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IMPROVING THE QUALITY OF LOCAL GOVERNMENT FINANCIAL REPORTING THROUGH THE IMPACT OF INTERNAL CONTROL SYSTEM WITH HUMAN RESOURCE COMPETENCIES AS A MODERATOR

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ABSTRACT

Purpose: *The increasing demand for transparency and accountability of the government institutions has led to an interesting discussion about the factors that affect the quality of government financial reports. This study examines the effect of the internal control system on the financial reports quality at Kudus Regency government agencies by raising human resource competency as a moderating variable.*

Methodology/approach: *Questionnaires were distributed to all local government institutions and as many as 106 answers were returned for processing. Analysis using Partial least Square (PLS) for hypothesis testing.*

Findings: *The results prove that the internal control system has a positive effect on the financial reports quality. However, in terms of moderating effect, human resource competence in fact, weakens the influence of the internal control system on the quality of financial reports.*

Practical implications: *By highlighting best practices from local government institutions, the results of this research are expected to become relevant considerations in determining strategy to improve local government services.*

Originality/value: *This study raises the case of best practice in the Kudus Regency Government, which in 2022 received an Unqualified Opinion from the Indonesian Audit Board on their Regional Government Financial Report for the 2021 fiscal year. The Unqualified opinion in Kudus Regency is the tenth consecutive achievement,*

making this research interesting and has become a model for other local governments.

KEYWORDS: *Financial Report Quality; Human Resource Competencies; Internal Control System.*

ABSTRAK

Tujuan penelitian: Meningkatnya tuntutan transparansi dan akuntabilitas lembaga pemerintah memunculkan pembahasan yang menarik mengenai faktor-faktor yang mempengaruhi kualitas laporan keuangan pemerintah. Penelitian ini menguji pengaruh sistem pengendalian intern terhadap kualitas laporan keuangan pada instansi pemerintah Kabupaten Kudus dengan meningkatkan kompetensi sumber daya manusia sebagai variabel pemoderasi.

Metode/pendekatan: Kuesioner disebar ke seluruh instansi pemerintah daerah dan sebanyak 106 jawaban dikembalikan untuk diproses. Analisis menggunakan Partial least Square (PLS) untuk pengujian hipotesis.

Hasil: Hasil penelitian membuktikan bahwa sistem pengendalian internal berpengaruh positif terhadap kualitas laporan keuangan. Namun, dalam hubungan moderasi, kompetensi SDM justru memperlemah pengaruh sistem pengendalian internal terhadap kualitas laporan keuangan.

Implikasi praktik: Dengan menyoroti praktik-praktik terbaik dari institusi pemerintah daerah, hasil penelitian ini diharapkan dapat menjadi bahan pertimbangan yang relevan dalam menentukan strategi untuk meningkatkan pelayanan pemerintah daerah.

Orisinalitas/kebaharuan: Studi ini mengangkat kasus best practice di Pemerintah Kabupaten Kudus yang pada tahun 2022 mendapatkan Opini Wajar Tanpa Pengecualian dari BPK atas Laporan Keuangan Pemerintah Daerah tahun anggaran 2021. Opini Wajar Tanpa Pengecualian di Kabupaten Kudus merupakan capaian yang ke sepuluh kali berturut-turut, membuat penelitian ini menarik dan menjadi percontohan bagi pemerintah daerah lainnya

KATA KUNCI: Kualitas Laporan Keuangan; Kompetensi SDM; Sistem Pengendalian Internal.

INTRODUCTION

The quality of financial reports becomes a benchmark in enhancing accountability and reliability of financial management within government, including local governments. As an official press released by Indonesian Audit Board (BPK RI), the number of local governments achieving unqualified opinions in 2016-2020 experienced a significant increase.

However, there were still 55 agencies that received qualified opinion and one local government that had not submitted LKPD until the release of the local government financial reports 2020 was published by BPK. Previous studies criticize the weak implementation of information freedom law creates chances for opportunistic behavior and rent seeking among interested parties (Irwandi, 2020; Pierre & Peters, 2017) so that it weakens the financial reporting quality. This study raises the case of best practice in the Kudus Regency Government, which in 2022 received an Unqualified Opinion from the Indonesian Audit Board on their Regional Government Financial Report for the 2021 fiscal year. The Unqualified opinion in Kudus Regency is the tenth consecutive achievement, making this research interesting and has become a model for other local governments.

