

# Internal Control Systems and Good Village Governance to Achieve Quality Village Financial Reports

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This study examines the effect of internal control system implementation and good village governance on the quality of village government financial reports in Buleleng Regency, Bali, Indonesia. The research method used is quantitative with a database of research respondents. Research data was collected through filling out questionnaires and multiple linear regression tests were conducted to obtain the results of the study. The number of samples used was 30 village heads who received the village funds from the central government in the Buleleng Regency. Sample determination is assisted by using the Slovin formula. The results obtained show that there are significant simultaneous effects between internal control systems and good village governance on quality village government financial reports. The partial test results show that the internal control system and good village governance variables have a significant positive effect on the quality of village government financial reports in Buleleng, Bali-Indonesia.

**Key words:** *Internal control system, good village governance, financial statements, village government.*

## Introduction

The enactment of Law Number 6 of 2014 concerning Villages, aimed to ensure that all the interests and needs of a village community can be accommodated better. Providing greater opportunities for villages to manage their own governance and equitable development implementation is expected to improve the welfare and quality of life of rural communities, so that problems such as disparity between regions, poverty, and other socio-cultural problems can be minimised (Atmadja and Saputra, 2017). The provision of substantial funds through village funds invites many negative assumptions among practitioners, academics and

politicians (Atmadja and Saputra, 2018). This view directs the argument that certain villages, which have not yet established good village governance, will experience disorientation in the implementation of government, if the maturity of human resources and institutional institutions is not prepared. Corruption and abuse of authority are the main issues in village governance. Therefore, the village government must be able to apply the principle of accountability in village financial management, where all the activities of the village administration must be accountable to the village community (Kampen, 2009) in accordance with the provisions so as to realise good village governance. This indicates that good village governance must contain transparent, accountable and participatory principles as stated in the Village Law (Atmadja, et al., 2018).

In terms of realising good village governance where the management of village funds adheres to the elements of transparency, accountable and participatory, it is recommended that all villages be obliged to run their government based on good village governance. Good village governance can create quality government financial reports and emphasise the process of financial management of the village government and the involvement of stakeholders in the social, economic and political fields (Riskawati, et al., 2016) and the enrichment of existing resources, human or even financial carried out according to their respective needs. Village financial management is intended so that management of the community finances held by the village government is carried out transparently both in the process of preparation to accountability. Effective and efficient financial management is one form of good governance.

Village financial management should not be used as a place to grow "small corruptors" in the village. Therefore, to protect village financial management from fraudulent actions, it is necessary to have a good internal control system, so that all acts of fraud can be prevented (Saputra, et al., 2018). Fadilah (2011), states that the internal control system has a direct influence on good governance which has implications for the quality of reporting in the organisation. Suveinakama (2011), stated that it is very important to implement local village governance which translates to good village governance at the smallest organisational level such as villages to realise balance and fairness in the distribution of funds collected from the community or subsidies from the central government. While (Serupeperli, et al., 2016), stated that in the implementation of village governance there is a need for seriousness of all parties and to provide the widest possible space for the internal control system to touch all lines in the organisation. (Salim, et al., 2017), stated that the application of village-level governance based on good village governance would produce good reports and have accountability and transparency. Based on results from other studies, this research has been undertaken with the title "Internal Control Systems and Good Village Governance to achieve quality village financial reports".

### ***The Influence of the Internal Control System on Financial Statements***

According to Mulyadi (2014), internal control systems include organisational structures, methods and measures coordinated to maintain organisational wealth, check the accuracy and reliability of accounting data, encourage efficiency and encourage management policies. In Government Regulation Number 60 of 2008 concerning the Government Internal Control System (SPIP) it is explained that the elements of the SPIP includes (a) Control environment, (b) Risk assessment, (c) Control activities, (d) Information and communication (e) Monitoring.

The Internal Control System is an integral process for actions and activities carried out continuously by the leadership and all employees to provide adequate assurance for the achievement of organisational goals. This is done through effective and efficient activities, reliability of financial reporting, safeguarding state assets, and compliance with laws and regulations (PP No 60 of 2008). This shows that the better the internal control system of the government, the better the quality of regional financial reports. Research conducted by (Herawati 2014; Maryani 2016) states that internal control has a positive effect on the quality of financial statements. Based on this description, the following hypothesis can be concluded:

**H1:** Internal control systems affect the quality of financial statements.

### ***Effect of Good Village Governance on Financial Statements***

As a principle, governance is a system of rules, processes and behaviors that influence how power is exercised at different levels of government, especially with regard to openness, participation, accountability, effectiveness and coherence (Pramusinto and Latief, 2011). Good governance contributes to various development goals because of internal changes in the way of managing power from the conventional ones of control and command by the state in a new way that is more networked and balanced in power with various stakeholders. Based on this statement, every organisation needs to implement good governance including at the village government level. Good village governance will also lead to efforts to improve the governance processes so that performance will be better (Yuhertiana, et al., 2016). To encourage the realisation of good village governance it is important to build governance which is transformed into good village governance (Widayanti, 2017).

