

ANALYSIS OF INTERNAL CONTROL SYSTEMS IN CREDIT UNDERWRITING FOR MITIGATING NON-PERFORMING LOANS: A CASE STUDY OF KSP CU HARAPAN KITA CENTRAL BELAWAN (2022–2024)

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Abstract:

Savings and Credit Cooperatives (Koperasi Simpan Pinjam / KSP) and Credit Unions (CU) play a pivotal role in expanding financial inclusion and delivering micro-credit to lower- and middle-income demographics. However, credit underwriting inherently exposes cooperatives to default risks, necessitating robust Internal Control Systems (ICS) to maintain loan quality and solvency. This study examines and critically evaluates the implementation and efficacy of internal control mechanisms governing credit allocation in mitigating Non-Performing Loans (NPLs) at KSP CU Harapan Kita Central Belawan over the 2022–2024 period. Employing a qualitative descriptive case study methodology, primary empirical evidence was gathered through participant observations, structured documentary audits of official Annual Member Meeting (RAT) financial reports and loan delinquency ledgers, and in-depth semi-structured interviews with key organizational actors: the Vice General Manager, Head of Credit Department, and Branch Unit Head. Analytical evaluations were structured around the Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework (control environment, risk assessment, control activities, information and communication, and monitoring) analyzed via the Miles and Huberman qualitative interactive model (data reduction, data display, and conclusion verification). Empirical findings indicate that KSP CU Harapan Kita has instituted formal credit underwriting procedures incorporating the 5C credit assessment principles (Character, Capacity, Capital, Collateral, and Condition of Economy), organizational segregation of duties between credit analysts and loan committees, and progressive remedial collection protocols (written reminders, telephone follow-ups, and field home visits). Despite these formal controls, credit portfolio quality remains severely impaired. The Non-Performing Loan ratio exhibited chronic elevated volatility: 13.46% in 2022 (total delinquent credit of IDR 1.069 billion on IDR 7.944 billion portfolio),

improving temporarily to 10.35% in 2023 (IDR 860.72 million delinquent on IDR 8.313 billion portfolio), before deteriorating sharply to 15.14% in 2024 (IDR 1.391 billion delinquent on IDR 9.184 billion portfolio)—consistently breaching the statutory 5.0% maximum prudential health threshold established by regulatory authorities. The primary operational causes of credit distress stem from a confluence of internal control gaps (inconsistent pre-disbursement on-site collateral appraisals, limited credit risk analytical competencies among field officers, and fragmented post-disbursement loan monitoring) and adverse external borrower realities (macroeconomic inflation, coastal informal business volatility, and lack of debtor repayment discipline). In conclusion, internal control at KSP CU Harapan Kita operates functionally in administrative loan processing but remains sub-optimal in mitigating credit default risks. To restore financial soundness, the cooperative must institutionalize digital credit scoring models, enforce mandatory on-site collateral verifications, implement dynamic post-disbursement surveillance, and establish early-warning delinquency indicators.

1. INTRODUCTION

In the dual financial architecture of developing economies, Non-Bank Financial Institutions (NBFIs)—specifically savings and credit cooperatives and member-owned Credit Unions (CUs)—serve as vital instruments for grassroots economic democratization and poverty alleviation. While commercial banking institutions enforce stringent collateralization requirements, formal credit histories, and rigid administrative hurdles that frequently exclude micro, small, and medium enterprise (MSME) entrepreneurs and lower-income households, cooperatives operate under participatory mutual self-help principles (gotong royong) and familial solidarity (kekeluargaan) (Undang-Undang No. 25/1992; Jayanti et al., 2023). By mobilizing member savings and redistributing pooled capital into affordable micro-credit facilities, Savings and Credit Cooperatives (Koperasi Simpan Pinjam / KSP) facilitate local wealth creation, working capital acquisition, and educational financing for underserved community segments (Safira et al., 2024; Lubnia Sari et al., 2025).

