financial reporting process. To do this, the auditor must have the latest insights. The knowledge gathered can help design an audit program that includes the most effective and efficient combination of tests that is responsive to each client's unique circumstances. For this reason, the risk-based approach is then superior to traditional audit methods (Gibson, 2003).

Although the risk-based audit approach has been widely used as a tool for internal control systems in the public sector, many scandals continue to reappear every year, what remains unclear is whether the risk-based approach is ineffective or the method of implementation is inappropriate. Perhaps the personnel involved in applying the risk-based audit approach, have spent a lot of funds and more needs to be done to justify the costs of implementing a risk-



based audit approach. Therefore this study seeks to establish the effect of the risk-based audit approach on the implementation of internal control systems.

Goodwin-Stewart and Kent (2006) state that internal audit plays an important role in monitoring company risk profile and identifying areas to improve risk management. The object of internal audit is to improve the efficiency and effectiveness of the organization through constructive criticism. In general, internal auditing has become an indispensable management tool for achieving effective control in both public and private organizations. RBIA is a methodology that connects internal audit with the organization's overall risk management framework. Through RBIA, internal auditors ensure that all organizational risk management processes are carried out to manage risks effectively.

The RBIA process allows internal audit reviews to be more focused on the business needs of the authorities and consequently the services / functions under review. Management will benefit from greater input into the form of audit reviews, ensuring that key concerns and significant perceived risks are considered within the scope of the audit. The review will be more holistic, focusing not only on financial risk but also other areas of business risk and corporate governance.

Why is there a need for the internal auditor to change the paradigm when from the beginning they have been part of the organization and serve to support the management? Internal auditors have indeed been designed to be part of the organization and support management and therefore, internal auditors must have the same language and orientation as management. Unfortunately the old paradigm of internal audit does not use the same language as management. The old paradigm that emphasizes the aspect of control (control-based) is considered no longer relevant because it is not directly connected to the focus of management objectives. Focusing on control aspects may direct the auditor to areas / fields that are not actually the focus of management objectives. As a result, internal audit results do not have a direct impact on the achievement of objectives.

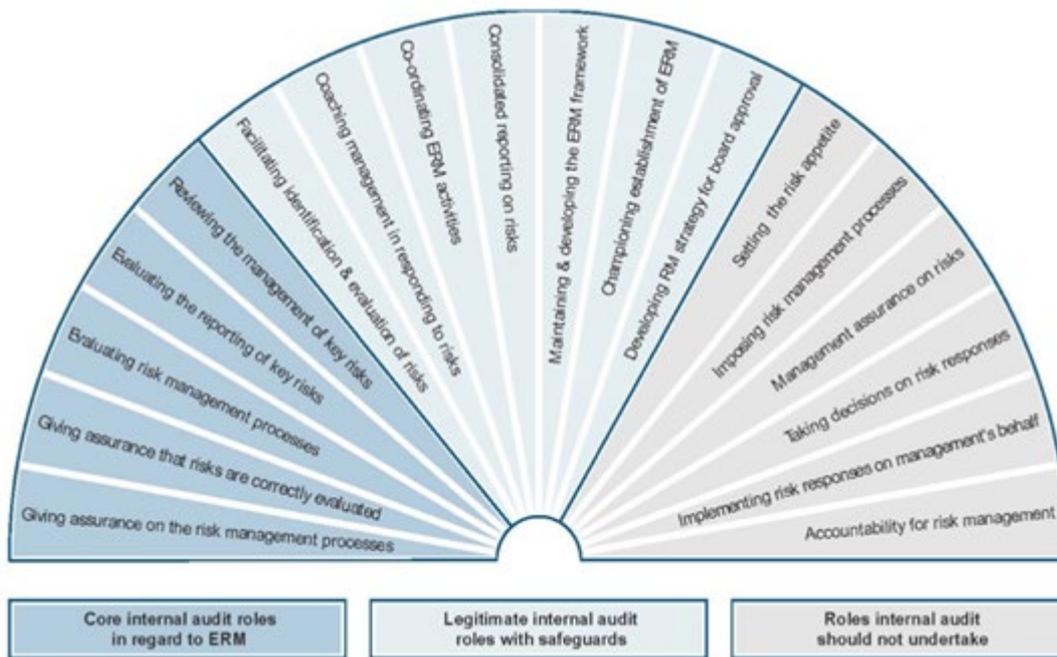
Internal auditor attention was shifted by this RBIA paradigm, to focus more on risk. Risks are factors that hinder the achievement of organizational goals. Focusing on risk makes the auditor the same language as the will of management. It is also expected that the achievement of organizational goals will be easier because the risks have been well identified and all handling measures have been tested for reliability through the internal audit process. Even though the auditor has focused on risk, management still needs help with control issues. The priority is on control that directly impacts the achievement of objectives. In fact, internal auditors are required to have more ability to be able to link control with the overall goals and risks of the organization. Thus, through RBIA the perspective of the internal auditor is made wider and more comprehensive.

