

THE EFFECTS OF IMPLEMENTATION ON INTERNAL AUDIT AND GOOD CORPORATE GOVERNANCE IN CORPORATE PERFORMANCE

Evi Octavia
Widyatama University

ABSTRACT

The purpose of this study was to determine The Effects of Implementation on Internal Audit and Good Corporate Governance in Corporate Performance. This research is motivated by the phenomenon of state owned companies in Indonesia that suffered losses. Reports on the audit of the five state-owned companies of all quantitative findings are losses due to inefficiency USD. 8.5 trillion and 1.6 billion dollars, the potential losses that occurred amounted to Rp. 7.3 trillion and 698 million U.S. dollars.

The units of analysis in this research are state-owned company in Bandung. The method of this research use descriptive research. It used an explanation (explanatory research) with descriptive and verification method approach because it explains the causal relationship between variables by testing the hypothesis, and data analysis on this study using multiple linear regression method.

The result of the implementation on internal audit and good corporate governance has a significant impact on company performance.

Keyword : *Internal Audit, Good Corporate Governance, Company Performance*

1. INTRODUCTION

State-Owned Enterprises (SOEs) is required as the motor of the country's economy. SOEs in Indonesia have not been able to work efficiently. From the audit report on the five state enterprises, the numbers of overall quantitative findings are losses due to inefficiency in Rp 8.5 trillion and 1.6 billion dollars. But not only that, there are also potentials losses that amounted to Rp 7.3 trillion and 698 million U.S. dollars. The most important of the SOEs is the opportunity to save money are still remain open in order to gain advantage in the amount of Rp 776 billion, and 147 dollars and profit of Rp 64.6 billion per year.

Zhuang (2000) in Yudha Pranata (2007) showed the weakness of Indonesian public companies in managing the company compared to Southeast Asian countries, this indicated by the lack of standards accounting and regulations, accountability to shareholders, the standards of disclosure and transparency as well as the processes of management of the company. This implies the weakness of Indonesian public companies on implementing good management company in satisfying stakeholders.

Theoretically, implementation of good corporate governance can consistently produce a reliable company for the shareholders and stakeholders (Dede Suryadi, 2008). Socialization of the need for the implementation of Good Corporate Governance (GCG) has started in Indonesia, both among academics and practitioners, both in the private sector and government. Emerge in the U.S. financial scandals ranging from Enron, Xerox, Merck to emphasize that the needs of Good Corporate Governance (GCG). Good Corporate Governance (GCG) needs to be applied because, in principle, is to create a rule for corporate objectives can be achieved through a good governance mechanism by the board of directors and management team. Thus the company is ready to enter the competition at the global level. (Dede Suryadi,, 2008)

Implementation of Good Corporate Governance in SOEs is norms or guidelines that required the corporation in a healthy state management system and to further improve the performance of SOEs, the implementation of good corporate governance principles need to be further optimized, so that was decided by the decision of the Minister of State Owned Enterprises on the implementation of Good practice Corporate Governance of State-Owned Enterprises through number 117/M-MBU/2002. The decision was SOEs are required to apply good corporate governance or make consistent and good corporate governance as the cornerstone of their operations.

Implementation of Good Corporate Governance is the control mechanism to regulate and manage the business with a view to increasing prosperity and corporate accountability, which ultimately aim to create shareholder value. This opinion is supported by Newel and Wilson (2002) in his article entitled "A Premium for Good Governance" in Dede Suryadi (2008) they stated that theoretically the practice of good corporate governance can increase the value of companies such as improving the performance of public companies, reducing risk of harm due to management actions that tend to benefit himself / herself, and general corporate governance to enhance investor confidence. With the implementation of GCG, the public and stakeholders will assess whether incentives or penalties. Incentives in the form of "trust" while penalties form of damage to company image or reputation for the quality of the implementation of Good Governance. Related to the assessment which would determine the financial performance in the long term, we expect a larger role than the accounting profession in general and internal auditors in particular. Internal audits should be able to answer these challenges by improving the quality of his work so that its presence can provide a significant added value efficient and effective. Corporate governance also provides a structure that facilitates the determination of the goals of a company, and as a means to determine the technical performance monitoring (Denis, Khomsiyah and Rika, 2004).

