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## **HOW DOES COMPANY MAINTAIN ITS CORPORATE GOVERNANCE?**

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### **Abstract**

The bigger company, the higher risk company has. It is a reason why the role of corporate governance is more crucial. To maintain quality of corporate governance, it needs some efforts to make sure corporate governance may cope with the risk that company face. This research aims to analyze the role of risk based audit (RBA) and internal control effectiveness may affect corporate governance (GCG) in a company. This research is a qualitative research which takes at the Indonesia's biggest mining company, PT Pertamina. Some findings conclude that internal auditor through risk based audit and the quality of Internal Control Systems (ICS) Implementation are positively influencing GCG. It is illustrated from company transparency, accountability, responsibility, independency, and fairness are very good as well as its risk based audit evaluation.

**Keywords:** good corporate governance, internal audit, internal control, risk based audit.

**JEL: M4**

### **1. Background of Research**

In every company internal control is the first line of defense which is used for the company to bring the company to achieve more efficient and effective operation. By the effectiveness of company operation, company performance will increase. Furthermore, by improvement of performance, the company profit will also be increased. To run the operation of a company, the internal control every procedure, regulations, and policies must be implemented to achieve company goals. The regulation exist because of some scandals that will harm the company, however in the company self-regulation is a must then company performance could increase, otherwise there could be bad behave of individual that could lead to scandals as a worst risk company should bear (Spira & Page, 2003). It is generally known that internal audit has roles to evaluate the internal control, as in Boța-Avram & Cristina (2013). They have functions to maintain internal control framework over organization, but they also must have their own control such as quality assurance and improvement program. The internal auditor is also known as important division since 1940s in organizational strategy and management and still develop until now (Castanheira, Rodrigues, & Craig, 2010).

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Development of practice also moves the concept that related to internal control that also becomes central to corporate governance now focus to the risk. And it gives new perspective way of company governance. Furthermore, the interest in risk comes from scandals in UK, and has been discussed in 1999 by Turnbull committee that makes the control and risk management becomes more important issue (Spira & Page, 2003). The model of risk based audit (RBA) as the new approach in risk management also become important issues that mostly known from the article from McNamee (1997) “The focus is shifted to audit that identifies, measures, and prioritize risks”. It will increase the opportunity get significant data, allows auditor to test most important controls or greater depth thoroughly.

As a fact known in organization, role of management in internal control becomes the main point in the company to implement strategies so that company could achieve its objectives. And then, internal control that is now associated with risk management and its risk concept, is a solution for a complex problem in corporate governance (Spira & Page, 2003). The concept of internal control that is mostly known is stated as old paradigm in McNamee (1997) is shifted to focus on the risk mitigation. This could also more focus to critical problem that could seek for any solution in organization (Budiman, 2013). IIA or Institute of Internal Auditing as independent, objective assurance and consulting activity designed to add value and to 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”. (Institute of Internal Auditors n.d.)

Therefore risk management and its concept of risk now are more important than to search someone fault such as a watchdog. This institute also develop its standard, however every year development of standards and regulations of the auditors are renewed and being updated. By practice and implementation of standard this development will be faster and more improved and give better solution to every problem faced by companies. Development of technology and Internet also makes the communication easier. One of the standards used for the internal auditor is from International Standards for The Professional Practice Framework (IPPF). This standard is promulgated by IIA as the conceptual framework that organizes authoritative guidance. This standard is accepted by internal auditors' worldwide. In the working area development of the audit standard, method and guidance for auditors have big role in the change of audit regulations and practice in the application. Every standards use the regulation and policy to measure the effectiveness of the performance. Therefore, internal auditors must follow their path in performing their works. findings of risk based auditing adoption in 2005 by the IIA-UK and Ireland and KPMG Ireland in Castanheira et al. (2010) found that 89 percent of heads of internal audit use a risk-based method when preparing annual internal audit plans; and 93 percent use a risk-based method in their internal audit assignments. It shows that this method is mostly used internationally and adopted for more than 85 percent of internal audit heads. In the implementation of audit, every aspect of systematic guidelines must be followed to achieve good governance. By corporate governance, company means the mechanisms that exist to ensure that managers pursue strategies that are in the interests of an important stakeholder group, shareholders. As the *agents* of stockholders, managers should pursue strategies that maximize

long-run returns to stockholders (subject to the constraint that they do so in a manner that is both legal and ethical) Charles W. L. Hill (2012).

