

# The Influence of the Implementation of the Government's Internal Control System on the Quality of Financial Statements and its Implications for Financial Accountability of the Regional Government at Bandung, Indonesia

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**Abstract**---This research aims to test and analyze of the influence of the Government's Internal Control System on the Quality of Financial Statements and its implications on Financial Accountability of the Regional Government at Bandung, Indonesia. The type of this research is explanatory research. The population in this research is government agencies in Bandung. Data was collected by using interview and questionnaires techniques then the data is analyzed by using path analysis. The results of this research are indicate that: 1) The Government's Internal Control System influences to the quality of financial statements; 2) The Government's Internal Control System and the quality of financial statement influences to the financial accountability of regional governments.

**Keywords**---Bandung, Financial Accountability, Government's Internal Control System, Indonesia, Quality of Financial Statements, Regional Government.

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## I. INTRODUCTION

There is a phenomenon regarding the weakness of internal control because its application has not been effective, or is unable to prevent and detect fraud. Another possibility is that internal control that is implemented has not been able to provide reliable financial information for stakeholders or the concept of internal control is being abandoned so that many violations occur. This is not in accordance with the management's goal of carrying out internal control is to produce reliable financial reports (Arenset al. 2010: 270).

Improving the quality of providing opinions on Financial Statements of Regional Government from Qualified Opinion becomes Unqualified Opinion due to improvements in weaknesses. These improvements include: 1) improvement of the goods and services management system, personnel expenditure, grant and social expenditure, 2) preparation evidence of realization of capital expenditures, 3) clarity of the value and status from capital of regional government and completeness of evidence, 4) improvement of recording and management of cash, accounts receivable, inventories, non-permanent investments, fixed assets, other assets and debts from third party, 5) distribution of tax revenue from provinces to districts and cities, 6) preparation of consolidated financial statements of regional government.

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Based on Article 6 of Law Number 15 of 2006 concerning the Supreme Audit Board, the government's external auditor has the duty to examine the management and financial responsibilities of the Regional Government. One of them is a financial audit that produces conclusions in the form of opinions on Local Government Financial Reports. The opinion given by the government external auditor is a conclusion regarding the quality of information presented in detail in the form of an assessment of the level of suitability of reporting and its presentation to Government Accounting Standards.

Supervision is the responsibility of the highest leadership, in the context of regional government, oversight responsibilities of regional financial management are part of executive duties. Executive oversight of financial management is seen through the executive's commitment to applying a policy that has been set so that policies can be achieved. These forms of policy are the preparation of financial reports in accordance with accounting principles, follow-up of external audit findings, and effective internal control for achieving objectives. The role of the executive becomes very important because if the chief executive does not play an active role in supervising financial management, it is feared that the level of corruption in regional financial management will be higher. As a result, it will reduce the accountability of government financial management itself (bnpk.go.id, 2015).

The application of Government Accounting Standards (SAP) makes it easier for users of financial information to know and understand the performance of local governments which is a manifestation of accountability of local governments in implementing regional finance. Financial accountability is the responsibility of public institutions to use public funds economically, efficiently and effectively so that there is no waste and leakage of funds, and corruption. This accountability requires public institutions to make financial reports to describe the financial performance of the organization to external parties. Financial accountability is related to avoidance of misuse of public funds (Saudi, 2018). The stages in financial accountability start from the formulation of a financial plan (budgeting process), implementation and financing of activities, evaluation of financial performance, and reporting (LAN, 2001).

Previous research conducted by several researchers examining topics regarding management and organizational commitment, financial reporting quality and financial accountability are as follows: Yousef Shahwan (2008) states that information is useful when demonstrating the economic reality of financial statements, and Marhaban's research (2010) states that there is a positive relationship between internal control, internal audit and organizational commitment. Supported by the research of Dadang Sadeli (2006) states that the professionalism of the internal control apparatus has a relationship with the implementation of government audits. Likewise the research conducted by Badara (2013) states that the internal control system can affect the effectiveness of internal audits at the local government level. With the existence of these studies, the authors are interested in conducting the same research but in different regional governments.

