



## BOOK OF PROCEEDINGS

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## Conference Proceedings, IRC- 2015



### Book of Proceedings

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We would like to thank everyone who helped us to organize IRC-2015. A very special thanks to our honorable scientific and review committee for spending much of their time in reviewing the papers of this event and helping the participants in publishing their research in affiliated journals. Also special thanks to all the session chairs from industry, academia and policy institutions who volunteered their time and support to make this event a success. A very special thanks to the great scholars for being here with us as key note speakers, their valuable thoughts will surely open the horizon of new research and practice for the conference participants throughout the world.

Wish you a very successful conference and a pleasant stay in Singapore.

Dr. Farooq Anwar bajwa  
Conference Convener.

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## **THE ROLE OF INTERNAL CONTROL SYSTEM IN IMPROVEMENT OF QUALITY OF FINANCIAL REPORTING IN CENTRAL JAVA PROVINCE**

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### ***Abstract***

Indonesian Republic Government Regulation No 60/2008 has required local government to manage and save their recourses. It is important to save public accountability and transparency. So government financial statement will become more qualified. This research purpose is to investigate the role of internal control system in improvement of quality of financial reporting in central java province.

The population in this research is all of local government in central java, Indonesia. It is consist of 6 city governments and 29 districts. So the number of population is 35. Purposive sampling is used to collect samples by some criteria's: first, local government have reported their financial statement every years start from 2008 until 2013. Second, they have to implement accrual basic on the financial reporting in 2011.

Based on the result of regression analysis, we got t-statistic about 3,076. This value was more than t-table about 1,96. So we can suggest that the hypothesis is accepted. It means that internal control system have positive significantly on quality of financial reporting in central java province. Thus local government has to always improve their internal control system. This research support the research which conducted by Badara & Saidin (2013) and Adward (2011).

**Keyword :** Internal Control System, Financial Reporting, Public Sector Accounting, Government Accounting Standard

### **Introduction**

Based on the law No. 32/2004, local government are doing manage their recourses; have to reported their result management. Financial statement is one of the result management. It is important to save public accountability and transparency. Moreover, government has issued government regulation no 60/2008 about government internal control system. This law can be control for state official to save their assets.

Internal control becomes important factor to increase accountability financial reporting. Schaefer& James (2010) mentioned that internal control was designed to provide reasonable assurance regarding the achievement of which objectives of effectiveness and efficiency of operations, reliability of financial reporting and compliance with applicable laws and regulations. Better internal control, financial reporting will be more accountable. Beside that if internal control is worst, so financial reporting would contain risk management. However, According to COSO (2013) control systems can provide reasonable, but not absolute, assurance that financial statements are reliable and prepared in accordance with GAAP.

The concept of New Public Management as described by Aucoin (1990) had give inspiration for government to increase their performance. Deaconu and Nistor (2011) said that government as public institutions has implemented the accrual accounting. It is a component of a new concept entitled New Public Management. Although, government is not private sector but it become entrepreneurial entities an organizational, functional and procedural review is required by implementing a managerial system specific to the business sector.

Adward (2011) assessed the role internal control in Wakiso district financial reporting. He recommended that Wakiso district management should ensure that all internal controls that are implemented are properly functioning and are not undermined by its staff as a way of attaining quality of financial statements since internal controls lead to quality of financial statements. It was supported by Badara & Saidin (2013) have been examined the relationship between effective internal control system and internal audit effectiveness at local government level. They concluded that effective internal control system can influence the effectiveness of internal auditors at local level. Base on the background research in above, thus this research purpose is to analyze how role of internal control system on local government quality financial reporting in central java.

### ***Government Accounting Standard***

The development of public accounting standard or we know as government accounting standard (Standar Akuntansi Pemerintahan/ASP) in Indonesia still gradually increase. Until now there are 13 standard which have been issued by government standard Board. If we compare with standard held by private sector accounting, this standard still lag. It will be hamper local government performance to create quality financial statement. In the context of Indonesia, Kristiansen et al. (2008) report that national systems and traditions of politics and bureaucracy have a strong negative impact on local administrative procedures, leaving only marginal space for regional variance and improvements. They further argue that there is a remarkable lack of transparency and checks and balances in public financial affairs in Indonesia.

Mir & Sutiyono (2013) mentioned that Indonesia's socio-political circumstances have changed tremendously since the late nineties. Indonesia's political, economic and social institutions have experienced significant change and political reform, and decentralisation has been accompanied by moves to adopt more sophisticated accounting approaches in the public sector since the collapse of the Soeharto regime in 1998 (Harun 2007). These reforms relating to public sector financial management flow from a recognition that the proper functioning of democracy at both central and local levels required detailed evaluation of the efficiency, effectiveness and integrity of government's use of scarce resources in discharging their accountabilities. The socio-political reforms in Indonesia have influenced Indonesian politicians and policy makers to reform, among other things, its public sector accounting infrastructure. This section discusses Indonesia's public sector accounting reforms, drawing on the accounting infrastructure elements framework of Wallace and Briston (p. 202), namely, the demand factor, supply factor and regulatory factor.