## **2. Theoretical Review**

### **2.1. Agency Theory**

This theory is commonly used principle in research about organization. This theory specifically shows relationship between principal and agent that should reflect to efficient organization of information and risk-bearing cost. Agency theory is concerned with resolving two problems that can occur in agency relationships. The theory stems from the synergy of economic theory, decision theory, sociology, and organizational theory. Agency theory was first proposed by Jensen and Meckling in 1976 and stated that the agency theory is the inequality of interest between principal and agent (Jensen & Meckling, 1976).

This theory is the best representation that in every company of course there could be conflict of interest because the interest between internal auditors and auditees. Internal auditor as the right hand of principal or it can be assumed auditor as principal here, they will give explanation to Board of Committee and Board of Directors which is the principal of the company. Hence, in running the assurance service such as evaluating the internal control internal auditor could face some problems.

Every agent in the company of course has its own interest, and then litigation and disciplinary sanctions are supposed to ensure auditor independence. Discipline of the person who carry out tasks should also be included in the audit process, by internal control internal audit assess audit risk in order to make workers disciplined. And it must be communicated to all workers in the systems and also program relate to company governance system. If the systems are not strong enough to enforce, auditors might be tempted to compromise their independence and hence, neglect to constrain earnings management or issue a qualified opinion when necessary Memiş & Çetenak, (2012)

### **2.2. Internal Control Structure**

Some studies find that the need to manage risk has become recognized as an essential part of good corporate governance practice. As the organ in the company that gives assurance internal audit assure that risks are properly managed after management identifying and managing the risk. It could be a pressure to company because company should identify all the business risk and manage them. However, it also becomes essential role in maintaining internal control in the company (Chartered Institute of Internal Auditors, 2006).

Portion of evaluation to maintain internal control is decreased, and now more focus to the risk. However, management should give their best to control over the company. Internal control over the organization structured in most commonly used over organization is from COSO framework. The idea of internal control in COSO's 2013 framework is outlined in the following principles:

- (1) Control environment, consist of commitment to integrity, competence, and ethical values. There must be established structure, authority and responsibility. Moreover, there must be over sighted responsibility and enforced accountability.
- (2) Risk assessment, consist of specifies suitable objectives, assess fraud risk, identifies and analyze significant change, then identifies and analyzes risk.
- (3) Control activities, consist of select and develop control activities, general controls over technology, much less, deploys through policy and procedures.
- (4) Information and communication develop by uses of relevant info, and then communicates internally and externally.
- (5) Monitoring defined by Conducts ongoing and/or separate evaluations also Evaluates and communicates deficiencies.

Internal control in organization could be different from one to another; therefore the implementation should follow the rules and regulation so that employee performance could improve. As stated before that internal auditors and their responsibility as an evaluator is related with control, risk management, and governance systems. Corporate governance system or mostly known as good corporate governance is a system which does not only contain the aspect of corporation as management but also every people, institution, whole in decision making process (Tabără & Ungureanu, 2012). The more grow the company is more profitable the company, more complexity they should face, also more risk they should bear. Then, there should be internal auditors as agent of stockholders. Right now internal auditor shift the focus to the term of something that is called risk in the company. Internal control is evaluated, but now the portion is reduced. It is used nowadays as the updated standard which better than before, they eliminate the symptoms before it happens or before it becomes bigger. It is because internal auditor could make company process more effective and efficient. As the time goes by effective and efficient company process would increase performance of the company also would increase more profit. This research is a combined research from (Indra et al., 2014), (Castanheira et al., 2010), and (Mattonrokang, 2015). However, this research is more focused to the risk based audit in PT PERTAMINA area SUMBAGUT as a sample to ascertain that company GCG is good, as stated in public and its effectiveness in internal control.