The Role of the Internal Audit Function

Internal auditors within the local government environment in Indonesia are called the Inspectorate. Currently the internal auditor's function is still as a conventional internal supervisor. The internal auditor's role should be to assess and advise on risk management, control and governance processes. As a result of changing organizational needs, technology and the complexity of the organization's activities and systems, the nature of the services sought from internal auditors has changed over the years from an emphasis on traditional compliance audits and as such, independence has become the main paradigm for the role of embodying values in which partnerships with management are given meaning greater (Abdolmohammadi et al., 2006).

Internal auditing is an independent, objective and consultative activity. Its core role is to provide an objective guarantee to the board on the effectiveness of risk management. Indeed, research has shown that the board of directors and internal auditors agree that the two most important ways that internal audit adds value to an organization are in providing objective guarantees that key business risks are managed appropriately and providing guarantees that risk management and internal control frameworks operate effectively.

Figure 1. The role of internal audit in ERM



Sources: *The Institute of Internal Auditors (IIA).*

Top Management Commitments

The commitment of top management is one of the factors that greatly influences the implementation of Risk Based Internal Auditing (RBIA) due to the support of strong leaders and better governance structures. The agreement and active involvement of the head of internal audit, senior management, audit and accounting staff and senior operational management can encourage an independent evaluation of the effectiveness of risk management, control and governance (Van Gansberghe, 2005).

Top management plays an important role in implementing RBIA, because such decisions involve commitment of resources and organizational change. Top management commitment is needed to identify whether the organization shows genuine interest in implementing RBIA. Wijethilake et al. (2017) emphasized that although organizations maintain the old audit approach as a guideline for conducting audits, top management commitment is the main indicator that determines the successful implementation of Risk Based Internal Auditing (RBIA). Without the leadership commitment, it is difficult to implement RBIA. Although RBIA is about risk-based auditing, this can only be achieved if leadership is efficient and the processes within the organization are in line with standards. It was found that management commitment affects the performance of all profitable organizations. Other important responsibilities of top management are building an environment with valued performance where management is able to motivate workers, establishing relationships where companies treat employees fairly and well and ensuring phases that emphasize principles where managers better utilize the creativity and imagination of their employees in the application of RBIA.

Risk Management

Ivanyos (2016) states that in accordance with ISO 31000 standards, risks arise as an impact that can be a positive and / or negative deviation from what is expected. The definition is far broader than traditional (control-based) applicable product probabilities and effects of negative problems. Strategy, Strategy, Strategy, Strategy, Strategy, Strategy, Management, Risk Management as a substitution, it must consider the significant effect of "persistent" (factual but difficult to consider) substitution on the objective, based on the best available information. This article is translated as fact. This article is translated from English to Indonesian. Related articles do not have relevant topics.

Some organizations recognize that well-coordinated risk management and internal audit functions are needed to support management and the board in managing finances to achieve business goals. Risk management has four main phases to implementation: risk identification, risk assessment, risk priorities and response planning in addition to the final monitoring phase. According to the standard approach, the monitoring phase risk must depend on internal auditing. In addition, several standard bodies clearly emphasize the importance of achieving

independent and objective guarantees in monitoring risk management activities and ensuring that the internal audit mission must comply with it. Fraser et al (2010) states that there are separate roles for internal auditors and risk management functions. In addition, they limit the role of internal audit by providing top management with independent guarantees regarding the effectiveness of risk management, by ensuring the effectiveness of controls, the risk management process, managing key risks, and reliability, in addition to the appropriateness of assessing and reporting risks and controls. Specifically, achieving independence and objectivity in this activity seeks separation in the role between risk management and internal audit (Bazerman et al, 1997).