The application of the principles of good village governance is inseparable from the problems of accountability and transparency in financial management as a reference for producing quality government financial reports. Rustiarini's research (2016) states that good governance has a very sensitive relationship to the prevention of village fund fraud that starts from the quality of its financial statements. Alvianty, et al., (2014) also stated that there is a great need

for accountability as part of good governance in preventing fraud that occurs in village fund management. Then there is transparency and accountability in reporting which protects it from various individuals or group interests. Research conducted by Maryani (2016), states that good governance has a positive effect on the quality of financial statements. Based on this description, the following hypothesis can be concluded:

**H2:** Good Village Governance affects the quality of financial statements.

## **Methodology**

The population of 129 villages for this study was village heads whose village received funds in the Buleleng regency. For data collection this research used questionnaires. The questionnaire method is a data collection technique that is done by giving a set of questions or written statements to respondents to be answered (Sugiyono, 2016: 199). The questionnaire consists of a series of questions regarding the government's internal control system, good village governance and the quality of financial reports. This study uses personally administered questionnaires which means researchers can deal directly with respondents and provide necessary explanations about the questionnaire and they can be collected immediately after the respondent has finished answering (Indriantoro and Supomo, 2009:154). The total sample in the study amounted to 30 questionnaires received from respondents. To test the effect of variables a multiple linear regression test was used. The questionnaire was previously tested for the validity and reliability of the instruments used. This study also used a classical assumption test which includes multicollinearity test, heteroscedasticity test and normality test. The validity test using Pearson Correlation correlates the scores of each question item with a total score which is the number of correlations.

The variable is said to be valid if it has a significance smaller than 0.05, while the variable is said to be reliable if it has a Cronbach alpha value greater than 0.70. The normality test is carried out using Kolmogorov Smirnov with the Asymp coefficient, Sig greater than 0.05. To detect the presence of multicollinearity, a tolerance value = 0.10 and a Variance Inflation Factor (VIF) = 10.0 are used. Heteroscedasticity testing uses the glejser test by registering the absolute residual value with the independent variable used.

## **Results and Discussion**

A validity test is used to measure whether a questionnaire is valid or not. A questionnaire is said to be valid if the questions are able to reveal something that will be measured by the questionnaire (Ghozali, 2016: 52). An instrument validation test can be said to be valid if it has a calculated coefficient  $>0.3$ . Based on the results of the validity test that has been done,

it can be seen that all the questions have a correlation coefficient greater than 0.3 so that all instruments are declared valid.

Reliability is a tool to measure whether a questionnaire is an indicator of a variable or construct (Ghozali, 2016: 47). SPSS software measures reliability with Cronbach Alpha (a) statistical test (Ghozali, 2016: 48). The reliability test results can be seen if the Cronbach Alpha value of each variable is greater than 0.70, so it can be said to be reliable.

Normality test aims to test whether the dependent variable and independent variables have normal or not regression models. The method used is One-Sample Kolmogorov-Smirnov. Kolmogorov-Smirnov test results in this study obtained the value of 0.452, Asymp. Sig. (2-tailed), which is greater than 0.05. This means that the residual data is normally distributed.

**Table 1:** Normality Test

			Unstandardized Residual
N			30
Normal Parameters	a,b	Mean	0.0000000000
		Std. Deviation	2.15117889
Most Extreme Difference		Absolute	0.086
		Positive	0.086
		Negative	-0.075
Kolmogorov-Smirnov Z			0.472
Asymp. Sig. (2-tailed)			0.979

a. Test distribution is Normal

b. Calculated from data

A multicollinearity test aims to test whether the regression model found a correlation between the independent variables (Ghozali, 2016: 103). Multicollinearity is analysed through tolerance and variance inflation factor. The multicollinearity test results of this study show tolerance value of 0.702 and variance inflation factor of 1.425. Therefore there is no independent variable with a tolerance value of more than 0.1 or less than 10.0 VIF. It is concluded that there is no multicollinearity between independent variables in the regression model.

**Table 2:** Multicollinearity Test

Model	Collinearity Statistics	
	Tolerance	VIF
1 (Constant)		
X1	0.702	1.425
X2	0.702	1.425

A heteroscedasticity test aims to determine whether in a regression there is a residual variance in residuals from one other observation (Ghozali, 2016: 134). The way to detect the presence or absence of heteroscedasticity can be identified by using the glejser statistical test. A regression model does not contain heteroscedasticity if the significance value of the independent variable has the absolute residual statistic value above  $\alpha = 0.05$ . The glejser statistical test obtained the significance value of the variable implementation of the government's internal control system of 0.088, and the variable good village governance of 0.282. All the Sig values in the two independent variables are greater than 0.05. This means that the regression model does not contain symptoms of heteroscedasticity.

**Table 3:** Heteroscedasticity Test Results

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig
	B	Std. Error	Beta		
1 (Constant)	15.886	4.740		3.351	0.002
X1	-0.035	0.020	-3.51	-1.769	0.088
X2	-0.119	0.108	-0.218	-1.099	0.282

**Dependent Variable:** Abres

In the multiple linear regression analysis model, the dependent variable is the quality of financial statements while the independent variable is the application of the government's internal control system and good village governance. The results of multiple linear regression are shown in Table 4.