### **2.3. Risk Based Audit**

Internal audit focuses on high potential risk that can make performance of the company down. Thus, risk based audit is focused on mitigates and giving solution to the company according to the risk that company will face. As mentioned above that risk based audit is now shifted to the new paradigm, it is described by McNamee (1997) as follows:

**Table 1**

**Old Versus New Paradigm**

<b>Audit Area</b>	<b>Old Paradigm</b>	<b>New Paradigm</b>
Audit Focus	Internal Control System	Business Risk
Test Focus	Control Activities	All Risk Mitigation Activities
Report Focus	Adequacy and Effectiveness of Internal Control	Adequacy and Effectiveness of Risk Mitigation
Audit Result	New or Improved Control	Appropriate Risk Mitigation

source: (McNamee, 1997)

This table illustrates that internal auditing nowadays has shifted to the new paradigm which now has more improved control and wider area. It is needed strategy to avoid risk by 3 steps of auditing like the old or traditional audit did. Risk based audit develops risk assessment and evaluate risk that is exists in the company. Identification of risk is used in every sector of company program. The role of internal auditor nowadays is also shifted from watchdog become the risk mitigation and risk averse, so that they are giving more value added to the company. Internal audit nowadays are more focusing on the business risk that could prepare critical problem and seek for solution. They become more thorough and seek more deep to what makes problem, then as stated by IIA, internal audit are responsible to accomplish company objectives by evaluate and improve risk management, control, and governance process.

Another statement from one of internal auditor VP in a company “the highest hierarchy in the achievement of their purposes is the internal auditor should be able to occupy his post into a Strategic Business Partner (SBP)” (Saputra 2010). Where in implementations, the auditors are required to have high integrity, and also must:

1. Professional in doing their job also becomes a consultant through a design that can provide added value (added value and value creation) in improving the operations of business entities.
2. Know direction and corporate strategy, goals and objectives to be achieved, as well as the process of overall business in the ordinary course of business so that they can survive, grow and develop.
3. Being able to help the company achieve its objectives through systematic evaluation and targeted to improve risk management and operation control.

Risk based audit steps started by identify business process in a company, then classify business risk, next communicate with management and agree to the scope of audit from management. After some of the steps that must be communicated with management audit conduct the audit, and then report to management for the result. After that every result must be given to the highest authority and then, management must run the follow up, while internal audit monitor the audit result (Karmudiandri, 2014, p.22-23). In every methods of audit there are some general steps that must be followed in order to fulfill the requirements for running the audit. In short those steps are consisted of 4 main cycles which are audit planning, conduct, report, and follow up monitoring.

#### **2.4. Good Corporate Governance**

Good Governance in corporate drives its people to achieve corporate success; it is driven also by compliance of the workers in company. Quoted from Aryani (2011) Corporate governance concept by The Indonesian Institute of Corporate governance (IICG) can be defined as a series of mechanisms directing and controlling an enterprise to be operational companies run in accordance with the expectations of stakeholders. Company must be compliance to the rules and regulation, then conformance to internal control and risk management and become professional and ethical to work, so that it will increase company sustainability. Somehow internal audit gives important role in the company to achieve good corporate governance. According to Zarkasyi in Mattonrokang (2015) there are 5 principles of GCG as follows:

1. Transparency

This principle is aim to maintain objectivity in doing business, companies must provide material and relevant information in a way that is easily accessible and understood by stakeholders.

2. Accountability

Companies must be accountable for performance in a transparent and fair. Therefore, the company must be properly managed, scalable, and in accordance with the interests of shareholders and other stakeholders.

3. Responsibility

Company must comply with the regulations of the legislation and carry out that responsibility towards society and the environment so that it can maintain the continuity of the business in the long term and to be recognized as a good corporate citizen.

4. Independency

This principle aim to accelerate the implementation of the principle of good corporate governance, the company must be managed independently so that each organ of the company does not dominate the other and cannot be interfered with by other parties.

5. Equality and Fairness (Fairness)

In carrying out its activities, the company must always take into consideration the interests of shareholders and other stakeholders based on the principles of equality and fairness.

#### **3. Research Methods**

Method used in this research is qualitative method and researchers obtained the data by questionnaire, interview, and documentation of some data that are given by respondent as it is means to finish the research. Data are collected to PT PERTAMINA area SUMBAGUT. Some data will be collected from key persons of some divisions such as human resource, internal audit, finance, operational and risk management. Calculation of the questionnaire using the formula Dean J. Champion in Basic For Social Research (Mattonrokang , 2015), by summing the number of answers "YES" and then stated the following formula:

$$\text{Persentase} = \frac{\Sigma \text{"Yes" Answer}}{\Sigma \text{Number of Question Answered}} \times 100 \%$$

The results of the questionnaire calculation that is related to analysis can be classified as follows:



1. Criteria for assessment of the results of the questionnaire related to adequate risk based internal audit is as follows:

**Table 2**  
**Criteria in measuring Risk Based Implementation**

Percentage	Criteria
0% - 25%	not adequate risk based audit implementation
26% - 50%	Fair Risk based audit implementation
51% - 75%	Good risk based audit implementation
76% - 100%	Very good risk based audit implementation

2. Criteria for assessment of the results of the questionnaire relating to “the embodiment of Good Corporate Governance” stated in table below:

**Table 3**  
**Criteria of measuring GCG implementation**

Percentage	Criteria
0% - 25%	Bad implementation of Good Corporate Governance
26% - 50%	Fair implementation of Good Corporate Governance
51% - 75%	Good implementation of Good Corporate Governance
76% - 100%	Good Corporate Governance very good implemented

3. Rating criteria from questioner result relating to “role of internal auditor in internal control improve Good Corporate Governance” is illustrated in the table below:

**Table 4**  
**Criteria of measuring role of internal auditor**

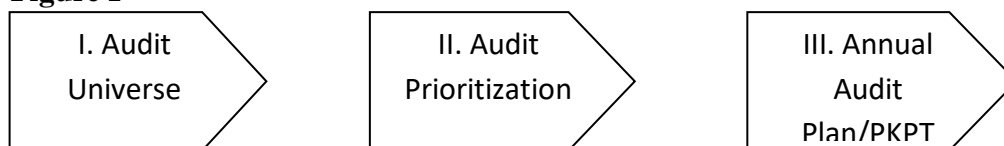
Percentage	Criteria
0% - 25%	Internal audit not improve Good Corporate Governance
26% - 50%	Internal audit have little role in improving Good Corporate Governance
51% - 75%	Internal audit have quite big role in improving Good Corporate Governance
76% - 100%	Internal audit plays important role in enhancing Good Corporate Governance

**4. Data Analysis and Discussion**

**4.1. Internal Auditor Function**

Internal Auditors in PT PERTAMINA use International Standards for the Professional Practice for Internal Auditing (IPPF) as their standard and other policy that relevance and used in PT PERTAMINA. This division should run audit used RBA method to manage the activity and monitoring business and doing audit which is consisting of planning, implementation, report and monitoring. Those steps are main cycle in the RBA which are very important in running the audit. Hence, to talk about audit, it is important to know audit in the macro level which are: audit universe, audit prioritization and annual audit plan, it could be described as follows:

**Figure I**



First macro level is audit universe; its implementation is broad and aimed to know whether there are potential changes in operation and risk. On the other hand, audit prioritization is a part when the auditors take qualitative and quantitative analysis to identify what is their audit priority based on rating analysis, and cooperation with management. Thus, auditor will be prepared for annual audit plan which will be used to audit the management. Next, Annual audit Plan/ PKPT is a process to know the priority of annual audit plan. This process will concern about higher risk and concern about some of criteria and consideration of audit also suggestion from management. After those steps are run there should be audit implementation. In the implementation of audit with RBA method run according to procedures from planning, conduct or implementation, report, and last is follow up. It is started with (a) planning stage that consists of some work such as making planning memo, run entry meeting, run walkthrough process, prepare audit program, and next is arranged the task distribution. After that (b) conduct of audit task consist of running test of control, running substantive test, documenting the assessment result, reviewing the assessment result, last is running exit meeting. (c) Third stage is report of audit consist of prepare the audit result concept, prepare executive summary, then review both concept, authorize the audit result report and executive summary and finally distribute it. Last is (d) follow up that consist of monitoring and follow up also validate the follow up.

Those steps are guidance from the company that must be followed by the auditor. There is also individual guidance and organization guidance that have to be fulfilled in order to improve company performance. However it is the responsibility of the individual that make the performance increase or decrease. So that every business division and business unit performance could be different from one to another.

#### **4.2. Interview**

From the interview researchers know that in internal audit the important role is related to governance, risk, and control and to improve operational effectiveness and efficiency of the company. However, in the implementation there could be some problems such as when implement the RBA some procedures are not run like the entry meeting, risk mapping that is not



finish, and some technical procedures. In the other side auditor within the company also less in number so that auditor is decentralized, it should be centralized. However, in the practice it is hard to implement. To improve the GCG it is also hard because there are some factors that have to be concerned, such as transparency that is still some practice that is not transparent like in SPBU or gas station financial report, and it is hard to measure this company profit because it is SOEs Company that must be ruled by government. Thus, if government wants to obtain dividend, the company give it, when the price of fuel raises company should do efficiency, while government make it some terms into subsidize.