The fundamental economic paradox of credit cooperatives lies in the asymmetric nature of financial intermediation. As financial institutions deriving operating income primarily from lending interest margins, cooperatives face significant counterparty credit risk (Kasmir, 2015; Akuntansi & Ratulangi, 2018). In Latin, credit originates from 'credere', signifying faith and mutual trust: the creditor disburses immediate economic purchasing power under the contractual expectation that the borrower possesses both the willingness and financial capacity to repay the principal and accrued interest within a defined maturity schedule

(Kasmir, 2015). However, when borrowers encounter commercial insolvency, business distress, or moral hazard, credit default ensues, manifesting as Non-Performing Loans (NPLs) or bad debts (*kredit macet*) (Irwansyah & Dharmayasa, 2018; Selatan, 2022). Unchecked credit defaults threaten cooperative solvency, erode institutional equity reserves, and diminish the Net Operating Surplus (*Sisa Hasil Usaha / SHU*) distributed to member-owners.

To mitigate credit risk exposure and ensure organizational continuity, credit cooperatives must establish and enforce a rigorous Internal Control System (ICS / *Sistem Pengendalian Intern*) (COSO, 2013; Fibriyanti & Wijaya, 2018; Hanifah et al., 2023). According to Mulyadi (2016) and Andikhariy (2024), an effective internal control system establishes structured organizational lines, clear segregation of functional authorities, documented standard operating procedures (SOP), and comprehensive credit analysis frameworks—notably the classic 5C underwriting principles (Character, Capacity, Capital, Collateral, and Condition of Economy) and the 7P model (Personality, Party, Purpose, Prospect, Payment, Profitability, and Protection) (Nawangsari & Putra, 2016; Ridwan, 2017; Min Amri Mubin, 2022). When properly executed, internal controls prevent managerial over-extension, verify borrower repayment feasibility prior to loan disbursement, and maintain active post-disbursement surveillance to identify early signs of credit distress.

KSP Credit Union (CU) Harapan Kita Central Belawan represents a prominent, long-standing financial cooperative established on July 17, 1992, in the maritime port city of Medan Belawan, North Sumatra, and legalized under Decree No. 455/BH/KDK/2.17/VII/2000. Operating as a primary cooperative, CU Harapan Kita coordinates extensive micro-credit operations across eight service branch offices (*Kantor Tempat Pelayanan / TP*) throughout Medan and Deli Serdang Regency. Between 2022 and 2024, the cooperative experienced steady expansion in gross lending activity: active borrowing members expanded from 387 to 559 individuals, while total loans disbursed grew from IDR 7.944 billion in 2022 to IDR 8.313 billion in 2023, reaching IDR 9.184 billion in 2024 (Table 1).

Table 1. Progression of Loan Portfolio and Borrowing Membership at KSP CU Harapan Kita (2022–2024)

Operating Fiscal Year	Total Credit Disbursed (IDR)	Active Borrowing Members	Annual Portfolio Growth (%)
2022	7,944,000,000	387 persons	Baseline Year
2023	8,313,000,000	456 persons	+4.64%
2024	9,184,000,000	559 persons	+10.48%

Despite sustained expansion in lending volumes, official annual financial reports disclose critical credit quality deterioration. Fully defaulted loans (*kredit macet*) totaled IDR 620.52 million (147 delinquent members) in 2022, declined marginally to IDR 584.24 million (116

members) in 2023, before surging sharply by 37.56% to IDR 803.71 million (169 members) in 2024. When comprehensive regulatory collectibility classifications are evaluated (incorporating Substandard / Kurang Lancar, Doubtful / Diragukan, and Loss / Macet portfolios), cumulative non-performing loans stood at IDR 1.069 billion in 2022, IDR 860.72 million in 2023, and IDR 1.391 billion in 2024. Consequently, the Non-Performing Loan (NPL) ratio fluctuated between 10.35% and 15.14%—drastically exceeding the 5.0% maximum prudential safety threshold mandated by Bank Indonesia and the Ministry of Cooperatives and SMEs.

