

Reliability of Financial Reports: Aspects of Internal Control Systems and Compliance with Legislation

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ABSTRACT: This study aimed to empirically test the effect of weaknesses in the internal control system and non-compliance with statutory provisions simultaneously on the reliability of financial statements, to empirically test the effect of weaknesses in the internal control system on the reliability of financial statements, and to empirically test the effect of non-compliance with statutory provisions on the reliability of financial statements. The type of research used is associative research. The data used was secondary data. The population in this study was 60 Financial Reports of the Sesumbagsel Regency/City Government in 2021-2022. The sample used was 60 Financial Reports of the Sesumbagsel Regency/City Government with the purposive sampling method. Data collection techniques are by using document analysis. The analysis methods used were quantitative and qualitative. The analysis technique used is multiple linear regression. The results showed that simultaneously, weaknesses in the internal control system and non-compliance with statutory provisions had a significant effect on the reliability of financial statements. Partially, Weaknesses in the internal control system had a significant effect on the reliability of financial statements. Partially, non-compliance with statutory provisions did not have a significant effect on the reliability of financial reports.

KEYWORDS :Weaknesses in Internal Control Systems, Non-Compliance with Statutory Regulations, and Reliability of Financial Reports

INTRODUCTION

The implementation of regional government accounting is carried out in each region, the regional government is obliged to report accountability for financial management to the central government, then it will be made into a consolidated report in the form of a regional government financial report. In article 31 of Law of the Republic of Indonesia No. 17 of 2003, concerning State Finance, it states that regional governments are required to report accountability for the use of regional revenue and expenditure budgets in the form of financial reports that have been audited by the Audit Board of Indonesia in carrying out its duties there are three types of audits carried out by the Audit Board of Indonesia, namely: a). financial audit, b). performance audit, and c). audit with a specific purpose.

The Audit Board is responsible for conducting audits on the management and accountability of state finances and providing opinions on financial reports. Financial report is to present useful information for users in assessing accountability and making decisions. The criteria for forming the quality of financial report information based on Government Regulation of the Republic of Indonesia No. 71 of 2010 concerning Government Accounting Standards replacing Government Regulation of the Republic of Indonesia Number 24 of 2005 states that quality financial reports must meet several characteristics, namely: understandable, relevant, reliable, and comparable. Government financial reports must meet these four

characteristics to achieve their objectives, because these characteristics are the requirements needed for government financial reports to meet the desired quality.

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The quality of the government's financial report can be identified through the opinion on the financial report of the ministry/institution given by the Audit Board of the Republic of Indonesia. Information in the financial report cannot be useful if the presentation and delivery of the financial information is not reliable. Government Regulation of the Republic of Indonesia Number 71 of 2010 states that reliability is information in the financial report that is free from misleading understanding and material errors, presents every fact honestly, and can be verified. Financial report information must also be presented completely by considering materiality and costs.

A good internal control system is expected to increase the reliability of financial reports, so it can convince stakeholders and the public about the accuracy of financial reports made by local governments (Emy, 2017). Local Government Financial Reports must be reliable in order to be useful for users, so they must be prepared based on good internal control system. An internal control system is an organizational structure, methods, and measure that are coordinated to maintain organizational assets, check the accuracy and reliability of accounting data, encourage efficiency and compliance with management policies (Mulyadi, 2014).

Law of the Republic of Indonesia No. 60 of 2008, concerning the Government Internal Control System, article 1 explains that the internal control system is an integral process in actions and activities carried out continuously by leaders and all employees to provide adequate assurance of achieving organizational goals through effective and efficient activities, reliability of financial reporting, security of state assets, and compliance with laws and regulations. In accordance with Law Number 60 of 2008, there are five elements of the internal control system, namely: Control environment, Risk assessment, Control activities, Information and communication, and Internal control monitoring. According to Arisanti (2011) a weak accounting system causes weaknesses in internal control and ultimately the resulting financial reports are less reliable and less relevant for decision making.

