

**THE IMPLEMENTATION OF INTERNAL CONTROL USING THE THREE
LINES OF DEFENSE MODEL IN CONTROLLING CORRUPTION IN THE
MINISTRY OF FINANCE OF INDONESIA**

Nur Achmad, HaulaRosdiana, SafriNurmantu

Faculty of Administrative Science

Universitas Indonesia

nurach_f@yahoo.com

Abstract

The Ministry of Finance of the Republic of Indonesia (MoF) plays an important role in the development of Indonesia as it is responsible for collecting 85% more state revenues through the Directorate General of Taxation (DGT) and the Directorate General of Customs and Excise (DGC). MoF is the pioneer of Bureaucracy Reform in Indonesia together with Mahkamah Agung (MA, as the Supreme Court) and Badan Pemeriksa Keuangan (BPK, as the supreme audit institution). As the government's internal audit apparatus, the Inspectorate General (IG) MoF role in keeping the state management tasks undertaken by the employees of the MoF carried out prudently, professional, accountable and committed by people who are competent and free of fraud. This paper analyzes the implementation of internal controls in controlling corruption in the MoF. This research uses interview data from internal and external sources of MoF using the internal control framework. Research shows that the MoF has implemented the Three Lines of Defense Model but this model has not been fully effective in controlling corruption in the MoF. The model is potentially developed and reinforced with an integrated corruption control policy and supported by strong leadership and integrity from all levels of MoF leaders.

Keywords: *fraud, corruption, anti-corruption policy, internal audit, internal control, Inspectorate General, Three Lines of Defense Model*

1. INTRODUCTION

In 2007, the MoF was in the spotlight as the International Transparency survey placed the DGT and DGC under the MoF as the two most corrupt agencies in Indonesia. Faced with this situation, the Bureaucracy Reform was conducted in Indonesia with MoF, MA, and BPK as the pilot project. Soon the Grand Design Bureaucracy Reform of Indonesia Year 2010-2025 was compiled as outlined in Presidential Regulation Number 81 Year 2010 as a follow-up of the regulation from the Ministry of Administrative and Bureaucratic Reform Number 20 Year 2010 on Roadmap Bureaucracy Reform 2010-2014. One of the programs implemented is the strengthening of supervision within the framework of bureaucratic reform aimed at improving the implementation of clean and free government of fraud and corruption. The supervision strengthening program consists of two activities namely the implementation of the Government Internal Control System (SPIP) in the overall environment of central government and local government (Government Regulation Number 60 Year 2008) and enhancement of the role of Government Internal Supervisory Apparatus (APIP) in quality assurance and consulting.

The task of the MoF in collecting state revenues, which is mostly tax, is a heavy task. Therefore, the IG as the Government's Internal Supervisory Apparatus (APIP) has a very strategic role in prevention and control of corruption especially in the MoF. Effective government activities by APIP will strengthen governance, reduce the risk of corruption by government employees, and provide public confidence that government entities are managed accountably by supervisors who demonstrate credibility, value, integrity and appropriate behavior. MoF implemented the Three Lines of Defense Model, but this model has not been able to eliminate or reduce the corrupt behavior of some employees. This study aims to analyze the effectiveness of the Three Lines of Defense Model in controlling corruption in the Ministry of Finance.

2. CONCEPTUAL FRAMEWORK

Internal control

The Committee of Sponsoring Organizations (COSO) of the Tread way Commission (1992) defines internal control as follows: *"Internal control is process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance about the achievement of objectives in the following categories: effectiveness and efficiency of operations, reliability of financial reporting and compliance with applicable laws and regulations"*. The internal control structure of COSO is known as the Internal Control - Integrated Framework and consists of 5 (five) components as follows: 1) control environment, 2) risk assessment, 3) control activities, 4) information and communication, and 5) monitoring. The COSO 2013 Framework adds several new things related to internal control and the prevention of corruption. One significant change is the addition of the 17 principles underlying the five existing components concept. The COSO 2013 Framework explicitly requires that all 17 principles be present and functional for the organization to have effective internal controls. This means that the internal control components and relevant principles are in the design, and the implementation of the internal control system appears in the internal control system operations.