## II. LITERATURE REVIEW

Some statements relating to the internal control system are presented as follows:  
Messier et al (2014: 290) states:

"Internal control is design and management, and is designed to provide reasonable assurance about the achievement of financial statement, (2) effectiveness and efficiency. of operations, and (3) compliance with applicable laws and regulations. "

Likewise Bodnar and Hoopwood (2010: 138) state:

"Internal control is a process that is designed to provide reliability of financial statement, (b) effectiveness and efficiency of operations, (c) compliance with applicable laws and regulations."

Whereas Elder et al (2010: 290) states:

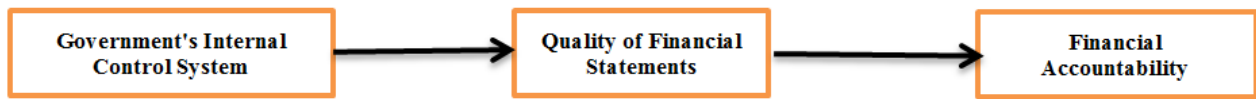
"A system of internal control, assurance that company achieves its objectives and goals. These policies are often called control, and they collectively comprise the internal control entity. "

The Committee of Sponsoring Organizations of the Threadway Commission (COSO, 2013) defines internal control as:

"The process, affected by board of directors, management and other personnel, is designed to provide reasonable assurance regarding the achievement of objectives for operations, statement, and compliance."

According to Ii Baihaqi (2004) stated that internal control used in an entity is a factor that determines the reliability of the financial statements produced by the entity. This is supported by the statement of Mahmudi (2013: 251), stating that the occurrence of corruption cases is often due to misappropriation of state finances, budget waste, organizational inefficiency, and the poor quality of government financial reports. Mahmudi (2013: 27) also stated that to produce financial reports of regional governance are needs a process and stages, regulated in the regional

government accounting system. The government accounting system regulates the government's internal control system. This shows that the quality of financial statements is strongly influenced by the application of internal control systems owned by local governments (Hussian et al., 2019).



**Figure 1:** Framework of Research

### II.I. Research Hypothesis

Based on the framework, the hypothesis formulation is arranged as follows:

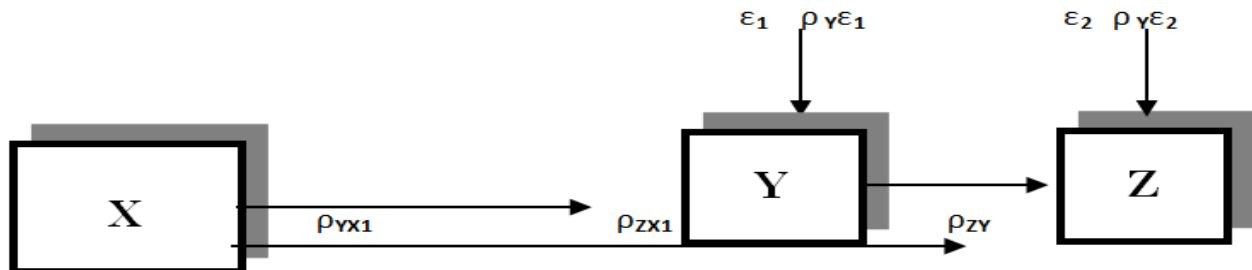
- H1: Implementation of the Government's Internal Control System will influence on the Quality of Financial Statements
- H2: Implementation of the Government's Internal Control System and the Quality of Financial Statements have an influences on Financial Accountability of Regional Government.

### III. RESEARCH METHODS

#### III.I. Data Analysis Method

Data analysis in this study used path analysis. The consideration is that the pattern of relationships between variables in this study is correlative and causal. This analysis is used to determine the magnitude of the influence of exogenous variables on endogenous variables. Path analysis, conceptually, is used because between exogenous variables have relationships. By using path analysis, the magnitude of the influence of each independent variable can be known directly or indirectly.

