

A Conceptual Paper: Internal Control System in Government

Azza Septiria^{1*}, Maya Indriastuti²

^{1 2} Department of Accounting, Faculty of Economics and Business, Universitas Islam Sultan Agung, Indonesia. Email: azzaseptiria00@gmail.com

ABSTRACT

This study aims to examine the influence of human resource (HR) competence on the quality of local government financial reports, with the internal control system acting as a mediating variable. Using a conceptual approach derived from prior empirical and theoretical studies, this paper explores how competent human resources and effective internal control systems contribute to the improvement of financial reporting quality in local governments. The study emphasizes compliance theory as the underlying foundation, explaining how adherence to regulations and standards enhances accountability and transparency in public sector financial management. Findings from previous research suggest that HR competence positively affects the internal control system, which in turn mediates its relationship with financial reporting quality. This conceptual model is expected to guide future empirical research using quantitative approaches, particularly SEM-PLS analysis, to validate the proposed hypotheses

Keywords: Human Resource Competence, Internal Control System, Financial Reporting Quality.

INTRODUCTION

Financial reporting in local governments serves as a manifestation of accountability in managing public finances. In recent years, many local governments in Indonesia have obtained unqualified audit opinions (WTP) from the Audit Board of Indonesia (BPK). However, this achievement does not automatically reflect optimal internal management quality. Several findings from BPK indicate weaknesses in internal control systems, such as accountability delays or deviations in budget realization. These conditions demonstrate that a good audit opinion does not necessarily imply strong internal governance.

The quality of local government financial statements is reflected in the audit opinion given by BPK after assessing the fairness and accuracy of the reports. According to Ahmad et al. (2020), financial statements are considered high-quality when prepared in accordance with government accounting standards and based on an effective internal accounting system. In the context of public sector accountability, the government continuously improves financial management mechanisms to ensure transparency, accuracy, and reliability in reporting. Compliance theory (Mitchell, 2008) supports this principle, emphasizing that entities must adhere to regulations as an expression of legal and ethical responsibility.

Human resource competence plays a vital role in ensuring reliable financial reporting. Competent personnel, who possess adequate knowledge, skills, and attitudes (KSA), can apply accounting principles accurately and ensure compliance with standards. Meanwhile, a robust internal control system (ICS) guarantees that financial transactions are properly supervised, recorded, and reported. The interaction between HR competence and ICS is thus essential in determining the overall quality of financial statements

LITERATURE REVIEW

Compliance Theory.

Compliance theory explains why individuals and organizations adhere to laws, norms, and rules. In public sector accounting, compliance with Government Accounting Standards (SAP) is crucial to maintaining the credibility of financial reports. Tyler (1990) differentiates between instrumental compliance motivated by avoiding sanctions and normative compliance driven by moral and ethical responsibility. Thus, competent HR and effective ICS jointly promote normative compliance that leads to improved reporting quality.

In the public accounting context, Compliance Theory explains why government officials and financial officers adhere to accounting standards and reporting regulations. Compliance with Government Accounting Standards (SAP) can be driven by instrumental considerations—such as the desire to avoid audit findings, reputational loss, or sanctions from oversight bodies like the Audit Board of Indonesia (BPK)—or by normative factors, including professional ethics, institutional culture, and organizational commitment to transparency (Mitchell, 2008). Empirical studies in public sector accounting suggest that normative drivers (professional identity, sense of duty) often enhance voluntary adherence to accounting procedures beyond minimal legal requirements, thereby improving report quality and public trust.

In summary, Compliance Theory supplies a robust theoretical foundation for the present study: it explains how regulatory adherence is produced through a combination of external enforcement and internalized norms, and it highlights the central roles of human competence and internal control systems in shaping accounting behaviour. The theoretical synthesis suggests three testable propositions: (1) HR competence enhances ICS effectiveness, (2) effective ICS improves financial reporting quality, and (3) HR competence influences reporting quality indirectly through ICS. Empirically testing these linkages will contribute to closing existing gaps in the literature by clarifying the mechanisms of compliance in local government financial reporting

HYPOTHESIS DEVELOPMENT

Human Resource Competence and Internal Control System

Human resource competence refers to the knowledge, skills, and attitudes (KSA) possessed by individuals that enable them to perform financial management functions effectively. In the public sector, competent personnel play a crucial role in ensuring accurate and transparent financial reporting. According to Compliance Theory, individuals with higher competence are more likely to comply with rules and standards not only because of enforcement mechanisms (instrumental compliance) but also due to internalized ethical norms (normative compliance) (Tyler, 1990; Mitchell, 2008).