Wallace and Briston (1993) argue that the basic elements of accounting infrastructure (i.e., the demand, supply and regulation of accounting information) are

influenced by a country's political, economic, social, educational and cultural factors, and that the national accounting infrastructure programmed suitable for a country would depend on the circumstances of the country. According to Mir & Sutiyono (2013) the demand factor for the Indonesian governmental financial statements would mainly come from the following stakeholders: citizens, National Parliament (Dewan Perwakilan Rakyat, DPR), supervisory agency and audit agency; other stakeholders which are involved in donations, investments and loans, and the government itself.

While Mir & Sutiyono (2013) also mentioned that the supply of accounting information is dependent on the training and education of the accountants and the auditors, the availability of quality institutions, and equipment in sufficient number to assist the accounting information producers. The accounting profession in Indonesia is regulated and controlled by the Indonesian Accounting Association (IAA) which was established in December 23, 1957. At the time of the writing the IAA has 6,899 members spread across Indonesia, which is divided into 20 regions. The IAA has four compartments with special guidelines to improve professionalism and to run professional activities and scientific function according to their field of work. These are:

1. Management Accountants Compartment;
2. Public Accountants Compartment;
3. Educational Accountants Compartment;

#### **4. Public Sector Compartment.**

The public sector compartment of the IAA (known as IAA-CPSA) deals with the training and education of public sector accountants and auditors. The objectives of the IAACPSA are: (1) to preserve the status and honour of the public sector accounting profession; (2) to improve the capability and responsibility of the public sector accountant profession; (3) to assist the public sector accountants in implementing their profession smoothly and responsibly; and (4) to improve the professional roles of the public sector accountant over time. IAA-CPSA has three categories of memberships: regular member, special member, and honorary member. In order to preserve the institution's professionalism, IAA has sanctioned mechanisms against the violations of their professional ethos in the form of (1) a written notice; (2) temporary suspension; (3) permanent dismissal. Each member of the IAA-CSPA is expected to go through ongoing professional education (SPE) involving the process of continuous learning to enhance their professional competencies. There are a number of training institutions including universities and colleges that also produce graduate accountants and some of these go through the process of the IAA to become professional accountants. However, very few of these institutions engage their resources in producing public sector accountants. Therefore, most of the university and college graduates including the professional accountants end up taking careers in private sector accounting. There are significant differences on the application and use of accounting information between private and governmental sectors, and the accounting training and education systems of Indonesia are yet to appreciate this.

#### **Internal Control System**

COSO (2010) defined internal control system as a process affected by an entity's board of directors, management, other personnel, designed to provide reasonable assurance regarding the achievement of objective in the following categories; effectiveness and

efficiency of operations, reliability of financial reporting, compliance with laws and regulations. There are five elements under the system which include; Control environment; the American institute of Certified Public Accountants (1994) control environment as an intangible factor and the first of the five components is the foundation for all other components of internal control, providing discipline and structure and encompassing both technical competence and ethical commitment. Manager must evaluate the internal control environment in their own unit and departments as the first step in the analyzing of internal controls. Control activities; these are policies and procedures that help ensure management directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the entity's objectives. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities as diverse as approvals, verifications, reconciliations, reviews of operating performance, security of assets and segregation of duties. (COSO, 2010)

The main objective of internal controls is to ensure that the business is carried in an orderly and efficient way, transactions take place according to set procedures, assets are safeguarded properly, prevention and detection of fraud and error, accuracy and completeness of accounting records and timely preparation of reliable financial information (Saleemi, 1991). Internal control activities are designed to provide reasonable assurance that particular objectives are achieved, or related progress understood. The specific target used to determine whether a control is operating effectively is called the control objective.

Management; the finance officer of the district has the overall responsibility for designing and implementing effective internal control. More than any other individual the finance and accounting officers have to set rules and policies that affect integrity and ethics in the organization (Welsch and Chesley, 1990). The internal auditors and external auditors of the government also measure the effectiveness of internal control through their efforts. The whether the controls are properly designed, implemented and working effectively and make recommendations on how to improve internal controls. They also review information technology controls, which relate to the IT systems of the district environment and commit the time necessary to fulfill their board responsibilities.

The role of internal control system is very important to increase quality of government financial statement. There is positive effect of internal control system on quality of financial statement. If internal control system is better, quality of financial is better. Based on this statement, we can take hypothesis that :

H : Internal control system have positive significant effect to quality of financial statement.