Governance activities and capabilities that are applied at the organizational and operational level support the effectiveness of risk management. The implementation of recommendations from the risk management model or approach applied cannot be evaluated and verified directly but only by examining the extent to which they are embedded in governance and control of operational processes, planning, decision making and reviewing organizational procedures, comprehensive governance policies and recording systems organization. Based on this, the quality of risk management can be better captured by assessing the ability of an organization's governance.

Research Hypothesis

This research was conducted using qualitative and quantitative approaches. A qualitative approach was used to formulate the first problem, while with the second problem formulation, the research team used a quantitative approach where the alleged factors were hypothesized from previous research. The hypotheses are as follows:

1. The commitment of top management has a positive effect on the successful implementation of Risk Based Internal Audit (RBIA).
2. The role of the internal audit function has a positive effect on the successful implementation of Risk Based Internal Audit (RBIA).
3. Risk management has a positive effect on the successful implementation of Risk Based Internal Audit (RBIA).

Methodology

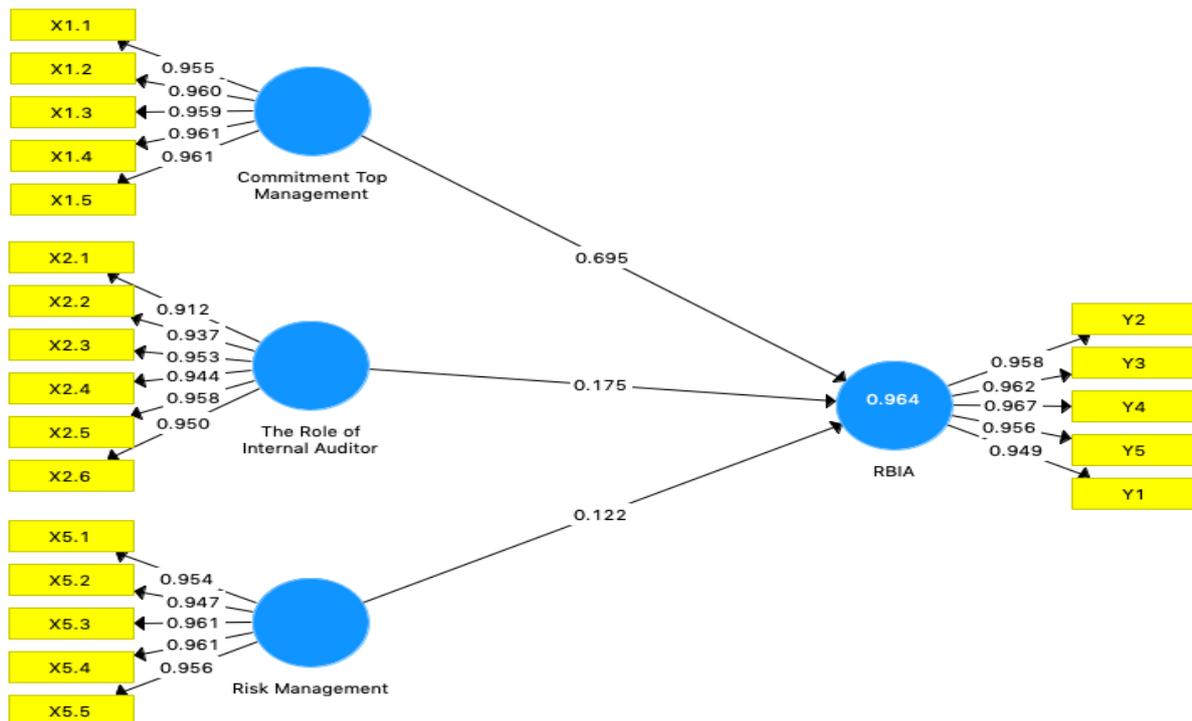
This research is causal research. The research hypotheses were tested using the PLS application. The population in this study comprise the budget users of several regencies / cities in North Sumatra Province. Data analysis used to answer hypothesis testing was conducted using descriptive statistics and Structural Equation Model (SEM) analysis. Analysis of the data obtained in this study will use a statistical tool that is SmartPLS (Ringle