Non-compliance with laws and regulations is also a determining factor in the high or low quality of a local government financial report. Non-compliance with laws and regulations is an illegal act against laws and regulations, fraud, and non-compliance that has a direct and material impact on the presentation of the quality of financial reports (Summary of Audit Results Semester I, 2020). Laws and Regulations are used by the Audit Board as a basis for testing to detect fraud that deviates from the presentation of financial reports. Testing of compliance will be presented by the Audit Board in the audit report in the form of findings of non-compliance. Findings of non-compliance include findings that result in state/regional/company losses, have 3 potentials, namely: a). state/regional/ company losses, b). lack of revenue, administration, c), inefficiency, inefficiency, and ineffectiveness.

Previous related studies conducted by Moemahadi (2017) and Emira (2020), showed that weaknesses in the internal control system and non-compliance with laws and regulations has a positive effect on the quality of financial reports. Furthermore, Faristina and Warsito (2015), Filbert (2016), and Emy et al. (2017), show that the internal control system has a positive effect on the reliability of financial reporting.

Furthermore, research conducted by Rofi (2017), the internal control system affects the opinion of the financial report and for compliance with laws and regulations does not affect the opinion of the audit results of the financial report. In general, the Summary of Semester Audit Results of the Audit Board of Indonesia states that the financial statements of local

governments that obtain an unqualified opinion and a qualified opinion have a proper/adequate internal control system, then the financial statements of local governments that do not provide an opinion (disclaimer opinion) and are unfair (adverse opinion) still need to require evaluation and improvement of the internal control system. It is concluded that the more audit findings in the financial statements of local governments indicate that the less effective the internal control system is in a local government entity or the smaller the opportunity to obtain an unqualified opinion and a fair opinion with exceptions.

Table 1. Total of Audit Opinions

Year	UO	QO	AO	DO	Local Government Financial Report
2018	52	8	-	-	60
2019	55	5	-	-	60
Total	107	13	-	-	120

Source : IHPS I, 2023

The financial reports of local governments in Sesumbagsel Regency/City that received an unqualified opinion have increased. In 2021, there were 52 local government financial reports that received an unqualified opinion, while in 2022, there were 55 local government financial reports that received an unqualified opinion. It means that there was an increase of 3 local governments that received an unqualified opinion. Meanwhile, the financial reports of local governments that received an unqualified opinion were 8 in 2021 to 5 in 2022. The increase in unqualified and qualified opinions given by the Audit Board on local government financial reports indicates that local governments have made improvements and have a proper/adequate internal control system. Referring to these results, there should be no more findings of weaknesses in the internal control system and non-compliance with legislation, but in reality, many of these weaknesses are still found in the financial reports.

Table 2. Total of SPI Weakness

NO	Province Regency/City	Total of SPI Weakness	
		2021	2022
1.	South Sumatra	84	83
2.	Lampung	78	71
3.	Bangka Belitung	38	40
4.	Bengkulu	56	66
5.	Jambi	49	58
Total		305	318

Source: IHPS, 2023

Table 2 shows that the number of findings of weaknesses in the internal control system increased from 2021 to 2022, namely in 2021 there were 305 SPI weaknesses increasing to 318 findings and in 2022. The increase in the number of weaknesses occurred due to problems with weaknesses in the accounting and reporting control system, weaknesses in the control system for the implementation of the revenue and expenditure budget, and weaknesses in internal control. This examination is included in financial examinations and examinations with specific objectives and contains problems that do not have a financial impact (Audit Agency of the Republic of Indonesia, 2017).

Table 3. Number of non-compliances

NO	Province Regency/City	Number of Non-Compliance	
		2021	2022
1.	South Sumatra	111	116
2.	Lampung	106	98
3.	Bangka Belitung	66	60
4.	Bengkulu	75	73
5.	Jambi	74	70
Total		432	417

Source: IHPS, 2023

Table 3 shows that the number of findings of non-compliance with legislation decreased from 2021 to 2022. The decrease in the number of findings of non-compliance with legislation occurred due to improvements in problems regarding non-compliance with legislation that caused losses, potential losses, shortfalls in revenue, administration and indications of criminal acts. These findings are found in financial, performance, and audit audits with specific objectives (Audit Agency, 2017). Based on tables 2 & 3, it is concluded that the weaknesses of SPI and non-compliance with legislation in 2021 and 2022 improved with a decrease in the number of non-compliance with legislation by 15 while the weaknesses of the internal control system decreased with an increase in the number of weaknesses by 13. Weaknesses. The motivation in this study, the importance of the internal control system, and non-compliance with the provisions of laws and regulations on the reliability of financial reports must be accompanied by a reduction in the number of weaknesses in the internal control system, and a reduction in the number of non-compliance with the provisions of laws and regulations so that it will result in good reliability of financial reports.