Competent financial officers are better able to understand accounting standards, implement control procedures, and maintain accountability in accordance with government regulations. Several studies have confirmed that HR competence has a significant effect on the effectiveness of internal control systems (Afiah & Azwari, 2015; Muda et al., 2017). Therefore, the first hypothesis is proposed as follows

H1: Human resource competence has a positive effect on the effectiveness of the internal control system.

Internal Control System and Quality of Financial Reporting

The Internal Control System (ICS) ensures that organizational operations are conducted effectively, efficiently, and in compliance with applicable laws and regulations. From the perspective of Compliance Theory, the ICS acts as an institutional mechanism that reinforces adherence to rules through both external enforcement (policies, sanctions) and internalized organizational norms. A well-implemented ICS minimizes errors and fraud, ensures accuracy of data recording, and enhances the reliability of financial reporting (COSO, 2013; Afiah & Azwari, 2015).

Empirical studies in local governments show that effective ICS improves the quality of financial reporting by strengthening accountability and transparency (Sumaryati et al., 2020; Yaya & Pawestri, 2021). Therefore, the second hypothesis is proposed as follows:

H2: The internal control system has a positive effect on the quality of local government financial reporting.

Human Resource Competence and Quality of Financial Reporting through Internal Control System

Compliance Theory also suggests that organizational outcomes such as high-quality reporting are achieved when competent individuals operate within an effective control environment. While HR competence directly influences reporting quality, its effect is often strengthened through the mediating role of internal control systems, which translate individual capability into institutionalized compliance practices (Ahmad et al., 2020; Muda et al., 2017). Competent employees design, execute, and monitor internal control activities more effectively, which in turn leads to improved accuracy, reliability, and transparency in financial reporting. Thus, the internal control system serves as a mediating mechanism between HR competence and reporting quality. Therefore, the following hypothesis can be formulated:

H3: Human resource competence positively influences the quality of local government financial reporting through the internal control system as a mediating variable.

EMPIRICAL RESEARCH MODEL

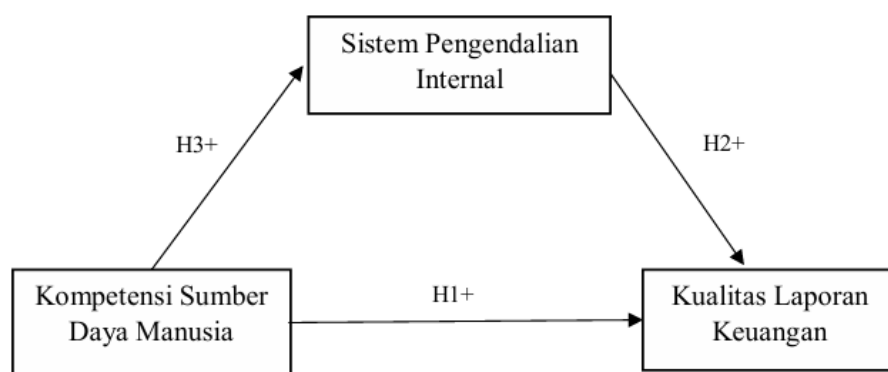


Figure 1. Research Model

RESEARCH METHOD

Type of research

this research adopts a descriptive quantitative research approach aimed at explaining the relationship between human resource competence, internal control system, and the quality of local government financial reporting. The study focuses on how the internal control system mediates the effect of HR competence on financial reporting quality in local governments.

