



THE INFLUENCE OF THE INTERNAL CONTROL SYSTEM AND ORGANIZATIONAL COMMITMENT ON FRAUD OF FINANCIAL REPORTS IN THE PUBLIC SECTOR

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Abstract

This study investigates the impact of internal control systems and organizational commitment on public sector financial statement fraud. This study uses a quantitative approach. The sample was the Government Internal Supervisory Apparatus (APIP) at the Inspectorate of East Java Province. This investigation utilized primary data through a questionnaire distributed to 49 participants. The analysis technique used outer and inner model tests with hypothesis testing using the WarpPLS version 7.0 statistical tool. The results showed that the internal control system had an effect on fraudulent financial reporting, and organizational commitment had an effect on fraudulent financial reporting.

Keywords: *Internal Control System; Financial Statement Fraud; Organizational Commitment.*

INTRODUCTION

The numerous requirements for producing high-quality financial reports do not preclude the possibility of dysfunctional behavior on the part of those who prepare the financial reports, such that the reporting serves the interests of only a subset of the population. In the preparation of financial statements, dishonesty and opportunities for fraud can lead to improper behavior on the part of those preparing the statements. The omission of amounts or disclosures in financial statements is one form of fraud that can be committed by misleading users of financial statements.

This research is motivated by the quality of the Indonesian Government Internal Auditor (APIP) examination, which still needs to improve. The phenomenon of APIP inspection quality is still relatively weak in Indonesia. The Association of Indonesian Government Internal Auditors (AAIPI) report states that more than 90% of 313 APIPs in the central and regional governments cannot detect corruption. If we refer to 5 levels of *Internal Audit*, more than 93% of internal control is still at level 1, only 5% is at level 2, and the rest are still at level 3 (Sari *et al.*, 2021). The level of urgency of cases that occurred in the East Java region related to violations, abuse of official authority, and a large number of findings of regional losses and irregularities that led to corruption was not detected by the internal auditor. However, it became findings by the external auditor, the Supreme Audit Agency. (Maulana & Yuhertiana, 2021).

Based on the regional financial reports by the BPK, which are further explained in the East Java Regional Government Financial Report, it is seen that the East Java regional government could have been more optimal in implementing the principles of *Good Governance*. In the 2018 Local Government Financial Report, the BPK gave Qualified Opinions to three East Java governments:

Jember Regency, Tulungagung Regency, and Pasuruan City. Some of the problems found by the BPK during the audit process affecting the fairness of the presentation of financial statements include inadequate presentation of Intangible Assets and other Assets balances, inaccurate recognition of Construction in Progress, and Inventory administration that needs to be orderly. BPK also found the use of Land Assets without the imposition of a lease, the realization of spending using SP2D LS that needed to be more appropriate, and delays in the completion of construction work (BPK RI, 2019).

Based on the Examination Report on the East Java Regional Government Financial Statements in 2019 results, Pasuruan City received a Qualified Opinion, and Jember Regency received an Opinion Without Expressing Opinion/*Disclaimer*. Likewise, in 2020, the BPK gave an Unfair opinion because seven points caused the Jember LKPD not to be presented fairly, such as no DPRD approval of the 2020 Fiscal Year APBD. There are actual payments presented in personnel expenditures that do not reflect the substance of personnel expenditures as stipulated in the Government Accounting Standards. There was cash in the disbursement treasury as of December 31, 2020, not in the form of cash and/or bank deposit balances according to the provisions in the Government Accounting Standards, and it has the potential to be irresponsible. Furthermore, other findings, namely the Management Team for School Operational Assistance and the Implementation of Free Education, did not recapitulate expenditure realization (BPK RI, 2021).

Information regarding prosecuting corruption cases by law enforcers can be found in East Java. Throughout the semester I of 2020-2022, many corruption cases occurred in East Java province. In 2021 there will be 17 cases, or around 8%. East Java Province has 79 Police and Prosecutor's Offices, with a target of 106 cases throughout the first semester. However, in reality, there were only 17 cases handled by APH. This means that the performance of prosecution of corruption cases in law enforcement institutions in East Java Province is very poor (Indonesia Corruption Watch, 2021). Based on data obtained from ICW (2022), budget abuse is the most dominant mode used by perpetrators of corruption cases. During the first half of 2022, APH mainly investigated corruption with the type of loss to the state (Indonesia Corruption Watch, 2022).

The internal control system is a process that is done based on the mandate of people who are in charge within an organization to save assets of the company and ensure all operations run based on applicable laws and regulations. The existence of criteria that influence the BPK audit opinion indicates that accountability is not only influenced by the BPK auditor's opinion but other findings that affect the BPK audit opinion, such as internal control weaknesses and problems related to non-compliance with laws and regulations. These two findings often influence BPK's opinion on LKPD, one of which is the local government in East Java.