This study aims to determine how much influence the Implementation of the Internal Audit Function and Good Corporate Governance on Corporate Performance.

2. THEORY AND HYPOTHESIS

2.1 IMPLEMENTATION OF INTERNAL AUDIT FUNCTION ON THE COMPANY PERFORMANCE

According to Eric J. Williams (2002) today's business world is undergoing phenomenal changes. Business conducted simultaneously in various countries and with many people, and the market is no longer limited by time zone boundaries. Role and skills required of Internal Auditors has become something important, The IIA clearly feel the necessity of the new global economic change, recognizing the need for an Internal Auditor to add value by utilizing their strengths to meet the needs of their organizations. However, the Internal Auditor in the future will look for opportunities to proactively adapt to changing business demands, not just reacting to them. To achieve this evolution, six focuses should be considered, as follows: Governance, Risk Management, eBusiness, fraud, outsourcing, and recruiting. This in the end the added value given by the Internal Auditor will improve company

performance.

It also presented by Muh. Arief (2006) that the scope of audit activities more widely, at this moment is not merely a financial audit and compliance audits, but the attention devoted to all aspects affecting the performance of the company and management control as well as considering aspects risk business / management.

Empirical evidence that shows the implementation of the internal audit function can improve the performance of the company as expressed by Anthony Walz (1997) that creates value in the end means to increase the company's market value. The Internal Audit function should be prepared not only to explain how they affect market value, but also to show an increase in value as well. Internal Audit can add value in two ways: by reducing the cost of the internal audit function itself, and to make recommendations that provide value-added auditing. Research conducted by Giselle Bou Road (2000) which examines the changing role of Internal Auditor from the traditional audit approach with value-added approach is more proactive in which the Internal Auditor to take the partnership with the Internal Auditor's management deemed to accept the changes to compete with market demand and do so in order provide valuable services for organizations that employ them. According to Mort Dittenhofer (2001) that one of the areas targeted by the Internal Audit was effectiveness. In line with research Pforsich et al. (2006) who conducted research on the Internal Audit department Schwan Food Company which has the motto to promote business.

Several factors are a measure of successful management or Internal Audit include:

1. Increasing the benefits and environmental monitoring
2. Opted by corporate leaders in a discussion of strategic issues
3. Opted to participate in various business review
4. Increasing the frequency of requests for assistance by the object to obtain support smooth implementation of the program
5. Human Resource Internal Audit to be made to set a nomination to fill the position formation
6. Improving the professionalism of auditors
7. Obtaining feedback from the object and its previous auditors

In the end, to be effective and successful internal audit function, this function must be supported by various components / elements:

1. Institutional / Organizational steady
2. Human Resources Professional
3. Long-term planning
4. Cultural environment conducive
5. Internal Audit Quality Assurance

2.2 IMPLEMENTATION OF GOOD CORPORATE GOVERNANCE ON THE COMPANY PERFORMANCE

Some empirical evidence which shows that the implementation of Good Corporate Governance can improve firm performance in Yudha Pranata (2007): (1) Research conducted by Ashbaugh, et al. (2004) of 1500 companies in the United States, shows that companies that implement good corporate governance has increased the credit rating (credit rating firm) was significant, (2) Alexakis et al. (2006) against the companies listing in the Greek capital market indicates that companies that are either fulfilling their corporate governance has increased the average stock return, and a significantly decreased risk, (3) Drobetz, et al. (2003) against the companies listing in the German capital market indicates that companies that implement good corporate governance has increased the expected stock return that is significant, (4) Firth et al. (2002) against the companies listing in Hong Kong stock market shows that companies that implement good corporate governance has increased the performance of the company (corporate

performance) are significant. Similarly, a study conducted by Brown and Caylor (2004) in Georgia, also show that companies that implement good corporate governance has increased the performance of the company (corporate performance) are significant. Research conducted by Cornett et al (2005) of companies incorporated in the S & P 100, also showed similar results where the companies that implement good corporate governance has a significant performance improvement company. Brown and Caylor (2004) showed that the implementation of good corporate governance can significantly improve the return on equity, net profit margin, Tobin's Q. Research conducted Claessens, (2006) in Pallab Kumar and Md. Hamid that the implementation of better corporate governance will improve performance, more efficient management, better asset allocation, better employee, or other similar increase in efficiency. So it can be concluded that the application of basic principles of good corporate governance is essentially a goal to provide progress on the performance of a company (Diah Kusuma, 2008).