et al, 2015). Partial Least Squares Analysis (PLS) is a multivariate statistical technique that makes comparisons between multiple dependent variables and multiple independent variables (Ghazali & Fuad, 2014). The evaluation of the PLS model is achieved by evaluating the outer model and the inner model. Outer model is a measurement model to predict the relationship between indicators or parameters estimated with their latent variables, while the inner model is a structural model to predict causal relationships between latent variables.

Results and Discussion

The outer model test starts with estimating or estimating parameters. Convergent validity test is made by looking at the value of the loading factor in each construct. A loading factor value above 0.7 is stated as an ideal or valid measure as an indicator in measuring constructs, values 0.5 to 0.6 can still be accepted, while values below 0.5 must be excluded from the model (Ghazali, 2008). Based on data calculations using the PLS algorithm method, the loading factor value of each indicator variable is as presented in Figure 2 below.

Figure 2. Loading Factor



Sources: Smart PLS Result (2019).

Based on Figure 2 above it can be seen that all indicator items are declared valid, this is seen in the loading factor value greater than 0.7. Based on the results of processing Cronbach's alpha value and the composite reliability of each variable above 0.7, it was found that all latent variables are reliable. The PLS Algorithm Smart PLS program results in assessing the

value of the path coefficient and R-square which can be seen in Table 1 below.

Table 1: Path Coefficient Values

	Original Sample	Sample Mean	STDEV	<i>t</i>	<i>p</i> Values	Decision
Commitment Top Management -> RBIA	0,695	0,690	0,093	7,452	0,000	Accepted
Risk Management -> RBIA	0,122	0,121	0,061	2,015	0,044	Accepted
The Role of Internal Auditor -> RBIA	0,175	0,182	0,099	1,764	0,078	Accepted

Sources: SMART PLS Result (2019).

The variable of organizational commitment, risk management has a significant positive effect on the successful implementation of RBIA, while the role of internal auditors has a significant effect with a significance level of 10%. The results of the research with a quantitative approach concluded that the communication process, the role of the internal auditor function, and the application of risk management have a positive and significant influence on the successful implementation of RBIA. Whereas the training and commitment of top management has no effect on the successful implementation of risk management. The commitment of top management is seen as very important in all regional organizations for the effective implementation of the RBA. Employees at all levels of the organization feel that top management does not support the implementation of RBIA. Respondents recommend internalization of the principles of strategic risk management so that all employees become more effective.

The results showed that the commitment of top management did not significantly influence the successful implementation of RBIA. This contradicts the literature review and the results of previous studies. From the results of interviews with several respondents, there is a tendency for leaders not to care so much about risk based internal audit, they do not understand the benefits of applying a risk based audit approach. Respondents face challenges and misunderstandings about how the auditor determines several audit procedures during the audit. Respondents feel that they do not have independence in carrying out their duties, it is difficult to conduct supervision that is more focused on an activity that is considered to have a high level of risk of errors and fraud, often OPD considers that the inspectorate seems to only find fault when they try to detect illegal acts and / or fraud. While on the one hand, users of audit reports have high expectations of the inspectorate in meeting and handling the audit findings.

Often the inspectorate is disappointed because the audit findings are not followed up on. Respondents felt their role in carrying out their functions as an internal audit had limitations. Significant criticism and litigation of the inspectorate as the inspection apparatus shows a gap between the public expectations of the auditor and the auditor performance perceived by the organization. Based on the results of the study, clarity of the role of the inspectorate function is needed so that the application of risk based internal audit runs well. In the local government, both the auditee and the auditor do not understand the role of the internal auditor in the stage of risk based internal audit. This clearly will hamper the process of implementing a risk based internal audit. If the auditee and auditor understand the stages of implementing RBIA raised by Griffith, then the application of RBIA will run smoothly.