Based on the explanation and data above, there are still many frauds that occur during the preparation of financial statements, so action is needed for prevention purposes. Prevention of fraud is an activity carried out by management related to the determination of policies, systems, and

procedures that help provide confidence that the parties in the entity have acted properly so that they can achieve the goals of the entity. One way to prevent fraud is the determination of quality internal control structures so that the goals set by Top Management can be achieved, company assets can be guaranteed safety, and operational activities can run effectively and efficiently (Rahayu & Prabowo, 2018). In the government environment, there is an internal control system called the Government's Internal Control System. The government's Internal Control System is regulated in PP RI Number 60 of 2008. It is explained that Government's Internal Control System consists of several elements, namely the control environment, risk assessment, control activities, information, and communication, as well as internal control monitoring.

According to research by Rahayu & Prabowo (2018), internal control systems negatively affect the level of fraudulent financial statements. These findings indicate that the better the implementation of the elements of the internal control system, the lower the level of fraud in local government financial reports. These results are also supported by research conducted by Krisprimandoyo *et al.* (2022) and Anggara *et al.* (2020). Different results were carried out by Wayan *et al.* (2022), which state that the internal control system does not affect fraudulent financial reporting.

In addition to the internal control system, there are challenges in task complexity and compliance with the code of ethics, so auditors need to have organizational commitment. According to Wijayanto (2020), organizational commitment is a form of individual loyalty to an organization. Gede Prema Utama & Adi Yuniarta (2020) in his research explained that if an employee is committed to the organization and the work he is doing, the tendency for fraud to occur is minimal, but if it is the other way around, the tendency for fraud to occur cheating is very high. However, in Fitri (2020), organizational commitment does not affect reducing fraudulent financial reports. The internal control system and organizational commitment are some of the most important things to reduce fraudulent financial reporting. This study aims to determine and examine the influence of internal control systems and organizational commitment on fraudulent financial reporting in the public sector.

Agency Theory

According to Jensen & Meckling (1976), an agency relationship is a form of contract between owners or principals and an agent. The work of the contract is by delegating all decision-making to the agent for the sake of getting benefits. In the public sector, agency problems occur between officials elected by the people as agents and voters (the public) as principals. In the public sector, the agency problem occurs between officials elected by the people as agents and voters (the community) as principals. Agency Problem arises when the principal delegates the authority of decision-making to the agent or in the work contract agreement between the principal and the agent. In the relationship between work contracts, the agent is morally responsible for maximizing principal benefits, but on the other hand, the agent also has an interest in maximizing their welfare (Ni Putu *et al.*, 2022).

Attribute Theory

Attribution theory, developed by Green and Mitchel (1979), provides a view of the process, its reasons, or causes of interpreting an event. The process is also related to internal and external factors. So that the actions taken by a leader or a person given authority or power in an organization have gone through a process that is influenced by the causative attribute factors. In preventing fraud, attribution theory is closely related to internal control and organizational commitment in the company. Internal control is closely related to the place of control, which is also a place for the application of attribution theory itself. This behavior is caused by internal factors and external factors.

Internal Control System

According to RI Government Regulation Number 60 of 2008, SPIP defines the Government's Internal Control System as a whole process plan and actions that are done continuously by leaders and all employees to provide adequate assurance of achieving organizational goals through effective and efficient activities, reliable financial reporting, safeguarding state assets, and compliance with laws and regulations invitation. The elements of the internal control system adapted in Government Regulation No. 60 of 2008 include the environment of control, risk assessment, control activities, information and communication, monitoring

Financial Statement Fraud

The Indonesian Accounting Association (IAI) defines fraud in financial statements as misstatements or fraud found in a report of financial; it can be a form of writing misstatements, omitting important information, and exposing financial statements aimed to trick users. Fraud in financial statements consists of manipulation, falsification of accounting records, deliberate deletion of information contained in financial statements, and intentional misapplication of accounting principles.

Organizational Commitment

Robbins (2008) explains that Organizational Commitment is when employee sides with a particular organization and its goals and desire to maintain membership in that organization. Organizational commitment is also the willingness of individuals to make the organization better with three indicators, namely affective commitment, continuance commitment, and normative commitment. Ferris & Aya (1983) in Trisnaningsih (2007) concerns three attitudes, namely, a sense of identifying with the goals of the organization, a sense of involvement with the tasks of the organization, and a sense of loyalty to the organization. Affective organizational commitment relates to a view of professionalism, namely dedication to the profession, while the commitment of the

Continuance organization is positively related to experience and negatively to the view of professionalism of social obligations.

Research Question

Referring to the explanation and problem above, the researcher submits answers with the following hypotheses:

1. The internal control system affects the fraud of financial statements.
2. Organizational commitment affects the fraud of financial statements.