2.3 COMPANY PERFORMANCE

Performance is a pattern of actions taken to achieve goals that are measured on the basis of a comparison with different standards. Performance is the achievement of a goal from a particular activity or work to achieve corporate objectives as measured by the standard. Corporate performance assessment aims to determine the operational effectiveness of the company. Corporate performance measurement can be performed using a method or approach. Measurements of corporate performance are grouped into two categories, namely non-financial performance measures and financial performance measurement. (Morse and Davis, 1996 in Hiro Tugiman, 2000:96; Hirsch 1994:594-607)

Information used in measuring non-financial performance information presented is not in units of currency or dollars (non-financial information) but with non-finance unit of measurement (Kitindi, 1992). The information used in measuring financial performance is financial information, the management accounting information and financial accounting information such as earnings before taxes, investment returns, and so forth.

2.3.1 SOEs PERFORMANCE ASSESSMENT

The development of business increasingly open economy situation needs to be based with the facilities and job evaluation system that could push the company toward to the improvement of efficiency and competitiveness. Based on this set conditions on the rating / assessment of the performance of SOEs with the decision of the Minister of State Owned Number: KEP-100/MBU/2002 on the Rating of State-Owned Enterprises. SOEs rating applies to all state-owned financial services and state-owned non-financial services. SOE state-owned non-financial services is engaged in infrastructure and engaged in non-infrastructure. The grouping of companies involved in the field of financial services is a state-owned enterprise engaged in the business of banking, insurance, financial services and insurance services.

Operational Aspects of Performance Appraisal

a. Indicators assessed

Indicators are assessed include the elements that are considered the most dominant activity in order to support the success of operations in accordance with the vision and mission.

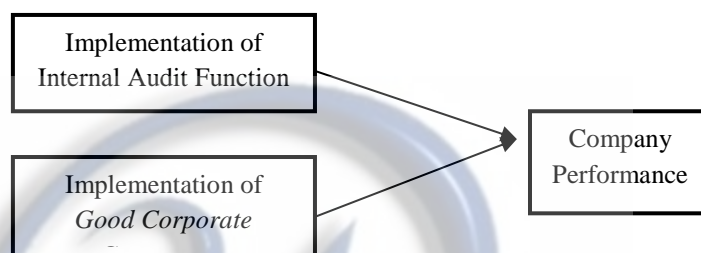
b. Number of Indicators

The number of indicators used for rating each year at least 2 (two) indicators and maksimal 5 (five) indicators, which if deemed necessary the indicators used for assessment of a year to the next can change

2.4 THEORITICAL FRAMEWORK

Based on literature review, both theoretically and empirically, researchers describe the thought patterns of the relationship between: the implementation of Internal Audit, Implementation of Good Corporate Governance and Corporate Performance with a diagram as follows:

2.1 Model Internal Audit function, Implementation of Good Corporate Governance and Corporate Performance



2.5 HYPOTHESIS

There are positive and significant impact of the implementation of the internal audit function and the implementation of good corporate governance on firm performance

3. RESEARCH METHODS

The method of this research use descriptive research. It used an explanation (explanatory research) with descriptive and verification method approach, because it explains the causal relationship between variables by testing the hypothesis. Data analysis in this research using multiple linear regression method.

In this research, the population is the states that have an internal auditor who was in Bandung. The unit of analysis in this research is the Company that has 34 SOEs contained in Bandung, only 15 SOEs which have an internal auditor found in Bandung, the rest position or function of the internal auditor at Jakarta. The number of questionnaires that had spread as much as 65 copies in 12 SOEs that have Internal Audit in Bandung. The amount collected after completed by the respondents is 32 copies.

3.1 HYPOTHESIS TEST

The test is conducted to determine whether jointly independent variables are statistically significant effect on the dependent variable. Hypothesis testing as a whole is:

$H_0: \beta_1 = \beta_2 = 0$ means that all the hypothesized independent variables simultaneously did not affect the dependent variable.

H1: At least $\beta_i \neq 0$ means that all the hypothesized independent variables simultaneously influence the dependent variable.