The success of the implementation of risk-based audits is dependant on all organizational units, in this case regional organizations have implemented risk management. If regional government organizations have not yet implemented risk management, it is difficult for auditors to conduct risk-based audits. Internal auditors can provide consulting services that improve organizational governance, risk management, and control processes. The level of consultation of the internal auditor will depend on other resources, internal and external, available to the board and on the maturity of the organization's risks and likely to vary from time to time. The expertise of internal auditors in considering risks, in understanding the relationship between risk and governance and in facilitation entails that internal audit activities are eligible for action, especially in the initial stages of introduction.

When organizational risk maturity increases and risk management becomes more inherent in business operations, the role of internal audit in fighting for risk management can be reduced. Likewise, if an organization uses the services of a specialist or risk management function, internal audit is more likely to give value by concentrating on the role of the guarantee, rather than by carrying out more consulting activities. However, if the internal audit has not adopted the risk-based approach represented by assurance activities it is not possible to be equipped to carry out consultation activities at the centre.

Internal audit can expand its involvement in risk management with certain conditions:

1. It must be clear that management remains responsible for risk management
2. The nature of the responsibilities of the internal auditor must be documented in the internal audit charter and approved by the audit committee.
3. Internal audits must not manage any risk on behalf of management.
4. Internal audits must provide advice, challenges, and support for management decision making, not risk management decisions themselves.
5. Internal audit also cannot provide objective guarantees on any part of the ERM framework for which it is responsible. Such guarantees must be provided by other qualified parties

accordingly.

6. Any work outside of guarantee activities must be recognized as a consultation engagement and implementation standards related to the engagement must be followed.

The main role of Internal Audit is to provide assurance to management and the board of the effectiveness of risk management. When guarantees cannot be given, responsibility rests with management to implement the appropriate response. Internal audits may still make recommendations, but this is part of the 'consulting' role. In the context of RBIA, internal audit can only provide guarantees where there is a risk management framework. By maintaining its independence, internal audit can conduct its assessments objectively, provide management and board an informed and unbiased governance process including risk management, and internal control. Internal audits strengthen corporate governance through risk-based audits that provide assurance and insight into the processes and structures that drive organizations towards success. As risk grows and becomes more complex, the role of internal audit is likely to develop in areas such as risk management, culture and behaviour, sustainability, and other non-financial reporting measures.

Based on interview results, some respondents concluded that the local government was not ready to be examined using a risk based approach. In addition, the research team concluded that some of the respondents lacked understanding of the RBIA and were unable to explain the process that had to be carried out to implement Risk Based Internal Audit. In an effort to increase adoption of RBIA, respondents recommend strengthening auditor performance monitoring, improving the quality of supervision throughout the OPD, improving the education of audit practitioners, introducing new audit standards, and educating the public about the audit function and auditor's work. Most respondents talked about the need for an approach to increase the level of user understanding and reduce differences in perception. Overall, the main solution lies in increasing the level of auditor independence and auditor responsibility with more punitive measures to reduce government reporting scandals so as to open the way to improve audit quality.

Conclusions

Regional financial management is currently showing poor results as can be seen from an examination of Regional Government Financial Reports. The poor management of regional finances in Indonesia can also be seen from various cases of acts of corruption that have occurred. Today in Indonesia the eradication of corruption is a crucial and important focus, as freedom from corruption is a measure of the success of national governance. Therefore, in creating healthy and viable government conditions, it is necessary to apply risk management by conducting an audit, conducted by an auditor and in this case the intended auditor is an internal auditor. The risk-based internal audit approach is an alternative to carrying out the



audit function in order that operations run effectively and efficiently.

Based on the results of the data analysis, the study result conclusions can be summarised as:

1. The level of understanding of auditees and auditors regarding risk management and Risk Based Internal Auditors is relatively lacking.
2. There are 4 factors that are most dominant influencing the successful implementation of Risk Based Internal Audit in the local government environment, namely (1) the role of the Internal Auditor's Function, (2) the commitment of top management, and (3) the application of risk management.

Based on the results of interviews and conclusions of this study, the research team suggest 4 stages that must be carried out by local governments in implementing Risk Based Internal Audit within the local Government environment. These stages are developed from the stages that initially conceptualized by Griffiths.



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