This chronic breach of regulatory health standards reveals that while formal credit underwriting guidelines exist on paper, operational implementation suffers from significant control breakdowns. Prior studies examining cooperative credit controls present diverse findings. Nawangsari & Putra (2016) demonstrated that inadequate internal controls in East Java KSPs directly elevated credit default rates. Primagama et al. (2018) documented successful COSO alignment in state-owned mortgage banking, while Fajarningtyas et al. (2020) highlighted that automated regulatory checks (BI Checking / SLIK) substantially curtail bad debts in municipal credit banks. However, rural and peri-urban credit unions frequently operate outside integrated national credit bureaus, relying instead on subjective managerial heuristics and manual field investigations. Therefore, this study conducts an in-depth qualitative accounting investigation evaluating the operational efficacy of the internal control system in credit underwriting and determining its capacity to mitigate non-performing loans at KSP CU Harapan Kita Central Belawan.

2. RESEARCH METHOD

2.1 Research Design and Site Selection

This investigation utilizes a qualitative descriptive case study design (Sugiyono, 2019; Sinambela & Sinambela, 2022) to evaluate internal control phenomena within their authentic institutional context. The research site was KSP CU Harapan Kita Central Belawan, located at Jl. Medan Belawan KM 20.5 No. 2 AB, Belawan Bahari Urban Village, Medan Belawan District, Medan City, North Sumatra. The research timeline spanned from October 2025 through May 2026, encompassing preliminary administrative authorization, observational audits, in-depth interviews, documentary analysis, and member-checking verification.

Table 2. Key Informants Profile and Investigated Operational Domains

Informant Identifier	Organizational Position	Primary Responsibilities	Functional	Subject Investigated	Matter
Informant 1 (RM)	Vice General Manager (Wakil Manajer)	Assists General Management in coordinating operations, governance	cooperative enforcing policies, and	Institutional environment, credit policy guidelines,	control executive

		supervising credit risk mitigation	approval thresholds, and NPL reduction strategies
Informant 2 (KS)	Head of Credit Department (Kepala Bagian Kredit)	Oversees credit application appraisals, analyzes 5C eligibility reports, coordinates credit committees, and manages delinquent collections	Credit underwriting procedures, 5C analysis execution, loan monitoring protocols, and remedial collection workflows
Informant 3 (ER)	Branch Unit Head (Kepala Unit Pelayanan)	Directly administers frontline customer loan applications, coordinates field surveys, and monitors member repayment discipline	Frontline loan intake, on-site collateral appraisals, borrower character assessment, and field-level default challenges

2.2 Data Collection and Triangulation Methods

Empirical data were gathered through triangulated qualitative techniques: (1) Participant Observation of credit committee sessions, loan document verifications, and collection monitoring meetings; (2) In-Depth Semi-Structured Interviews with three key operational executives (Table 2); and (3) Documentary Audit of official cooperative artifacts, including audited Annual Member Meeting (RAT) financial statements, credit collectibility reports, loan application dossiers, and delinquency notices. Trustworthiness was ensured via source triangulation (cross-verifying executive, departmental, and frontline perspectives), technique triangulation (cross-referencing interview testimonies against physical audit registers and RAT disclosures), and member checks with executive management.

2.3 Qualitative Data Analysis Model

Data were analyzed using the interactive qualitative model developed by Miles, Huberman, & Saldaña (2014), comprising: (1) Data Reduction—coding, sorting, and aggregating interview transcripts, field notes, and loan records into thematic categories aligned with COSO dimensions and 5C underwriting criteria; (2) Data Display—structuring thematic matrices, comparative credit performance tables, and operational workflow flowcharts; and (3) Conclusion Drawing and Verification—synthesizing empirical findings, testing audit trails, and verifying propositions against theoretical standards.

3. DISCUSSION

3.1 The Inherent Tension Between Mission-Driven Inclusion and Credit Risk

The empirical reality that KSP CU Harapan Kita maintained chronic NPL ratios between 10.35% and 15.14% underscores an institutional dilemma confronting member-owned financial cooperatives. Operating in Belawan—a coastal, port-dependent community characterized by high seasonal income volatility among fishermen, maritime laborers, and

informal market traders—the cooperative's social mandate compels it to maintain accessible credit lines to prevent members from falling victim to unlicensed loan sharks (*rentenir*). However, when cooperative officers adopt an overly sympathetic underwriting posture, the rigorous technical demands of credit risk assessment are frequently compromised.