The formula for the entire test is used as suggested by Gujarati (2003:258) are as follows:

$$F = \frac{R^2 / (k)}{(1 - R^2) / (n - k)}$$

Where:

R² = coefficient of determination

k = Number of parameters

n = number of samples used

Decision:

When $F \geq \alpha F_{\{2; n-3\}}$ then accept H₀; $\beta_j \leq 0$ ($j = 1, 2, 3$).

When $F < \alpha F_{\{2; n-3\}}$ then reject H₀; $\beta_j > 0$.

4. ANALYSIS

4.1 CLASSICAL ASSUMPTION TESTING

Testing the hypothesis by using multiple linear regression analysis tool (multiple regression).

1. Multicollinearity Test

By using SPSS 10.0 for windows, obtained the following results:

Table 4.1

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	1.964	1.569		1.252	.221		
	JML_X1	2.457E-02	.052	.128	.474	.639	.346	2.888
	JML_X2	.147	.099	.404	1.490	.147	.346	2.888

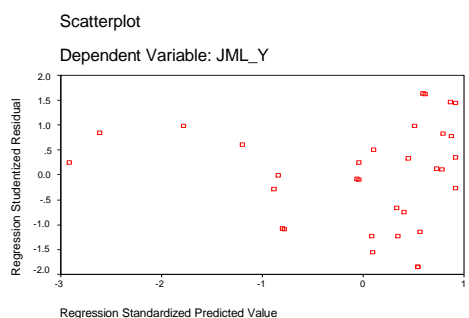
a. Dependent Variable: JML_Y

From the table above can be seen that the value of VIF for the variables X_1 and X_2 , has a value below the number 10. It can be concluded that the regression model used in this research did not contain symptoms multicollinearity.

2. Heteroscedasticity Test

By using SPSS 10.0 for windows, then obtained the following graph plots

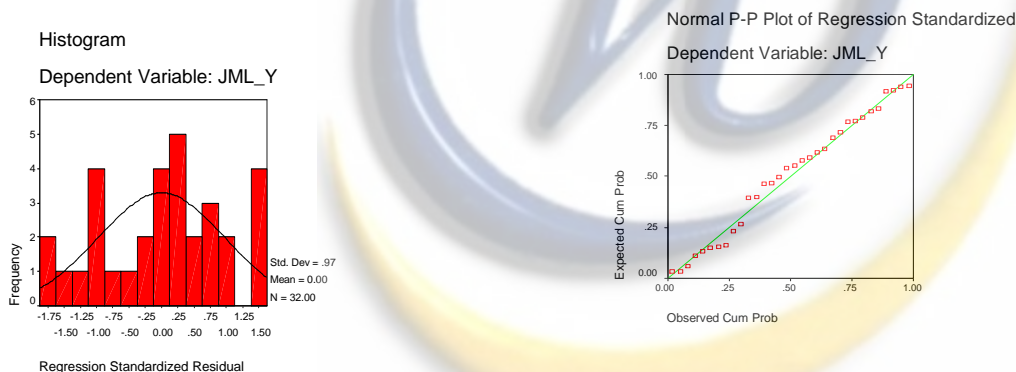
Picture 4.1 Plot between ZPRED dan SRESID



In the plot at the top of the visible dots spread randomly and do not form a clear pattern. This shows that there is no symptom heteroscedasticity in regression models, so that proper regression model used for prediction of the dependent variable based on the independent variable input.

3. Normality Test

By using SPSS 10.0 for windows, then the obtained histograms and normal probability plot as follows:
Picture 4.2 Histogram and Normal Probability plot residual



In the graph above shows the points spread around the diagonal line, and its spread following the diagonal direction. Then it can be concluded that near-normal data distribution, so that normality assumptions are met.

Results of testing the classical assumptions above indicate that the analysis using multiple linear regression models and hypothesis testing research can be proceed.

4.2 DISCUSSION

Data analysis in this research using multiple linear regression method, and SPSS 10.0 for Windows software. The results can be seen in the following table.

