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Internal Control Systems Improve the Quality of Government Financial Reporting

Muhammad Rifky Setyawan Asdar[1]

[1] Universitas Muhammadiyah Makassar, Makassar, Indonesia

Abstract

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This study aims to analyze the influence of accountability, transparency, and internal control systems on the quality of financial statements in the public sector. The research employs a descriptive qualitative approach by reviewing various recent empirical studies relevant to the topic. Accountability and transparency play a crucial role in building public trust and ensuring that financial management is carried out efficiently and in accordance with the principles of good governance. Meanwhile, a strong internal control system contributes to preventing errors and fraud while ensuring compliance with applicable regulations. The synthesis of the literature indicates that these three variables are interrelated and mutually reinforcing in improving the quality of government financial statements. Public sector entities that demonstrate accountability and transparency, supported by an effective internal control mechanism, are more likely to produce financial reports that are reliable, relevant, and free from irregularities. These findings are expected to serve as a reference for policymakers in strengthening public financial governance that is both professional and integrity-driven. Strengthening these three aspects collectively can contribute to enhancing the credibility of public sector financial information and supporting better decision-making processes within governmental institutions.

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1. Introduction

Accountability and transparency are two fundamental pillars in the practice of good governance. In the context of public administration, these two principles form the foundation for the effective, efficient, and accountable conduct of state financial management. Accountability asserts the government's obligation to provide an account for the use of public resources to the public. Meanwhile, transparency is closely related to the openness of information, allowing the public to clearly and easily understand the processes and results of state financial management (Dewi et al., 2019). Both have become increasingly important with the rising public demand for a clean, integrated, and responsive bureaucracy. Within this framework, government financial reports serve as the main instrument for upholding public accountability. Through financial reports, the public and stakeholders can assess the extent to which the government manages public resources appropriately, adheres to financial management principles, and effectively implements development programs.

Furthermore, financial reports also serve as a basis for evaluating policy effectiveness, supporting decision-making processes, and improving public sector organizational performance in the subsequent period (Brusca et al., 2018). Thus, the quality of information presented in financial reports reflects the government's level of reliability, relevance, and compliance with applicable government accounting standards. The role of financial reports is not merely administrative but also strategic in maintaining public trust in the government. Nevertheless, various studies reveal that there are a number of challenges in efforts to improve the quality of government financial reports. One factor that is highly influential is the effectiveness of the Internal Control System (*Sistem Pengendalian Internal*/SPI). Ningtyas et al. (2019) assert that SPI is a set of policies, procedures, and control mechanisms designed to provide reasonable assurance that organizational activities run systematically, orderly, efficiently, and in accordance with regulations. The presence of an effective SPI functions to minimize the risk of fraud, detect recording errors, ensure compliance with regulations, and maintain the reliability of the financial reporting process.

Thus, SPI is viewed not only as a technical instrument but also as an essential component in guaranteeing the integrity of government financial reporting. The effectiveness of SPI itself is heavily influenced by human resources and organizational culture factors. Limited competence of personnel, lack of leadership commitment, and weak internal supervision are often the main causes of suboptimal system implementation. Chalmers et al. (2019) emphasize that the success of SPI in the public sector is determined not only by the existence of regulations governing control mechanisms but also by the ethical awareness, professionalism, and integrity of the personnel implementing them. In other words, a strong control system must be supported by bureaucratic actors who understand the importance of accountable governance.

The relationship between accountability, transparency, and SPI has a mutually reinforcing nature. High accountability encourages broader information transparency, while transparency strengthens the effectiveness of internal control through public involvement in the oversight process. The interaction of these three elements forms a comprehensive financial governance framework to enhance the quality of government financial reports. An accountable and transparent government has a greater chance of building an effective control system, while a strong SPI helps reinforce the credibility and public trust in the information presented. Based on this description, this research focuses its analysis on the link between accountability, transparency, and the internal control system in influencing the quality of government financial reports. By examining the findings of previous research, this study is expected to provide theoretical and practical contributions to strengthening public financial governance that is integrated and oriented towards public trust.

2. Literature Review

2.1. Accountability and Transparency in Public Financial Management

Accountability is a moral and legal obligation for every public entity to account for the management of resources and the implementation of policies financed by public funds. Dewi et al. (2019) explain that public accountability includes administrative, financial, and social responsibilities aimed at ensuring that government actions comply with regulations and can be evaluated by the public. An accountable government is able to provide financial reports that are honest, transparent, and reflect the efficient and effective use of the budget. Transparency complements accountability by demanding openness regarding financial information and public policy. Brusca et al. (2018) assert that transparency in financial reporting allows the public to assess and oversee government performance through access to clear and relevant information. Information openness creates active public participation and strengthens social oversight.