METHOD

Methods of quantitative research were used for this study. In this particular study, financial statement fraud served as the dependent variable. The independent variables were the internal control system and organizational commitment. The population was all auditors assigned to the Inspectorate of East Java Province. The process of selecting a subset of a population to serve as a representative example of the whole population is referred to as sampling. The population as a whole was used as respondents for the sampling project, which resulted in what is known as total sampling. The data were collected using field surveys by distributing questionnaires. The analysis technique used Partial Least Square (PLS) and the WarpPLS 7.0 software analysis tool consisting of stages outer model, inner model, and hypothesis testing.

RESULTS AND DISCUSSION

Description of Research Object

Based on the 49 questionnaires distributed, all questionnaires have been returned and can be processed. A total of 49 auditors consisted of 22 male auditors and 27 female auditors. There were 24 auditors (49%) with a Bachelor's degree/graduate level of education and 25 auditors (51%) with a master's degree/second degree. Respondents consisted of first auditors, junior auditors, and middle auditors.

Description of Research Statistics

A total of 49 respondents' answers have been processed with descriptive statistics. According to the results of descriptive statistics, the average respondent indicated that they agreed with the proposed indicator statement.

Outer Model

Convergent Validity Test

Table 1. Outer Loading

	Indicator	Loading Factor	Description
Internal Control System (X1)	X1.1	0.767	Valid
	X1.2	0.743	Valid
	X1.4	0.722	Valid
	X1.5	0.863	Valid
	X1.6	0.781	Valid
	X1.9	0.867	Valid
	X1.10	0.761	Valid
	X1.11	0.863	Valid
	X1.12	0.788	Valid
	Organizational Commitment (X2)	X2.1	0.841
X2.2		0.798	Valid
X2.3		0.813	Valid
X2.4		0.764	Valid
X2.5		0.785	Valid
X2.6		0.788	Valid
X2.7		0.844	Valid
X2.8		0.731	Valid
X2.9		0.783	Valid
X2.10		0.864	Valid
X2.11		0.821	Valid
X2.12		0.763	Valid
Financial Statement Fraud (Y)	Y1.1	0.703	Valid
	Y1.2	0.847	Valid
	Y1.3	0.851	Valid
	Y1.4	0.865	Valid
	Y1.5	0.849	Valid
	Y1.6	0.777	Valid
	Y1.7	0.801	Valid
	Y1.9	0.765	Valid

Source: Data Processed by WarpPLS 7.0

Based on Table 1, shows a loading value of > 0.6 which indicates that all indicators in this study have met the convergent validity test.

Discriminant Validity Test

Testing the value of the cross-loading of each indicator on the variable has a greater cross-loading value than the other variables. This shows that all variables have fulfilled the discriminant validity test.

Table 2. AVE Value

Variable	AVE
Internal Control System	0.630
Organizational Commitment	0.641
Financial Statement Fraud	0.655

Source: Data Processed by WarpPLS 7.0

Table 2 shows that the resulting AVE value for the Internal Control System constructs, Organizational Commitment and Financial Statement Fraud is >0.5. Based on the AVE criteria, these results have shown all valid variables.

Reliability Test

Composite reliability and Cronbach alpha tests were carried out to look for the reliability of data. Composite reliability test results and Cronbach alpha Each variable has a composite reliability value > 0.7 and Cronbach alpha > 0.6.

Table 3. Composite Reliability & Cronbach Alpha

Variable	Composite Reliability	Cronbach Alpha
Internal Control System	0.938	0.926
Organizational Commitment	0.955	0.949
Financial Statement Fraud	0.938	0.924

Source: Data Processed by WarpPLS 7.0

The results of the composite reliability and Cronbach alpha tests in Table 4 show that the three variables have been declared reliable, indicated by composite reliability, which has a value of more than 0.7, and Cronbach alpha has a value of more than 0.6.

Inner Model

R-Squares

Table 4. R-Square Value

Variable	R-Square
Financial Statement Fraud	0.585

Source: Data Processed by WarpPLS 7.0

Table 4 above shows that the R-square value of variable Y is 0.585. This means that the variable Financial Statement Fraud can be explained by the Internal Control System (X1) and Organizational Commitment (X2) variables with a percentage of 58%. While the rest is influenced by other variables not examined in this study.

Table 5. Model Value Fit and Quality Indices Full Model

Fit Model Indicator	Index	P-value	Hasil
APC	0.400	<0.001	Accepted
ARS	0.585	<0.001	Accepted
AVIS	2.938	-	Accepted

Source: Data Processed by WarpPLS 7.0

Table 5 shows that the index for APC, ARS, and AVIF is 0.400, 0.585, and 2,938. The p-value value on APC and ARS is <0.001. Thus, the p-value value <0.05, and AVIF is 2,938 or AVIF<5. This research has fulfilled the rules of the fit model.