Related to the risk of fraud, one component of internal control is risk assessment which is one of the components that get additional attention (enhances focus on risk of fraud). This is based on the view that most organizations have long regarded the risk of fraud as part of their assessment (fraud risk assessment). This area is the focus of the COSO 2013 Framework and is stated in Principle 8: *The organization considers the potential for fraud in assessing risks to the achievement of objectives. This requires organizational consideration of various types of fraud (including corruption) in the context of motivation and causes of corruption such as incentives and pressures, opportunities, and attitudes and rationalizations.*

According to Pope (2000) the Inspectorate General along with the Ombudsman need to be strengthened and must demonstrate their independence and professionalism. As part of the Institutional Pillars of the National Integrity System, the IG and Ombudsman reports must be publicly available and the recommendations made should be implemented by the government. Huther and Shah (2000) argue that one of the anti-corruption policies that need to be applied to countries with high levels of corruption and poor governance is to strengthen the institutions that handle accountability such as the IG, the judiciary and the legislature. This is because the institution is not effective in improving accountability.

Three Lines of Defense Model

Since the global financial crisis, the design and the implementation of internal control systems and risk management has gained more attention. IIA (2013) introduces the Three Lines of Defense Model used by organizations to build risk management capabilities across the organization's business processes and lines for both corporate banking or real sector organizations and government organizations is known as Enterprise Risk Management (ERM). The model distinguishes between business functions as risk owner functions to manage risks, and between overseeing risks and functions that provide independent assurance (independent assurance). The Three Lines of Defense Model assumes that one of the management functions that control the function is not executed optimally by management. Therefore, deviations including fraud and corruption by management as the first line are still possible, and control activities need to be done by the second and third line.

3. METHODOLOGY

This paper used data from interviews with internal and external parties from IG and MoF and secondary data from MoF's regulation. Internal interviews were conducted with the Inspector of IG. External interviews were conducted with governmental organizations related to the functions of IG i.e. Komisi Pemberantasan Korupsi (KPK- Corruption Eradication Commission) and Badan Pengawasan Keuangan dan Pembangunan (BPKP- Indonesia's National Government Internal Auditor). The results of the interview are then analyzed to obtain the implementation of the Three Lines of Defense Model at MoF.

4. RESULTS

As a guardian of bureaucratic reform in the MoF, the IG has shown the following roles:

1. The IG shall maintain the compliance of the State's finances. The task of the MoF in maintaining the state's finances requires the role of IG to remind that the Minister of Finance needs to achieve the common goal. According to the Regulation of the Minister of Finance Number 234 Year 2015 on the Organization and Working Procedure of the MoF, the IG has the task of organizing internal control over the execution of duties within the MoF and performs the functions of: a) the preparation of technical policy of internal supervision over the implementation of duties in the environment of the MoF; b) the implementation of internal control over the execution of duties within the MoF on performance and finances through audit, review, evaluation, monitoring and other supervisory activities; and c) implementation of supervision for a particular purpose for the assignment of the Minister of Finance.
2. The IG refers to Government Regulation Number 60 Year 2008 concerning Government Internal Control System and performs Internal Supervision on the implementation of duties and functions of the MoF in order to provide adequate assurance that activities have been implemented in accordance with measurements that have been established effectively and efficiently for the benefit of leaders in realizing good governance.
3. The IG as the internal auditor of the MoF, in accordance with the Minister of Finance's Regulation Number 12 Year 2016 regarding the Implementation of Risk Management in the MoF, shall serve as the Compliance Office for Risk Management that supervises the implementation of Risk Management. Risk categories consist of Risk of Revenue, Risk of Expenditure, Financing Risk, Strategic Risk, Fraud Risk, Compliance Risk, Operational Risk, and Reputation Risk. Risks must be systematically managed to determine the best course of action to deal with risks. The IG's duty and responsibility is to provide independent assurance on the effectiveness of the implementation of Risk Management in the MoF to relevant stakeholders.

As a compliance office, IG functions to:

- a. Monitor and review the Risk Management Process, at the Ministry level, Echelon I units, or at Echelon II unit level;
- b. Assess the maturity level of the implementation of Risk Management, at the Ministry level, Echelon I units, and Echelon II units;
- c. Audit the Risk Management Process, at the Ministry level, Echelon I units, or at the Echelon II unit level;
- d. Provide consultation services and assistance for the implementation of Risk Management within the Ministry of Finance if requested.

4. The IG uses the Three Lines of Defense Model that distinguishes between business functions as owning risks / risk owner for managing risks, and overseeing risks and functions which provide independent assurance. These functions play an important role in the Enterprise Risk Management (ERM) platform for both corporate banking organizations and the real sector, as well as governmental organizations. The implementation of the Three Lines of Defense Supervisory Model in the MoF is summed up below:
- 1) Management Control in each Echelon I Unit: exercises overall control over task and function activities;
 - 2) Internal control of entities or strategic activities through the Internal Compliance Unit (UKI): assisting management by monitoring; and
 - 3) IG: Providing insurance and consulting on the implementation of tasks and functions of Echelon I Unit.