In the context of public finance, transparency is not only a formal aspect but also a means of building trust between the government and the community. Veale et al. (2018) add that consistent transparency practices can increase public legitimacy and strengthen the reputation of government institutions. The link between accountability and transparency is very close; both principles mutually reinforce each other in forming good governance. Basri et al. (2021) state that the higher the level of accountability, the greater the transparency, as the government is encouraged to open up the budget management process. Conversely, without transparency, accountability is difficult to realize because the public does not have access to the necessary information to conduct oversight.

2.2. Internal Control System in Improving the Quality of Financial Reporting

SPI is an important instrument in maintaining the integrity and reliability of public sector financial reports. SPI functions to provide reasonable assurance that organizational activities are carried out efficiently, financial reports are accurate, and public assets are protected from misuse. Ningtyas et al. (2019) explain that SPI consists of five main components: control environment, risk assessment, control activities, information and communication, and monitoring. If implemented consistently, these five components are capable of detecting errors and preventing fraud in financial reporting. Chalmers et al. (2019) found that the effectiveness of SPI in the public sector is greatly influenced by organizational culture, human resource competence, and leadership commitment. A good SPI is not limited to administrative procedures but also involves the values of integrity and ethics of the employees.

Weak implementation of SPI has the potential to decrease the quality of financial reports because it increases the risk of misstatement and non-compliance with accounting standards. Meanwhile, Adiputra et al. (2018) states that the effective implementation of SPI contributes significantly to increasing reporting transparency and operational efficiency of public institutions. Furthermore, routine evaluation of SPI effectiveness is necessary to maintain its relevance and accuracy. According to Brusca et al. (2018), common weaknesses often found in SPI implementation are non-compliance with procedures and lack of technical training for employees. Therefore, institutional reform and capacity building of human resources are important steps to ensure that the control system runs optimally and sustainably.

2.3. The Relationship of Accountability, Transparency, and SPI to the Quality of Financial Reports

The quality of government financial reports depends not only on compliance with accounting standards but also on the application of accountability, transparency principles, and the effectiveness of the internal control system. Chalmers et al. (2019) show that increased public accountability is directly proportional to improvements in the quality of financial reports because it encourages honesty, integrity, and responsibility in reporting. High accountability ensures that every financial transaction can be accounted for administratively and morally. Meanwhile, Adiputra et al. (2018) asserts that transparency acts as a catalyst in creating financial reports that are more reliable and easily understood by the public. When financial information is presented openly, the risk of data manipulation decreases and public trust increases. In addition, the effective implementation of SPI helps ensure that every financial recording process runs according to procedure, thereby producing relevant and trustworthy reports (Ningtyas et al., 2019).

The combination of accountability, transparency, and SPI is proven to have a significant influence on improving the quality of government financial reports. Kristensen et al. (2019) highlight that public organizations capable of balancing these three aspects will find it easier to build a credible financial reporting system that aligns with good governance principles. Furthermore, Veale et al. (2018) add that quality financial reporting is a reflection of an accountable and transparent government system that has effective internal controls. Conceptually, the synergy between these three variables forms the basis for public accountability reform in the government sector. When the government is able to implement strong accountability, adequate information openness, and an effective internal control system, the quality of financial reports will increase significantly. This condition ultimately strengthens public trust and supports the creation of clean and integrated governance.

3. Methods

This research uses a descriptive qualitative approach aimed at deeply describing the phenomenon of accountability, transparency, and the effectiveness of SPI in improving the quality of public sector financial reports. This approach was chosen because it is capable of explaining the social and organizational context more broadly and interpreting the meaning behind empirical data and findings. According to King et al. (2021), qualitative research provides a comprehensive understanding of social phenomena by considering context, perceptions, and interactions between actors within the system. The descriptive method is used to outline the relationships between variables based on literature reviews and relevant previous research findings. Research data was obtained through library research by reviewing various scientific publications from the last five years, including national and international journals indexed by Google Scholar or Research Gate.

This technique is consistent with the documentary analysis approach, where secondary data such as research reports, journal articles, and policy documents are used to identify conceptual and empirical patterns (Davie & Wyatt, 2021). The data analysis process was carried out through three main stages: data reduction, data presentation, and conclusion drawing. These stages follow the interactive analysis model proposed by Wiliamson et al. (2018), where data is selected, categorized, and systematically interpreted to find conceptual relationships between variables. Data reduction is performed by selecting relevant literature, then data presentation is carried out in a narrative form that connects accountability, transparency, and SPI to the quality of financial reports.

The final stage is conclusion drawing to provide theoretical and practical interpretations of the literature synthesis results. Data validity is maintained through source triangulation, namely by comparing various research results with a similar focus to ensure the consistency of findings. Mertens (2019) explains that triangulation in qualitative research is important to strengthen the validity of results and avoid researcher bias. Furthermore, the researcher ensures credibility by selecting relevant and up-to-date scientific sources within the last five-year period. Thus, this research is not only descriptive but also interpretive, as it attempts to interpret how the application of accountability, transparency, and the internal control system conceptually and empirically contributes to improving the quality of government financial reports.