The GCG also have its own aspects that is also hard to measure it just from the internal auditor, but internal auditor also the one that most helpful to it by ensure the efficiency and effectiveness of operation by some policy and regulation that must be comply by management. In running GCG also there are some practice that is hampering it like giving some tips to make work better, and some bending rules to get more money from individuals. From those explanation of respondents researcher get the score of GCG in public with the explanation are have very big different. The information and issues inside the company cannot be approved if there is no actual event. While, company score and rate in public grow rapidly with their change, efficiency, and resolution to become the world-class national energy company.

### 4.3. Questionnaire

From the data researchers obtain, it is shown that people work in this company is between 30 to 49 years old. Workers in this company have many diverse educational backgrounds and few people in this company have post graduate degree. It is shown that around 4 people have graduated from post graduate program in the university. From the time of work in the company, it could be seen that there are many people who work for more than 10 years. It means people work here is capable and professional in their work. Analysis of the questionnaire obtained the result as follows:

**Table 5**  
**RBA Analysis**

No	Description	Percentage	Result
1	Planning	87,33	Very good
2	Implementation	79,17	Very good
3	Report	86,67	Very good
4	Follow Up & Monitoring	86,67	Very good
<b>Total Score</b>		339,83	Very good
<b>Average</b>		84,96	

According to the table, it shows that implementation of RBA methodology is run by internal auditor in PT PERTAMINA area SUMBAGUT is very good implemented. It is seen on the result of the implementation of planning, conduct, report, and follow up & monitoring are very good implemented. It means that implementation of RBA in internal auditor is run their policy and regulation well and also follow every step and procedures in the company. However, some of the

works of auditor also need some improvements to make better internal control and evaluation done by implementing the RBA methodology. It is described that from the questionnaire in the implementation or conduct stage is the lowest from all stages. It means that internal auditor work still needs more improvements such as in delivering audit memo to the auditee, so that the work will be more transparent. And the entry meeting also should be run when running audit task. Some technical problem will give problem if communication and information to one division to another not complete. It is a responsibility for a manager to maintain the rhythm of organization with good culture however every individual must follow good culture in order to make their work effective and efficient.

**Table 6**  
**GCG Analysis**

No	Description	Percentage (%)	Result
1	Transparency	87,78	Very good
2	Accountability	90,56	Very good
3	Responsibility	85,83	Very good
4	Independency	84,67	Very good
5	Fairness	92,67	Very good
<b>Total</b>		432,61	441,51
<b>Average</b>		86,52	

From table above it is described that implementation of GCG in the company is following procedures and regulation as a part of a big entity. It is illustrated from the table all of the aspects of GCG show result of more than 80 percent, it means every workers agree that implementation of GCG are well in the company in every sector not only in internal auditors. From the table it is shown that what is needed to be improved is in the independency which is the lowest one from all aspect of GCG. It is a general knowledge that PERTAMINA is state owned enterprises which means they have to be transparent to government and others, because this company also vital as an energy company that can define the economic value of our country. If this company is not transparent public can give their bad opinion and will give bad effect also for our country stabilization.

Company position as a state owned company influenced by their management and economic activities. As explained below that this company cannot raise fuel price, but the government does. As a result it also influences company independency, as a company they have to get more profit, but as state owned company they have to give the profit to be used for govern the economy in Indonesia. However, overall the result of GCG from transparency, accountability, responsibility, independency and also fairness in the result are very good implemented. According to explanation in some research GCG is company representations in all aspect of company activities. These results also prove that internal controls of the company are very good and implemented well by the management as first defense of line that applied procedures and policy.

**4.4. Internal Control**

Every step in management process of the company must have a system that must evaluate every activities of the company to make the process effective and efficient. Some of the works of management are also being controlled by that system, it is called control system. Every management division also must have their internal control to make sure their processes are following the procedures. But in a big company there is also a need for more wide and completely evaluation of every operation and process in the company especially for economic activities. Here are the internal auditor as evaluator of the control and activities in the company. In new development of internal auditor they also have to give more added values to the company also become strategic business partner in the companies that also help management in the company to achieve company goals. Internal auditors have to help management solve their problems by the new best practices also come with solution and consultative organ in the body of company. Internal control analysis below will examine whether the effectiveness of internal control good or not, and to prove the doubt that internal audit influence GCG with the RBA method.