Table 4.2

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	1.964	1.569		1.252	.221		
	JML_X1	2.457E-02	.052	.128	.474	.639	.346	2.888
	JML_X2	.147	.099	.404	1.490	.147	.346	2.888

a. Dependent Variable: JML_Y

The equation obtained from the analysis process is as follows:

Model Equations

$$Y = 1.964 + 0.0457 X_1 + 0.147 X_2 + \varepsilon$$

$$\varepsilon = \text{errorvar} = 0.737 \text{ and } R^2 = 0.263$$

The interpretation of the regression equation above is as follows:

X_1 regression coefficient is 0.0457, this shows that any increase in the variable implementation of the internal audit function for one unit of value will increase the company's performance unit value of 0.0457 or 4.57%, assuming other variables are constant.

X_2 regression coefficient is 0.147, this shows that any increase in the variable implementation of Good Corporate Governance for one unit of value will raise the performance of the company amounted to 0.147 units of value or 14.7% assuming other variables are constant.

Errorvar value that is equal to 0.737 show the influence of other factors beyond the implementation of Internal Audit and Implementation of Good Corporate Governance of the Company's performance that is equal to 73.7% while the value of the coefficient of determination R^2 or a multiple of 0,263 shows the enormous impact that the implementation of Internal Audit and Implementation of Good Corporate Governance as a whole on the performance of the Company that is equal to 26.3%.

4.2.1 THE EFFECTS OF IMPLEMENTATION ON INTERNAL AUDIT AND GOOD CORPORATE GOVERNANCE IN CORPORATE PERFORMANCE

Having obtained equation model of this research, the next will be tested by the influence of the Implementation on the Internal Audit Function (X_1) and the Implementation of Good Corporate Governance (X_2) on the Performance of Company (Y) in Bandung SOEs simultaneously. Form the hypothesis is as follows:

Ho: There is no influence of the Implementation of the Internal Audit Function and the Implementation of Good Corporate Governance on the Performance Company in the SOEs in the city of Bandung

H1: There is the influence of the Implementation of the Internal Audit Function and the Implementation of Good Corporate Governance on the Performance Company in the SOEs in the city of Bandung

From the test results (R-square value of Model Summary table) obtained the value of coefficient of determination (R^2) regression equation that is equal to 0.263. This means that any change in performance of the Company of 26.3% is affected by changes in the variable implementation of the Internal Audit Function and Implementation of Good Corporate Governance. The 73.7% influenced by other factors

Table 4.3
Model Summary^b

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.513 ^a	.263	.212	1.5266	1.380

a. Predictors: (Constant), JML_X2, JML_X1

b. Dependent Variable: JML_Y

To determine whether or not significantly influence the function of Internal Audit (X_1) and the implementation of Good Corporate Governance (X_2) on the Performance of Company (Y) as a whole is to perform the F test with two-party testing in the 5% significance level (0.05).

Table 4.4
ANOVA^b

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	24.128	2	12.064	5.177	.012 ^a
	Residual	67.583	29	2.330		
	Total	91.711	31			

a. Predictors: (Constant), JML_X2, JML_X1

b. Dependent Variable: JML_Y

From the table 4.4 obtained values F that is equal to 5,177. To find out the price obtained F is significant or not, it should be compared with the value F_{table} . F_{table} value for $n = 32$ and $k = 2$ at 5% significance level is at 4,17. So that it can be seen that $F_{>} > F_{table}$. This means accepting H_1 and reject H_0 , means the Implementation of Internal Audit and Implementation of Good Corporate Governance have a significant impact on company performance.

From Table 4.4 above shows that the results obtained are significant or in other words the effect that there can be generalized to the entire population of the SOEs in the city of Bandung.

5. CONCLUSION

And the result of this research by testing hypothesis that there is an influence of the internal audit function and the implementation of good corporate governance to corporate performance results are significant. This means that changes that occur in the implementation of the internal audit function and good corporate governance will affect the performance of state-owned company in Bandung. In line with Giselle Bou Road (2000) which examines the changing role of Internal Auditor from the traditional audit approach with value-added approach is more proactive in which the Internal Auditor to take the partnership with the

Internal Auditor's management deemed to accept the changes to compete with market demand and do so in order to provide service valuable for organizations that employ them. In line with the research: Brown and Caylor (2004) in Yudha Pranata (2007) in Georgia, also show that companies that implement good corporate governance has increased the performance of the company (corporate performance) are significant.

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