4. Results

The results of this study indicate that there is a strong and significant link between the application of accountability principles, transparency, and the effectiveness of SPI in improving the quality of financial reports in the public sector. Based on the synthesis of literature from various previous studies, these three variables do not only function as standalone aspects but also interact and contribute synergistically to the realization of good governance. Governments that consistently implement accountability and transparency, supported by an effectively operating SPI, tend to produce financial reports that have a higher level of reliability, relevance, and trustworthiness.

Viewed from the aspect of financial accountability, previous research shows that public institutions with a high commitment level to accountability mechanisms usually produce reports that are more timely, more accurate, and more informative. Dewi et al. (2019) assert that public accountability requires every government entity to account for the use of finances to the community, legislative bodies, and external auditors. Financial reports serve as the formal embodiment of this accountability. When accountability becomes a principle embedded in bureaucratic practice, transparency will follow naturally because the organization becomes more open to the processes and results of public fund management. This condition strengthens the organization's integrity and increases public trust in state financial governance.

In addition, Hertati et al. (2019) revealed that public accountability is not only related to financial reporting mechanisms but is also closely related to the ethics and morality of personnel. Government personnel who possess ethical awareness will be more responsible in using public resources, thus producing reporting quality that is more transparent and honest. Studies in the literature show that increasing accountability can be achieved through several ways, including strengthening financial reporting mechanisms, optimizing the internal audit function, and applying the principle of responsibility at every organizational level. From the perspective of financial transparency, the results of the literature review show that the openness of public information plays an important role in improving the quality of financial reports. Transparency allows the public to trace, assess, and monitor the process of using public resources.

According to Veale et al. (2018), public organizations that proactively implement information openness tend to gain a higher level of public trust and have a lower risk of fraud or financial problems. In the governmental context, transparency is not only realized through the publication of financial reports but is also demonstrated through the provision of information regarding the budget cycle, program implementation, and fiscal policy evaluation. Transparency is also proven to contribute to increased efficiency and effectiveness of public organizations. The open availability of information encourages the strengthening of social oversight and increases moral pressure on the government to manage finances carefully and efficiently, as every decision can be evaluated by the public. Basri et al. (2021) emphasize that effective transparency functions as a means to suppress potential budgetary deviations, strengthen public accountability mechanisms, and contribute to better decision-making.

Therefore, transparency is not only aimed at fulfilling the demands of openness but also acts as an internal instrument that encourages a culture of integrity within the bureaucracy. The next aspect that plays a crucial role is the Internal Control System (SPI). Based on the results of the literature analysis, SPI is proven to have a significant influence on the reliability, accuracy, and integrity of government financial reports. Tambingon et al. (2018) state that a well-implemented SPI contributes directly to the quality of financial reports through three main mechanisms, namely error prevention, early detection of potential fraud, and increased compliance with applicable accounting standards and regulations. In public organizations that have a strong internal control structure, the financial reporting process can run more systematically, be well-documented, and have minimal risk of data manipulation.

In addition, SPI also provides assurance to organizational leaders that operational activities have proceeded according to established goals, procedures, and policies. Furthermore, Adiputra et al. (2018) adds that the effectiveness of internal control can improve operational efficiency and the accuracy of financial reporting, which ultimately strengthens public trust in the government. However, the effectiveness of SPI is strongly influenced by management support and the quality of human resources. Many public institutions still face obstacles in the form of a lack of understanding among employees about the importance of the internal control system and weak management commitment in implementing it. Therefore, continuous training, capacity building, and personnel development are strategic steps to strengthen SPI implementation in the government environment.

The literature findings also indicate that the synergy between accountability, transparency, and SPI provides a greater collective impact compared to the contribution of each factor separately. A government with a high level of accountability and broad transparency but not supported by an adequate SPI still risks producing financial reports that are inaccurate or unreliable. Conversely, the implementation of a good SPI without a culture of accountability and transparency also does not yield optimal results. Kristensen et al. (2019) assert that the quality of public sector financial reports can only be achieved if these three components work harmoniously within an integrated governance system framework. Further analysis found several key indicators that influence the success of applying these principles in the public sector.

First, the commitment of organizational leadership to the consistent application of accountability and transparency has a significant impact on organizational culture. Leadership oriented towards integrity will encourage all personnel to follow the same principles. Second, the quality of human resources (HR) is an important factor in ensuring the effectiveness of SPI. Employees who have an adequate understanding of accounting principles and financial reporting standards will be able to perform their duties more professionally. Third, the use of information technology also has a major impact on accelerating the financial reporting process and increasing data openness. With a digitally integrated financial information system, the risk of data manipulation can be minimized and the audit process becomes more efficient.