**Table 7**  
**Internal Control Analysis**

No	Question	Answer	
		Yes %	No %
1.	In the implementation management run the internal control effectively	73,33	26,67
2.	Risk based audit work according to procedure and concern the aspect of good corporate governance	83,33	16,67
3.	Information of company performance increase worker involvement	100	0
4.	Internal control run simultaneously hence, it increase good corporate governance in the company	96,67	3,33
5.	Risk management role in ERM enhance the good corporate governance	100	0
6.	Internal auditor have role in improving GCG in the company	100	0
7.	Internal Auditor help management in evaluate risk management	70	30
8.	Internal auditor giving service as consultant and become strategic business partner for management.	100	0
<b>Total</b>		<b>90,42%</b>	<b>9,58%</b>

Every internal control is developed to increase the performance of the company. However, in the implementation of internal control the performance of the company cannot give more value to make workers keep their good work. From the table above it can be understood that many respondents agree management in the company run internal control effectively, but some others

are not. It means that the internal control of this company is still needed more improvements by the time being. RBA methodology is applied in the company also needs more improvement such as follow the procedures from planning until monitoring stage. It is hard to see just from the internal audit division to know that company implement GCG very well, but from the answer it is proved that RBA is also improving the GCG.

All respondents agree that Information of company performance increases the work of workers inside the company. It means that workers in the company need to improve and keep their performance as good as possible. Internal auditor procedures and policy are maintained well, but every step of process must move forward, and increase the performance. Small things must be counted if one does not want to miss the train, or in this case the company wants to achieve its goals. Internal control around the company is maintained well by every people so that works in the company are effective and efficient. All of respondents agree that Risk management also help to improve GCG, and many respondents also agree that internal auditor also influences the GCG. 70 percent of respondent agree that internal auditor work has to help the ERM division to improve their quality. All respondents agree that internal auditor should give consultation and become strategic business partner for management. As stated by (Indra et al., 2014) “internal auditor competency and quality of their service simultaneously influence GCG”. From explanation above and result of questionnaire it is agreed that company internal control are very good and it influences the work of auditor with their RBA method. Hence, it is proved the result that effectiveness of internal control and RBA method, GCG will positively be influenced as mentioned above. It could be inferred from the result that if the score of internal control increased, RBA score will increased, and then score of GCG will increased.

**Table 8**

No	Details	Percentage	Result
1.	Internal Control	90,42%	Internal audit play important role in enhancing GCG

Internal control not only related to the internal auditors, as an evaluator. Every management division must have its control. From the result of internal control analysis in PT PERTAMINA area SUMBAGUT almost all fulfilled. The score of the analysis shows that internal controls in the company are very good or very adequate. It also means that internal audit plays important role in enhancing good corporate governance. This research result is in line with research that conducted by Gramling et al. (2004), RAZIMAH ABDULLAH (2014), Tabără & Ungureanu (2012), Mattonrokang (2015), Indra et al. (2014), and Maylia Pramono Sari (2011).

## 5. Conclusion

From the result of research that has been conducted about the implementation of risk based audit to improve company good corporate governance through the effectiveness of internal control, can be concluded that internal control effectiveness have positive influence to RBA method, and then it simultaneously influence the GCG. Finally, it is proved that company GCG

and internal auditor in PT PERTAMINA area SUMBAGUT has very good score, and prove that this company score as stated in public score.

## **6. Recommendation**

Based on the result there are some works that have to be improved either way company will not increase the performance. As result from questionnaire and interview recommendation, company should fulfill the empty space by recruit more people for IA division because problem of overlapping task could make ineffective work of auditor, hence IA function could be more focused on the business risk that is handled by them. It is also knowledge of auditor and communication within the IA function should be improved, because miscommunication and different knowledge of auditor can result in ineffective work of auditor. There should be knowledge sharing, and intense communication within workers to make internal auditor work more effective.

Policy and regulation in running the audit have to be fulfilled, so that the work could be more effective and help other division to get more relevant and clear information when IA run the audit. ERM as a support division should improve their work so it could help other division and Internal auditor should Improve the detail and complete documentation of work.

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