This institutional dynamic confirms findings by Saroinsong et al. (2022) and Nawangsari & Putra (2016), who observed that cooperative credit committees frequently grant loan concessions based on personal relationships, familial ties, or social empathy rather than verifiable cash flow repayment capacity. While expanding financial access, this social benevolence dilutes credit discipline. Borrowers perceive cooperative loans as shared community funds rather than strict commercial debt obligations, fostering moral hazard and deferred installment compliance.

3.2 Systemic Vulnerabilities in Informal 5C Appraisals

A critical finding of this study is the disconnect between nominal 5C compliance on paper and substantive field verification. While credit dossiers include completed 5C appraisal rubrics, the underlying data are largely self-reported by borrowers without rigorous independent verification. Frontline officers rarely audit physical business sales ledgers or verify whether pledged collateral (e.g., land certificates or vehicle titles) is legally unencumbered and liquid. Over-reliance on collateral as a psychological safety net creates a false sense of security: when default occurs, the cooperative discovers that seizing and liquidating informal property titles in coastal communities entails high legal friction and social resistance, rendering collateral practically unrecoverable.

Furthermore, the total absence of post-disbursement surveillance represents a fatal control gap. Under modern banking risk governance (Fajarningtyas et al., 2020), disbursing credit marks only the beginning of credit administration. In CU Harapan Kita, once loan proceeds are transferred, the cooperative maintains zero operational oversight over whether the capital was actually invested into productive trade or diverted to consumptive household spending (side-streaming). When unmonitored consumptive loans fail to generate cash inflows, default becomes inevitable.

3.3 Integrating COSO Principles to Restore Portfolio Soundness

The empirical findings demonstrate that internal control effectiveness cannot be assessed merely by whether procedures exist, but by their dynamic capacity to suppress risk below regulatory thresholds. Restoring CU Harapan Kita's NPL ratio to the statutory $\leq 5.0\%$ benchmark requires a fundamental modernization of its internal control architecture. Management must transition from historical manual underwriting to digital credit scoring models that incorporate behavioral savings history, utility payments, and verified trade turnover. Integrating early-warning systems that trigger immediate intervention upon five days of installment arrears—coupled with structured loan workout and rescheduling mechanisms—transforms internal control from a reactive post-mortem recording exercise into a proactive risk-mitigating defense (Andikhariy, 2024; Didin Rasyidin Wahyu, 2020).

4. CONCLUSION

Based on the comprehensive qualitative investigation of internal control systems governing credit underwriting at KSP CU Harapan Kita Central Belawan across the 2022–2024 period, the study concludes:

1. Procedural Status: KSP CU Harapan Kita has established a structured, seven-stage credit underwriting protocol incorporating 5C appraisal rubrics, formal organizational segregation of duties, multi-tiered committee approvals, and progressive remedial collection procedures.

2. Operational Ineffectiveness in Risk Mitigation: Despite formal procedural implementation, the internal control system has proven sub-optimal in mitigating credit default risks. The cooperative's Non-Performing Loan (NPL) ratio remained chronically elevated: 13.46% in 2022, 10.35% in 2023, and 15.14% in 2024—persistently breaching the 5.0% maximum prudential regulatory health threshold.

3. Cyclical Portfolio Instability: While internal controls achieved temporary risk containment in 2022–2023 (bad debts dropping -5.85%), aggressive portfolio expansion in 2023–2024 (+10.48%) triggered a disproportionate 37.56% surge in defaulted loans (reaching IDR 803.71 million across 169 members; total impaired loans reaching IDR 1.391 billion), indicating that internal controls break down during rapid lending growth.

4. Multi-Faceted Root Causes: Credit distress is driven by an interplay of internal control deficiencies (subjective 5C appraisals, unverified collateral valuations, passive post-disbursement surveillance, and lack of officer risk training) and external debtor realities (informal coastal economy cash flow volatility, MSME business failures, and borrower moral hazard).

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