The study results also show that public institutions that routinely carry out internal and external evaluations of their financial reports experience an improvement in reporting quality over time. Internal audits carried out independently and continuously help identify weaknesses in the control system at an early stage. Meanwhile, external audits from independent examination bodies strengthen the credibility of financial reports in the eyes of the public. This process is in line with the concept of continuous improvement in public management, where each reporting cycle becomes a momentum to strengthen organizational accountability and transparency. From a theoretical perspective, the results of this study strengthen the good governance theory framework, which asserts that accountability and transparency are the two main pillars in the conduct of effective and integrated governance.

When these two values are applied consistently and supported by an adequate SPI, public sector financial governance will achieve an optimal level of integrity and efficiency. Hertati et al. (2019) emphasize that the quality of financial reports is the main indicator of the success of government governance, as it serves as a means of communication between the government and the community, as well as a basis for performance evaluation. Overall, the results of this study underscore that the quality of public sector financial reports is not merely the result of a technical accounting process but is also a reflection of organizational culture and personnel integrity. The integration of strong accountability, broad transparency, and an effective internal control system forms the main foundation for efforts to improve the quality of financial reporting. When these three aspects are implemented consistently, comprehensively, and sustainably, public trust in government institutions will be strengthened, and the goal of clean, accountable, and public service-oriented governance can be achieved.

5. Discussion

The results of this study confirm that the relationship between accountability, transparency, and SPI plays a strategic role in improving the quality of public sector financial reports. These three aspects cannot be separated because they mutually reinforce each other within the framework of good governance. Accountability serves as the basis for the government's moral and administrative responsibility to the public, while transparency is the means for the public to conduct oversight, and SPI plays a role in maintaining the integrity and reliability of financial data. This finding is consistent with the research of Dewi et al. (2019), who state that strong public accountability strengthens public trust in government institutions. When public organizations are able to account for every use of funds, the credibility of financial reports increases, and public perception of government effectiveness becomes more positive.

In this context, accountability reflects not only administrative compliance but also ethical commitment in state financial management. Furthermore, Hertati et al. (2019) assert that transparency, realized through the openness of public information, plays an important role in creating public participation in the oversight of government finances. With open and easily accessible information, the public can assess the performance of public institutions and provide feedback on fiscal policies. Effective transparency also suppresses the potential for corruption, collusion, and budget misuse because every financial decision is under public scrutiny. Meanwhile, SPI is the foundation for a structured and auditable accounting process.

Tambingon et al. (2018) state that an effective SPI creates a reporting system that is more accurate, efficient, and in accordance with government accounting standards. Consistent implementation of SPI is capable of reducing recording errors and preventing fraud, thereby improving the quality of financial reports. However, the effectiveness of SPI is highly dependent on management commitment and human resource competence. Many public institutions still face constraints in the form of a lack of employee understanding regarding the importance of the internal control system and weak management commitment in implementing it.

This finding also strengthens the results of Adiputra et al. (2018) research, which shows that the combination of accountability, transparency, and SPI has a direct influence on improving the quality of financial reports. When these three aspects are applied simultaneously, public institutions can build a reporting system that is credible, efficient, and aligns with good governance principles. Thus, the results of this study reinforce the view that improving the quality of financial reports is not only the result of technical accounting processes but is also a reflection of the ethical values, integrity, and professionalism of the public bureaucracy. Conceptually, the synergistic relationship between these three variables indicates that the success of public financial governance highly depends on the alignment between the system, structure, and behavior of personnel. A government committed to accountability and transparency and implementing an effective SPI will be able to create financial reports that not only fulfill legal-formal aspects but also reflect institutional integrity and social responsibility to the public.

6. Conclusion

This research concludes that accountability, transparency, and SPI are three main pillars that complement each other in improving the quality of public sector financial reports. Accountability reflects the moral and administrative responsibility of the government for the use of public resources, while transparency ensures that every financial activity can be accessed and supervised by the public. Both play a role in strengthening public trust in the integrity of government institutions. The Internal Control System serves as an oversight mechanism that ensures the reliability of financial information and prevents errors and fraud.

Good implementation of SPI strengthens the effectiveness of financial management, increases bureaucratic efficiency, and supports the achievement of good governance principles. When accountability, transparency, and SPI are implemented consistently and sustainably, the quality of financial reports will significantly increase not only in terms of technical aspects but also in terms of public trust and bureaucratic ethical values. Therefore, a strong commitment from public institution leadership is needed to instill a culture of integrity, openness, and responsibility in every financial reporting process. Internal oversight reform, human resource capacity building, and the implementation of a transparent financial information system are key to the success of quality, credible, and public interest-oriented public financial governance.

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