## **Research Method**

The population in this research is all of local government in central java, Indonesia. It is consist of 6 city governments and 29 districts. So the number of population is 35. Purposive sampling is used to collect samples by some criteria's: first, local government have reported their financial statement every years start from 2008 until 2013. Second, they have to implement accrual basic on the financial reporting in 2011. The source of data used is the secondary data attained directly from Indonesia financial regulatory agency website (Badan Pengawas Keuangan/BPK). Data in the form of result of financial

statement audit did by BPK. In this research have one variable independent: internal control system which measured by sum of fraud, and quality financial reporting which use measurement auditor opinion (1: Disclaimer, 2: Fair qualified and 3: Fair unqualified)

## Research Findings

### Respondents Identity

In this research, there were 36 government financial statement during 6 years. So sum of the samples were 216 samples. This following is description statistic about the sampes.

**Table 1.**  
**Descriptive Statistics**

	Mean	Std. Deviation	N
R QF	2.1250	.38353	216
ICS	8.6713	4.41333	216

Based on the table 1 about samples description statistic, we see that mean of internal control system about 8.6713. It is mean that sum of fraud which conducted by government average is 8.6. It is very big if we compare with degree of materiality about 1 or 2 fraud. QFR (quality of financial reporting) about 2,1. It is mean that all of financial statement got fair qualified opinion).

### Hypotheses Test

The following is the result of Multiple Linear Regression to test each hypothesis:

**Table 2**

### Hipotheses Test Results

#### Coefficients<sup>a</sup>

Model	Unstandardized Coefficients		Standardize d Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	1.970	.057		34.844	.000
ICS	.018	.006	.206	3.076	.002

a. Dependent Variable: QFR

Source: The analyzed primary data (2014)

The hypothesis is Internal control system have positive significant effect to quality of financial statement. Based on SPSS test toward Table 2, the test result of t–statistic value is 3,076 and t-table is 1,96. While the estimation coefficient value ( $\beta$ ) is 0,018. It means that  $H_a$  is acceptable and  $H_o$  is unacceptable or, in other words, Internal control system have positive significant effect to quality of financial statement. It also means that **the hypothesis is provenly true and acceptable.**

This result support the research which conducted by Adward (2011) which assessed about the role internal control in Wakiso district financial reporting and Badara & Saidin (2013). They have been examined the relationship between effective internal control system and internal audit effectiveness at local government level. It is mean that government has to consider this factor to increase their quality of financial statement. So, government must start to revise or redesign their internal control system to be better. Their internal control must can detect or minimize the fraud.

## Conclusion

The result of this research can be concluded that the internal control system have positive significantly on quality of financial reporting in central java province. This research support the research which conducted by Badara & Saidin (2013) and Adward (2011). Thus local government has to always improve their internal control system. This way to save accountability and transparency of their financial statement. Effective controls reduce the risk of asset loss, and help ensure that plan information is complete and accurate, financial statements are reliable, and laws and regulations are complied with. When internal control is effective, you have reasonable assurance that your plan is achieving its financial reporting objectives. When it is not effective, you have little or no such assurance (AICPA, 2007)

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**Appendix 1: Data of Internal Control System**

No	Name of Local Government	ICS					
		2008	2009	2010	2011	2012	2013
1	Prov Jawa tengah	8	4	8	11	7	13
2	Kab Banjarnegara	7	7	6	11	11	5
3	Kab Banyumas	0	10	4	3	6	10
4	Kab Batang	4	11	9	9	9	18
5	Kab Blora	0	12	8	12	10	15
6	Kab Boyolali	1	4	6	5	10	5
7	Kab. Brebes	6	7	9	13	17	14
8	Kab. Cilacap	15	7	11	10	15	13
9	Kab. Demak	10	7	9	11	15	14
10	Kab. Grobogan	0	8	10	15	9	13
11	Kab. Jepara	7	10	5	8	6	7
12	Kab. Karanganyar	0	7	6	10	11	10
13	Kab. Kebumen	0	15	12	19	14	4
14	Kab. Kendal	0	4	4	14	17	9
15	Kab. Klaten	7	9	8	10	9	9
16	Kab. Kudus	10	8	7	9	14	10
17	Kab. Magelang	0	12	8	18	12	14
18	Kab. Pati	0	10	5	8	7	10
19	Kab. Pekalongan	0	5	10	10	16	14
20	Kab. Pemasang	0	11	7	6	11	9
21	Kab. Purbalingga	0	10	10	10	18	8
22	Kab. Purworejo	6	6	10	9	16	16