Based on the relationship between exogenous variables and endogenous variables, it is illustrated a path diagram that describes the paradigm of relationships between variables, as shown in the following figure:

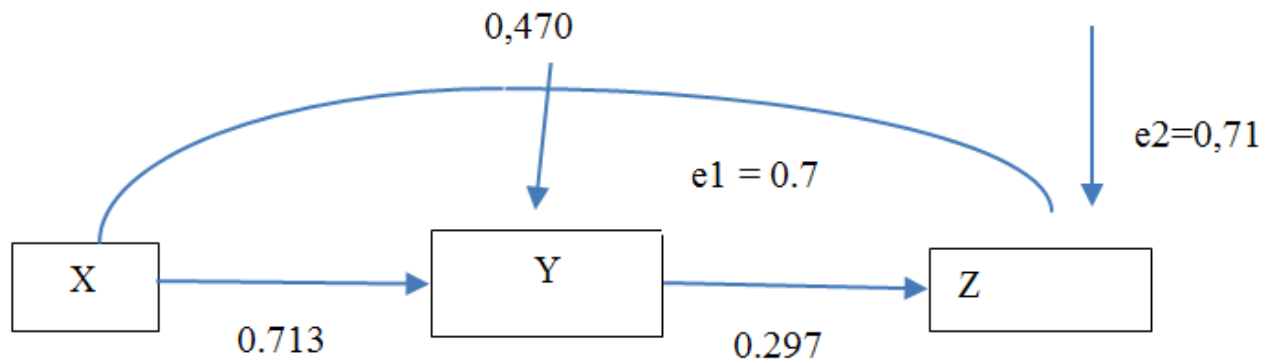


**Figure 2:** Path Analysis Structure

### IV. RESULTS AND DISCUSSION

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The first hypothesis tested is the influences of implementing the Government's Internal Control System on the quality of financial statements. The second hypothesis tested is the influence of implementing the Government's Internal Control System and the quality of financial reports on the financial accountability of local governments. Based on the research paradigm, the structure to be tested is described as follows:



#### IV.I. Path coefficient 1 (Variable X to Variable Y)

The sig value  $<0.05$  means that Variable X has a significant effect on Variable Y, for the value of R which is 0.509, the remain is the influence from the outside (value e1) of  $\sqrt{1-0.509} = 0.7$

#### IV.II. Path coefficient 2 (Variabe X to Variable Z)

The sig value  $<0.05$  means that Variable X has a significant effect on Variable Z directly and indirectly, also Variable Y has a significant effect on Variable Z.

The effect of Variable X and Variable Y on Variable Z is equal to the value of R, which is 0.5, and the outside influence (value e2) is  $\sqrt{1-0.5} = 0.71$

The effect of Variabel X on Variabel Z directly is 0.47.

The effect of Variabel X on Variabel Z indirectly (through Variable Y) is  $= 0.713 \times 0.297 = 0.212$

From the description above it can be concluded that all hypotheses can be accepted.

## V. DISCUSSION

Community demands regarding the accountable and transparent governance of government are increasing made the regional government agencies and its staff must exercise control over all activities. Therefore, the implementation of activities in a government agency is carried out in an orderly, controlled, effective and efficient start from planning, implementation, supervision, to accountability activities.

The implementation of the Government's Internal Control System must pay attention to the sense of justice and propriety and consider the size, complexity and nature of the duties and functions every government agencies. In order to strengthen and support the effective implementation of the Internal Control System, internal supervision must be carried out and fostering the implementation of the Government's Internal Control System.

Internal supervision is one part of internal control activities that has a function to independently assess the implementation of duties and functions of government agencies. The scope of internal control arrangements includes institutions, scope of work, human resource competencies, ethical codes, auditing standards, reporting, and peer review.

The guidance on the implementation of the Government's Internal Control System includes the preparation of technical guidelines for the implementation, outreach, education and training, guidance and consultation of the Government's Internal Control System, also improving the competence of auditors of Government Internal Supervision Apparatus.

## VI. CONCLUSION

1. The implementation of the Government's Internal Control System influences to the Quality of Financial Statements.
2. The implementation of the Government's Internal Control System and the Quality of Financial Statements influences to the Financial Accountability of Regional Governments.

#### VI.I. Suggestion

Based on the results of the study, the suggestions that can be given are: The Government's Internal Control System and the quality of financial statements are important factors in the financial accountability of regional governments. The researcher suggests to the government agencies about the important of the accounting function to actualize of the transparent and accountable financial statements in government agencies start from transaction analysis process up to compile the financial statement. This achievement must be supported by competent human resources. Competent human resources are human resources who have educational backgrounds that are in accordance with their fields, have high ethics and morals. This research has not revealed all the variables that can influences to the quality of financial statements and have an impact on the financial accountability of regional government. For further research it

is recommended to involve other variables such as human resource competencies, commitment of regional chief, accounting information systems, and information technology.

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