LITERATURE REVIEW

The reliability of financial reports occurs if the information presented is free from errors, presented as it is, sincerely, honestly and fairly (Albertus, 2013). Reliable describes the economic phenomena in financial report (Nelson, 2014).

Reliability is information with reliable quality if it is free from misleading understanding, material errors, and can be relied on by its users as a sincere or honest presentation of what should be presented or what is reasonably expected to be presented (Wiratna, 2016).

According to Government Regulation Number 71 of 2010, concerning Government Accounting Standards, reliability is Information in financial statements and it is free from misleading understanding and material errors, presents every fact honestly, and can be verified. Information may be relevant, but if its nature or presentation is unreliable then the use of the information can potentially be misleading. The criteria and elements that form the quality of information that create the information in a government financial report have value or benefits consist of: a) relevant, b) reliable, c) comparable and d) understandable.

The Internal Control System is an integral process in actions carried out based on four objectives to be achieved, by building a government internal control system through effective and efficient activities, reliable financial reporting, securing state assets, and compliance with laws and regulations (Government Regulation No. 60 of 2008).

According to COSO (Committee Of Sponsoring Treadway Organization Commasion) internal control system is designed and influenced by the entity's board of directors, management, and other personnel o provide reasonable assurance about the achievement of the entity's objectives in the following categories: Reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations (William et al., 2014: 192). Internal control system is a system created to provide security assurance for elements within an entity (Wiratna, 2015: 69). Internal control system is an organizational structure, methods, and measures that are coordinated to safeguard the organization's assets, check the accuracy and reliability of accounting data, encourage efficiency and compliance with management policies (Mulyadi, 2014).

Internal control system is a plan that includes organizational structure, all methods, and coordinated tools used in an entity with the aim of maintaining the security of company assets, checking the accuracy and truth of accounting data, encouraging efficiency, and helping to encourage compliance with established management policies. The objectives of the internal control system are (Arens, 2012): a). Reliability of financial reports, b). Effectiveness and efficiency of operations, and c). Compliance with applicable laws and regulations.

Internal control system weaknesses are significant deficiencies in internal control that, alone or in combination with other significant deficiencies, make it less likely that misstatements will be prevented or detected (Arens.et.al: 2008). Non-compliance is a failure to comply with a requirement or violation of a prohibition contained in a regulation, contract, or assistance that leads to the conclusion that a collection of misstatements is a result of the failure or violation (Faiz, 2014). Non-compliance with laws and regulations is an illegal act

against laws and regulations, fraud, and non-compliance that has a direct material effect on the presentation of financial statements (Financial Audit Agency: 2020).

RESEARCH METHDOLOGY

The population in this study was 60 regencies/cities in Sesumbagsel, namely Jambi Province with 11 regencies/cities, Bangka Belitung Province with 7 regencies/cities, Lampung Province with 15 regencies/cities, Bengkulu Province with 10 regencies/cities, and South Sumatra Province with 17 regencies/cities. This study is a study using secondary data in the form of the Summary of Semester Financial Audit Results (IHPS) obtained from the website www.Badan Pemerikasan Keuangan.go.id. In the 2021-2022 IHPS

RESULTS AND DISCUSSION

Descriptive statistical test is to find out and explain the variables of internal control system weaknesses and non-compliance with the provisions of laws and regulations used in this study. Based on the results of descriptive testing, the following table can be seen:

Table 4. Descriptive Statistics

	N	Min	Max	Mea	Std.
		ium	imu	n	Deviation
Weaknesses in the internal control system	68	4	12	9,16	1,850
non-compliance	68	11	15	12,49	1,000
rebiability	68	7	12	10,05	1,370

Source: data processing, 2024

The results of the normal probability plot test showed that the data graph provided a normal distribution pattern, as seen from the graph that the points were distributed around the line and follow the diagonal line. Furthermore it showed that all independent variables in this study did not experience multicollinearity symptoms, in this study there was no heteroscedasticity in the regression model, furthermore there was no autocorrelation in the regression model. The results of the hypothesis testing were shown in the following table:

Table 5. Simultaneous Hypothesis Testing

ANOVA^b

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.049	2	.025	4,079	.021*
	Residual	.394	65	.006		
	Total	.444	67			

a. Predictors: (Constant), LN_e, LN_w

b. Dependent Variable: LN_r

The test results showed that weaknesses in the internal control system and non-compliance with the provisions of laws and regulations had a significant effect on the reliability of financial reports. Furthermore, the partial hypothesis test was shown below:

Table 6. Partial hypothesis test table

Model	Unstandardize	Stand	t	Sig.	
	d Coefficients	rdized			
	B	Std.E	Coeffic		
		rror	ients		
(Cosntant)	7,597	2,216	3,428	0,001	
Weaknesses in the internal control system	1,85	0,089	0,250	2,080	0,041
non-compliance	0,062	0,164	0,045	0,374	0,709

a. Dependent variabel: reliability

The Internal Control System weaknesses had a partial and significant influence on the reliability of regional government financial reports. Meanwhile, non-compliance with laws and regulations did not affect the reliability of financial reports. Based on the results of hypothesis testing in the study, it showed that weaknesses in the internal control system and non-compliance with the provisions of laws and regulations together had a positive and significant effect on the reliability of local government financial reports. The more weaknesses in the internal control system and non-compliance with laws and regulations in the financial reports, the worse or lower the reliability of the financial reports.

On the contrary the less the weaknesses of the internal control system and the non-compliance with legislative regulations on the financial statements then the better or higher the reliability of the financial statements. It is because internal control systems and non-compliance with legislative regulations were important factors in the presentation of financial statements.

Good presentation of financial reports results in good reliability of financial reports. The results of this study are supported by the theory of William et al. (2014), Sunardi, et al. (2021), the internal control system is designed and influenced by the entity's board of directors, management, and other personnel to provide reasonable assurance about the achievement of the entity's objectives in the following categories: Reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

According to the Financial Conduct Authority (2020). Non-compliance with legislative regulations is illegal act against legislative regulations, fraud, as well as non-compliance with material direct effect on the presentation of financial statements.

Based on the results of the hypothesis test, it showed that the weaknesses of the internal control system significantly affected the reliability of financial reports, it means that the more weaknesses in the internal control system, the worse or lower the reliability of the financial reports. Conversely, the fewer weaknesses in the internal control system, the better or higher the reliability of the financial reports. The better the implementation of the internal control system, the better the reliability of the financial reports. A good internal control system, if not implemented effectively, it may cause many discrepancies between the ongoing process and applicable regulations, so that the quality of the resulting financial reports will not improve.

The results of this study are supported by the theory of William *et al.* (2014) that the internal control system is designed and influenced by the entity's board of directors, management, and other personnel to provide reasonable assurance regarding the achievement of the entity's objectives in the following categories: Reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

The test results showed that non-compliance with the provisions of laws and regulations did not significantly affect the reliability of financial reports, it means that non-compliance with the provisions of laws and regulations did not have an effect and is not significant to the reliability of financial reports. It is because non-compliance is a level of assessment of whether all regional government apparatuses have complied in implementing laws and regulations. The level of non-compliance depends on how many findings and evidence are related to regional government apparatuses that do not comply with laws and regulations.

The Audit Board of Indonesia (2020) explains that non-compliance with laws and regulations is an illegal act against laws and regulations, fraud, and non-compliance with direct and material impact on the presentation of financial statements. a collection of misstatements as a result of failure or violation.

CONCLUSION AND SUGGESTION

The conclusion of the study is: a). Weaknesses in the internal control system and non-compliance with the provisions of laws and regulations with significant effect on the reliability of financial reports, b). Weaknesses in the internal control system has a significant effect on the reliability of financial reports, and c). Non-compliance with the provisions of laws and regulations does not affect the reliability of financial reports. Furthermore, this study provides suggestions: a). The local government should strengthen the internal control system to minimize findings, both material and the total number of findings. b). The local government must make improvements to the findings and comply with laws and regulations.

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