2								
3	Kab. Rembang	0	10	6	19	10	12	
2								
4	Kab. Semarang	5	6	9	9	10	13	
2								
5	Kab. Sragen	0	8	9	10	11	11	
2								
6	Kab. Sukoharjo	0	3	6	7	10	10	
2								
7	Kab. Tegal	0	0	5	4	10	10	
2								
8	Kab. Temanggung	4	11	10	17	17	12	
2								
9	Kab. Wonogiri	0	8	6	9	8	9	
3								
0	Kab. Wonosobo	0	12	11	8	8	9	
3								
1	Kota Magelang	6	6	7	16	11	12	
3								
2	Kota Pekalongan	0	0	8	13	11	7	
3								
3	Kota Salatiga	9	9	9	10	11	11	
3								
4	Kota Semarang	13	4	13	10	15	12	
3								
5	Kota Surakarta	5	5	6	8	13	12	
3								
6	Kota Tegal	0	8	7	8	17	11	

## Appendix 2: Data of Quality of Financial Reporting

No	Name of Local Government	QFR						
		2007	2008	2009	2010	2011	2012	2013
1	Prov Jawa tengah	WD P	WD P	WD P	WD P	WTP	WTP	WTP
2	Kab Banjarnegara	WD P	WD P	WD P	WD P	WD P	WD P	WTP

3	Kab Banyumas	TMP	TMP	WD P	WD P	WD P	WD P	WD P	WD P
4	Kab Batang	WD P	WD P	WD P	WD P	WD P	WD P	WD P	WD P
5	Kab Blora	WD P	WD P	WD P	WD P	WD P	WD P	WD P	WD P
6	Kab Boyolali	WD P	WD P	WD P	WD P	WD P	WTP	WTP	WTP
7	Kab. Brebes	WD P	WD P	WD P	WD P	WD P	WD P	WD P	WD P
8	Kab. Cilacap	WD P	WD P	WD P	WD P	WD P	WD P	WD P	WD P
9	Kab. Demak	WD P	WD P	WD P	TMP	WD P	WD P	WD P	WD P
10	Kab. Grobogan	WD P	WD P	WD P	WD P	WD P	WD P	WD P	WD P
11	Kab. Jepara	WD P	WD P	WD P	WD P	WTP	WTP	WTP	WTP
12	Kab. Karanganyar	WD P	WD P	WD P	WD P	WD P	WD P	WD P	WD P
13	Kab. Kebumen	WD P	WD P	WD P	WD P	WD P	WTP	WTP	WD P
14	Kab. Kendal	TMP	WD P	WD P	WD P	WD P	WD P	WD P	WD P
15	Kab. Klaten	WD P	WD P	WD P	WD P	WD P	WD P	WD P	WD P
16	Kab. Kudus	WD P	WD P	WD P	WD P	WD P	WD P	WTP	WTP
17	Kab. Magelang	WD P	WD P	WD P	WD P	WD P	WD P	WD P	WD P
18	Kab. Pati	WD P	WD P	WD P	WD P	WD P	WD P	WD P	WD P
19	Kab. Pekalongan	WD P	WD P	WD P	WD P	WD P	WD P	WD P	WD P
20	Kab. Pemasang	WD P	WD P	WD P	WD P	WD P	WD P	WD P	WD P
21	Kab. Purbalingga	WD P	WD P	WD P	WD P	WD P	WD P	WD P	WD P
22	Kab. Purworejo	TMP	WD P	WD P	WD P	WD P	WD P	WTP	WTP
23	Kab. Rembang	WD P	WD P	WD P	WD P	WD P	WD P	WD P	WD P
24	Kab. Semarang	WD P	WD P	WD P	WD P	WD P	WTP	WTP	WTP

2		WD	WD	WD	WD	WD	WD	WD	WD
5	Kab. Sragen	P	P	P	P	P	P	P	P
2			WD	WD	WD	WD	WD	WD	WD
6	Kab. Sukoharjo	TMP	P	P	P	P	P	P	P
2		WD		WD	WD	WD	WD	WD	WD
7	Kab. Tegal	P	TMP	P	P	P	P	P	P
2		WD	WD	WD	WD	WD			
8	Kab. Temanggung	P	P	P	P	P		WTP	WTP
2		WD	WD	WD	WD	WD	WD	WD	WD
9	Kab. Wonogiri	P	P	P	P	P	P	P	P
3		WD	WD	WD	WD	WD	WD	WD	WD
0	Kab. Wonosobo	P	P	P	P	P	P	P	P
3		WD	WD	WD	WD	WD	WD	WD	WD
1	Kota Magelang	P	P	P	P	P	P	P	P
3		WD	WD	WD	WD	WD	WD	WD	WD
2	Kota Pekalongan	P	P	P	P	P	P	P	P
3		WD	WD	WD	WD	WD	WD	WD	WD
3	Kota Salatiga	P	P	P	P	P	P	P	P
3		WD	WD	WD	WD	WD			
4	Kota Semarang	P	P	P	P	P		WTP	WTP
3		WD	WD	WD				WD	WD
5	Kota Surakarta	P	P	P		WTP	WTP	P	P
3		WD	WD	WD	WD				
6	Kota Tegal	P	P	P	P		WTP	WTP	WTP