**Table 4:** Results of Multiple Linear Regression Analysis

Model	Unstandardised Coefficients		Standardised Coefficients	t	Sig
	B	Std. Error	Beta		
1 (Constant)	15.886	4.740		3.351	0.002
X1	-0.035	0.020	-3.51	-1.769	0.088
X2	-0.119	0.108	-0.218	-1.099	0.282
Dependent Variable: Abres					
R 0.816					
R <sup>2</sup> 0.656					
F count 26.886					
Sig. F count 0.000					

From the results of the regression analysis in the Table 4 the regression equation is:

$$Y = 18,553 + 0,192X_1 + 0,472X_2 + e$$

Based on the above values, it can be stated that hypotheses 1 and 2 are accepted, which means that there is a need to implement an internal control system in village government to achieve quality and accountable village government financial statements. Furthermore, the implementation of good village governance has an influence on the quality of village government financial reports.

### ***Determination Analysis***

Determination analysis is used to determine the percentage influence of the variables studied, namely between the independent variables of implementation of the government's internal control system (X1), and the good village governance (X2) simultaneously to the dependent variable quality of financial statements (Y).

The coefficient of determination is 65.6%, meaning that the effect of implementing the internal control system of government (X1) and good village governance (X2) simultaneously on the quality of financial statements (Y) is 65.6%. The remaining 34.4% is influenced by other factors not examined on this occasion. The effect of the application of government internal control systems (X1) and good village governance (X2) of 65.6% shows the percentage of the effect of implementation of the government's internal control system (X1) and good village governance (X2) to explain the quality of financial statements (Y).

**Table 5:** Determination Test

Model	R	R Square	Adjusted R Square	Std. Error Estimate
1	0.816 <sup>a</sup>	0.656	0.641	2.22943

a. Predictors: (Constant), X2, X1

b. Dependent Variable: Y

### ***Simultaneous Test (Test F)***

To examine the effect of independent variables on the implementation of government internal control systems (X1), and good village governance (X2) simultaneously on the dependent variable quality of financial statements (Y), the significance test (F-test) was carried out. According to the calculation results obtained, F count = 26.888 compared with the value of F table = 3.1. This means that the F count value is greater than the value of F table and F count. This shows that at the level of  $\alpha = 5\%$  simultaneously the application of government internal control systems (X1) and good village governance (X2) has a significant (real) influence on the quality of financial statements (Y).

**Table 6:** Simultaneous Test

Model	Sum of Squares	df	Mean Square	F	Sig
<sup>1</sup> Regression	267.267	2	133.634	26.886	0.000 <sup>a</sup>
Residual	134.200	27	4.970		
Total	401.467	29			

a. Predictors: (constant), X2, X1

b. Dependent Variable: Y

***Partial Test (t test)***

The partial t test is used to test the significance of each regression coefficient, so that it is known whether individually or partially the implementation of the government's internal control system influences the quality of financial statements is indeed real (significant) or only obtained by chance. Hypothesis one test results stated that: the value of t count = 4.710 compared to the value of t table = 1.6, this means that in the condition of constant good village governance (X2) statistically at the level of confidence (5%), the application of the government's internal control system (X1) has a significant positive effect on the quality of financial statements (Y). Hypothesis two states that the value of t count = 2.137 is compared with the value of t table = 1.6, then the value of t-count is greater than the value of t-table, this means that in the state of constant internal control system (X1), statistically at the level of trust ( $\alpha$ ) = 5%, good village governance (X2) has a significant positive effect on the quality of financial statements (Y).

**Table 7:** Partial Test

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig
	B	Std. Error	Beta		
1 (Constant)	15.886	4.740		3.351	.002
X1	-.035	.020	-3.51	-1.769	.088
X2	-.119	.108	-.218	-1.099	.282

**Dependent Variable:** Abres

Empirical testing results prove that the implementation of the government's internal control system has a significant effect on the quality of financial statements. There is a positive influence on the implementation of the government's internal control system on the quality of financial reports, which means that the better the implementation of the government's internal control system, the better the quality of financial reports. The results of this study are consistent with research conducted by (Herawati 2014; Maryani 2016) which states that internal control has a positive effect on the quality of village government financial reports. The results of the second hypothesis tested prove that good village governance has a significant effect on the quality of financial report., There is a positive influence of good





village governance on the quality of financial reports, which means that the better the village governance, the better the quality of the financial statements of the village government. The results of this study are consistent with research conducted by Maryani (2016) which states that good governance has a positive effect on the quality of financial statements.

## **Conclusions**

This study aims to determine the effect of the application of government internal control systems and good village governance on the quality of financial statements. Based on the data collected and the tests carried out, it can be concluded as follows: (1) there is a significant partial effect between the application of the government's internal control system and good village governance on the quality of financial statements. (2) there is a simultaneous positive relationship between the application of the government's internal control system and good village governance on the quality of financial statements.

Based on the discussion of these results, the advice for further research is to develop the research location and to include other variables such as locus of control, organisational culture and local culture that are strong factors in scientific research.

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