Analysis of the implementation of internal control using the Three Lines of Defense Model in controlling corruption in the Ministry of Finance is as follows:

1. MoF is tasked with collecting funds and distributing them through expenditure and budget expenditures. In performing these tasks, MoF has the potential to meet conditions or events and circumstances that may threaten the achievement of these objectives, including the events faced by day-to-day operational management including the potential for corruption. These potential events create risks that must be identified and analyzed, in order to determine ways to address them.
Some risks may be acceptable (in whole or in part), and some risks may be wholly or partially reduced to the point where they are at an acceptable level to the organization. One way to reduce these risks is to implement effective and efficient internal controls. Management at service offices is a front-line manager who owns and manages day-to-day risks and controls. Operational managers develop and implement organizational risk management and control processes. Operational management is the first line of defense that is fully responsible for running all the organization's policies by running internal controls continuously in every stage of the activity. These tasks include an internal control process designed to identify and assess significant risks, carry out the intended activities, highlight inadequate processes, address disturbance controls, and communicate with key stakeholders of the activity. The operational manager must be skilled enough to perform these tasks within the area of operations and ensure that the operational tasks are performed in a regular, economic, efficient, and effective manner. Managers at this level are the most important defenses in preventing errors, detecting fraud, and identifying control weaknesses and vulnerabilities. One of the Commissioners of KPK, Marwata, mentioned the importance of self-control and environmental factors in controlling corruption. The complete statement of informants is as follows: *Bad boys always exist everywhere. We cannot remove it 100%. It will always be there. For me, self-control and the environment also play a role* (Interview with Marwata, February 21, 2016)
2. Establishment of the Internal Control Unit (UKI) to accelerate the implementation of internal control within the Ministry of Finance, through the concept of Three Lines of Defense, in which the structure of this UKI will be at the center or in the regional office. UKI, as the second tier defense after a direct superior will maintain internal control over the quality of services provided and avoid deviations. UKI must be able to provide reasonable assurance to the achievement of organizational goals by improving the effectiveness and efficiency of operations to maintain compliance with laws and regulations.
To improve the effectiveness of the implementation of governance, risk management, and internal control, the first echelon unit project empowers internal compliance units or other designated units. Nevertheless, according to resource persons, Ritza, Inspector of IG's Investigation Unit, UKI still faces some problems in preventing corruption, among others: *the complexity of implementation guidelines, insufficient number of employees, the number of additional tasks to be performed and lack of independence, integrity and competence of employees.* (Ritza's presentation slides, November 10, 2017)
3. IG has a very important role towards the prevention and eradication of corruption, especially in implementing Internal Control over the implementation of tasks and functions, implementation of governance, risk management, and internal control within the Ministry of Finance through audit activities, review, evaluation, monitoring, and supervising other activities. IG is expected to optimize its function in increasing public confidence in the way of government, overseeing public services, and minimizing corruption. The perception of the public that IG is the most responsible party for detecting and capturing the perpetrators of corruption and fraud is not entirely true. Nevertheless, IG as the internal auditor of the government has made much effort in controlling corruption through the strengthening of internal controls. The position of the IG which is inherent in each Ministry/Agency

allows IG to monitor the use of state finances in detail to prevent irregularities and become an early detection tool for potential deviations. Head Deputy of BPKP Investigation, Elmi, mentioned the corruption control, completely as follows: *There have been many efforts to prevent corruption. Well, if we talk of control, we do not suddenly talk about corruption control. We know, starting from internal control. Then we see reality. So much effort to strengthen control, and with its various purposes. Starting from the reports on time, then the efficiency, effectiveness, early detection, and securing assets. (Interview with Elmi, August 1, 2016)*

4. Every layer of defense in the Three Lines of Defense will be effective if supported by the strong integrity of the leader. An organization's leader will show whether he or she is ethically leading.