Population and sample

The population in this study consists of employees from various local government offices (Organisasi Perangkat Daerah/OPD) in Semarang City who are directly involved in financial management and reporting processes. The sample will be selected using a purposive sampling technique, targeting officials in accounting, budgeting, and treasury units who have direct responsibility for preparing financial statements. The estimated sample size is around 20 respondents representing several local government agencies.

Data collection methods

Data will be collected using questionnaires distributed to respondents through both printed and online formats. The questionnaire will use a Likert scale to measure the degree of agreement with statements related to HR competence, internal control system, and financial reporting quality. In addition, interviews and documentation studies will be conducted to strengthen understanding of how internal control mechanisms operate within local government institutions.

CONCLUSION

This conceptual paper concludes that both human resource competence and internal control systems play significant roles in improving the quality of local government financial reporting. The internal control system serves as an important mediating mechanism that connects the technical and behavioral aspects of HR competence to the organizational outcome of transparent and accountable reporting. This framework provides a theoretical foundation for future empirical studies on public sector accounting quality improvement in Indonesia.

REFERENCES

- Afiah, N. N., & Azwari, P. C. (2015). The Effect of the Implementation of Government Internal Control System on the Quality of Financial Reporting of the Local Government. *Procedia - Social and Behavioral Sciences*, 211, 811–818.
- Ahmad, I., Abdullah, A., Khalik, A., & Putra, A. H. P. K. (2020). Competencies of Apparatus and Internal Control System Effect on The Quality of Financial Statement Information and Good Governance. *European Journal of Business and Management Research*, 5(4), 1–6.
- Mitchell, R. B. (2008). Compliance Theory. In *The Oxford Handbook of International Environmental Law*. Oxford University Press.
- Muda, I., Erlina, & Bukit, R. (2017). The Influence of Human Resources Competency and the Use of Information Technology on the Quality of Local Government Financial Report. *Journal of Theoretical and Applied Information Technology*, 95(20), 5552–5561.
- Tyler, T. R. (1990). *Why People Obey the Law*. Yale University Press.
- Yaya, R., & Pawestri, D. C. N. (2021). The Quality of Local Government Financial Statement and Its Determinant Factors. *Proceedings of the 4th International Conference on Sustainable Innovation 2020*.
- Sudiarianti, N. M. (2015). 'Pengaruh Kompetensi Sumber Daya Manusia Pada Penerapan Sistem Pengendalian Intern Pemerintah dan Standar Akuntansi Pemerintah Serta Implikasinya Pada Kualitas Laporan Keuangan Pemerintah Daerah', *Penelitian mandiri*, 4(71), pp. 1–25.

- SUMARYATI, A., NOVITASARI, E. P. and MACHMUDDAH, Z. (2020) 'Accounting Information System, Internal Control System, Human Resource Competency and Quality of Local Government Financial Statements in Indonesia', *The Journal of Asian Finance, Economics and Business*, 7(10), pp. 795–802. doi: 10.13106/jafeb.2020.vol7.n10.795.
- Usman, A., Wirawan, H. and Zulkifli (2021a) 'The effect of human capital and physical capital on regional financial condition: the moderating effect of management control system', *Heliyon*, 7(5). doi: 10.1016/j.heliyon.2021.e06945.
- Usman, A., Wirawan, H. and Zulkifli (2021b) 'The effect of human capital and physical capital on regional financial condition: the moderating effect of management control system', *Heliyon*, 7(5), p. e06945. doi: 10.1016/J.HELİYON.2021.E06945.
- Wiyani, L. and Viddy, A. (2022) 'Influence of Human Resources and Competency Internal Control System on the Quality of Financial Reports with the Application of Accrual Based Accounting Standards as a Mediation Variable', *Proceedings of the International Conference on Applied Science and*
- Rizka S, A., Zamzami, Z. and Gowon, M. (2021) 'Pengaruh Kompetensi Sumber Daya Manusia Dan Sistem Pengendalian Internal Terhadap Kualitas Laporan Keuangan Dengan Kesuksesan Penerapan Sistem Informasi Pengelolaan Keuangan Daerah Sebagai Variabel Intervening', *Jurnal Akuntansi & Keuangan Unja*, 6(3), pp. 136–148. doi: 10.22437/jaku.v6i3.1611