Result of Hypothesis Testing

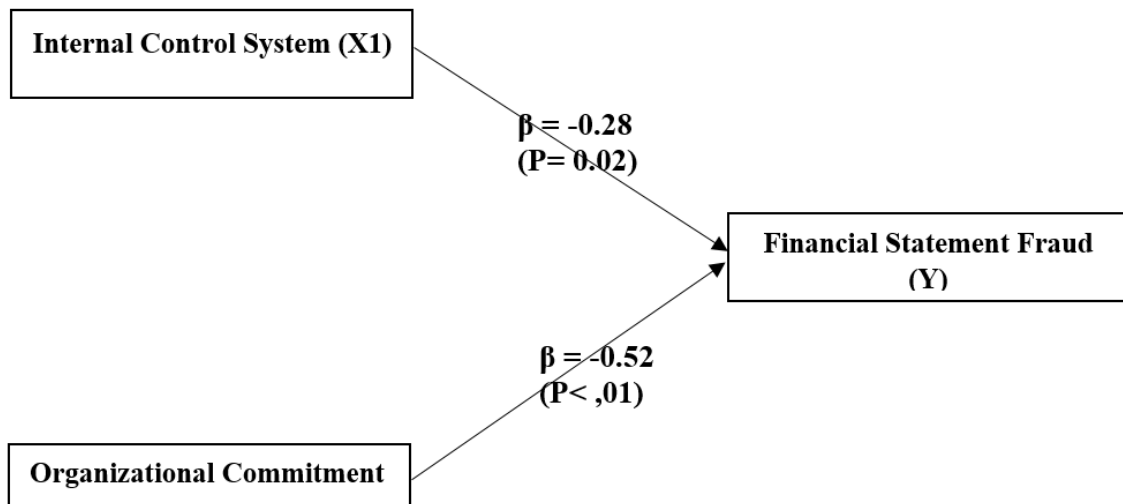


Figure 1. Hypothesis Test Results

Source: Data Processed by WarpPLS 7.0

Based on the results of the hypothesis test X1 Y produces a regression coefficient value of -0.28 and a p-value of 0.02. Whereas the X2à Y test results produce a regression coefficient value of -0.2 and P -the value of <0.01 or less than 0.05. This shows that conclusions H1 and H2 are accepted.

The Influence of the Internal Control System on Fraudulent Financial Statements

The results of the H1 test proved that the internal control system variables affected financial statement fraud. The Internal Control System was capable of influencing fraudulent financial

reporting. Therefore, the better the internal control system is implemented, the less fraudulent financial statements will be.

When management can apply good internal control procedures to prevent fraud, which results in the unreliability of financial statements, the organization can achieve reliability of financial reports, efficiency and effectiveness of company operations, and compliance with laws and regulations. It is supported by attribution theory which explains that a person's behavior in acting or decision is influenced by two forces, namely, internal and external. The results of this study also support previous research conducted by Rahayu & Prabowo (2018), Krisprimandoyo et al. (2022), and Anggara *et al.* (2020), which proves that the internal control system affects fraudulent financial reporting. Different results in research conducted by Wayan *et al.* (2022) state that the internal control system does not affect fraudulent financial reporting.

The Effect of Organizational Commitment on Fraudulent Financial Statements

The hypothesis test shows that the financial statement fraud variable affects organizational commitment. Financial statement fraud hurt organizational commitment. With a good level of organizational commitment, it will be able to minimize fraudulent financial statements that occur at the Inspectorate of East Java Province. People with high commitment care about the organization, and they never have a personal interest in advancing the organization. On the contrary, people with low commitment involve a personal interest in doing activities related to the organization. If an employee is committed to the organization and their work, the tendency for fraud to occur is very small, but if it is the other way around, it is very high. Because the higher the commitment, the tendency to commit fraud is minimal. This research is in contrast to research conducted by Fitri (2020) but in line with research conducted by Prihandoko & Rusdi (2020) and Anggara *et al.* (2020), which states that the better the organizational commitment of the company's employees will make employees loyal to the company and assist the company in improving the prevention of accounting fraud. So that later the organizational commitment of employees will make them carry out their level of professionalism in the company by making financial reports without any personal intervention problems. It indicates the fear of being penalized if they betray an organization and the desire of individuals to get guarantees of good in the future from the company concerned.

CONCLUSION

Based on the analysis and hypothesis testing that has been done in this study, it can be concluded that the internal control system and organizational commitment in the Inspectorate of East Java Province can be affected by fraudulent financial reporting as well. A more efficient internal control system will suppress the occurrence of fraudulent reports happening in finances. Likewise, the

employee's strong organizational commitment will reduce the level of fraudulent financial statements that occur.

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