The more ethical and responsible the style of leadership, the more likely subordinates will respond to such leadership styles and will behave in an ethical and responsible way. Conversely, if the leader shows little attention to honest and ethical behavior, then his subordinates will also follow. To get a good leader the approach used is to build an agent of change, not just as a leader but a leader who can build a good system of corruption prevention. One of the Group Head of KPK, Hartono, mentioned the leadership process, as follows: *It could be personal approach, build people. If he is not corrupt, as long as we can build an agent of change for the future leadership process. This is to anticipate if change leadership, also to build the system (Interview with Hartono, February 18, 2016)*

5. IG applies internal control using the Three Lines of Defense Model. However, this model is not optimal to control corruption in MoF. Other programs and activities are needed to control corruption. IG MoF has implemented several anti-corruption activities such as the use of whistleblower reporting system, wealth reporting, gratuity reporting, and anti-corruption socialization. In MoF, these activities have not yet been summarized in an integrated corruption control policy. In this case, a fraud control plan or fraud control system should be developed to integrate all activities of corruption control so that the same pattern of action can be used by the MoF in controlling corruption.

5. DISCUSSION

The MoF has implemented the Three Lines of Defense Internal Control Model

Since 2011, the concept of Three Lines of Defense has been implemented in MoF with the issuance of Decree of the Minister of Finance No. 152 / KMK.09 / 2011 on Improving the Implementation of Internal Control in the Ministry of Finance which is the application of Enterprise Risk Management (ERM). ERM optimization needs to be supported by the implementation of a three-tier defense system, i.e. from the managerial side as well as internal control. The first line is a management line that technically operates business processes.

The second line is the unit which ensures that the internal control system inherent the organization's business processes is running effectively, namely the Internal Compliance Unit (UKI). The third line, by the IG, serves as the last defense so that the risks inherent the organization's business processes both operational and fraud can be minimized. The Three Lines of Defense is implemented with the aim that the internal control structure introduced by COSO and stipulated in Government Regulation Number 60 of 2008 on Government Internal Control System (SPIP) can be applied optimally and comprehensively in the MoF.

IG strengthens the Three Lines of Defense Model as an effort to control corruption

The Three Lines of Defense Model still needs to be strengthened, especially the first line of defense. It takes professional and integrated leadership that will bring management in carrying out daily business processes. As a leader, he should be viewed as a subordinate person who can provide an example, especially in preventing corruption in the organization. If a leader often breaks a rule, hides or twists facts, or achieves results by all means regardless of the applicable provisions then his subordinates will be affected to behave in the same way. In general, IG can also control corruption in MoF by designing an integrated fraud control system.

6. CONCLUSION

The IG is a unit in the MoF that can be used as second opinion by the Minister of Finance and can be trusted to be professional, effective and solutional. The IG is part of the credibility and effectiveness of MoF. The Three Lines of Defense Model implemented by IG assumes that one of the management functions is a controlling function which is not executed optimally by the management, so the abnormalities of the management as first line are still possible and control activities are required by the second line, the internal compliance unit, and the third line is IG. The Three Lines of Defense model alone is not enough to control corruption so it must be supported by a leadership that has integrity and can be a role model for its subordinates in anti-corruption behavior. In addition, the policy of corruption control must be supported by other anti-corruption policies that can control the corruption behavior of MoF officials.

References

- [1] Republic of Indonesia, Presidential Regulation Number 81 Year 2010
- [2] Republic of Indonesia, Regulation of the Minister of Ministry of Administrative and Bureaucratic Reform Number 20 Year 2010
- [3] Republic of Indonesia, Government Regulation Number 60 Year 2008
- [4] Republic of Indonesia, Ministry of Finance Regulation Number 12 Year 2016
- [5] Republic of Indonesia, Ministry of Finance Regulation Number 234 Year 2015
- [6] IIA Position Paper: The Three Lines of Defense in Effective Risk Management and Control. January 2013
- [7] COSO 1992 Framework
- [8] COSO 2013 Framework, Glossary
- [9] MacRae, Elizabeth and Diane van Gils. Nine Elements Required for Internal Audit Effectiveness in The Public Sector. A Global Assessment Based on The IIA's 2010 Global Internal Audit Survey. 2nd Edition. The Institute of Internal Auditors Research Foundation (IIARF). 2014
- [10] Pope, Jeremy. Confronting Corruption: The Elements of a National Integrity System. Transparency International Source Book. 2000.
- [11] Shah, Anwar and Schacter, Mark. *Combating Corruption: Look Before You Leap. A lack of progress in eradicating corruption could be due to misguided strategies.* World Bank. 2010
- [12] Elmi, Iswan. [2016, August 1]. Personnel interview
- [13] Hartono, Dedi. [2016, February 18]. Personnel interview
- [14] Marwata, Alexander. [2016, February 21]. Personnel interview
- [15] Ritza, M. Rahman. [November 10, 2017]. Slide presentation