In terms of the need to improve the quality of financial reporting, in general world, State Civil Apparatuses are currently receiving tighter supervision (Hyndman & Liguori, 2016). Measuring government performance becomes a universal component in terms of public sector budgeting, accounting, and management. Therefore, the importance of internal control is highlighted in the administrative system of public institutions, including in presenting quality financial reports to monitor performance and ensure that government staff carries out instructions according to applicable standards and policies. Pierre & Peters (2017) stated that it is still found a “contractual regime” with ordered actors in Anglo-Saxon democratic countries. However, a few trust-based regime models remain in Scandinavian, Asian, and European countries. Public sector financial reports are presented in the context of compliance in accountability and retrospective reporting, authorization planning and reporting, organizational continuity, and public relations (Gustina, 2021).

This study refers to research by Umar et al. (2018), who rely on internal control variables and HR competencies in influencing the quality of local government financial reports in the West Gane region, North Maluku. In his findings, it is proven that HR Competencies has a significant positive effect on the quality of financial statements while internal control has an insignificant effect on the quality of financial statements. This result is inconsistent with previous findings which state that internal control has an important influence on improving the quality of financial reports (Darmawan, 2019; Ridzal et al., 2022; Syahadatina & Fitriyana, 2016). Internal control, which is the first layer of supervision efforts in an organization, should have a major impact on the quality of government agency reporting. Moreover, research by Agustiawan & Rasmini (2016) utilize HR Competencies to moderate the effect of internal control towards the quality of local governments reports. Therefore, this study tries to modify Umar et al. (2018) research by using the HR Competencies variable which has been proven to have a significant effect towards financial report quality to strengthen the influence of internal control towards financial report quality. Competent human resources are predicted to be able to understand the implementation of an effective and efficient internal control system so that the system will produce the proper impact on the quality of financial reports. In this regards, this study examines HR competence as a moderating variable on the effect of internal control on financial report quality.

Internal control in the cycle of an organization is useful for being aware on problems that may arise and hinder the achievement of organizational goals. In its implementation, internal control involves all parties within the internal organization to be aware of any actions that deviate from the organisation’s goals. An Internal Control System (ICS) in an organization that is properly designed and implemented by all elements of the organization will ensure that the organization's internal control goals can be achieved. One of the objectives of ICS implementation in organizations is to create a mechanism for preparing financial reports in accordance with applicable regulations. This will produce good-quality financial reports that

meet the dimensions of financial report quality. Therefore, the existence of people with adequate capabilities is an important factor in forming an ideal control environment (Gustina, 2021; Umar et al., 2018). This research aims to test the effect of the internal control system on the quality of local government financial reporting with human resource competency as a moderating variable. The results of this study are expected to become a reference for managerial stakeholders in government institutions in understanding the antecedents of quality financial reporting as a form of accountability for the management of public funds.

Davis et al. (1997a, 1997b) present Stewardship Theory as a basis for analysing executive responsibility in its motivation for organisational success. Executives in Stewardship relationships are more focused on the organisational interest and are motivated only to be good managers and loyal to the organization (Davis et al., 1997a; Schillemans & Bjurström, 2019). This theory connects psychological and sociological aspects that motivate executives to actualise themselves in prioritising service to gain recognition and appreciation (Hardiningsih et al., 2019; Restuningsih & Wibowo, 2019). As the government has the main task of serving the public and managing public funds to provide welfare, they are responsible for presenting quality information in Regional Government Financial Report reporting. Stewardship theory is implied by the motivation of actors in community service who seek to become parties that the community can trust. Through a good internal control system supported by selected human resources based on adequate competence, it is hoped that the presented financial report meets public expectations. However, Gamayuni & Setyawan (2020) stated that Regional Government Financial Report discloses accounting information for government institutions which is very important to determine public policies, economic decisions and various regional planning strategies. The internal control system is an effort to keep government management on track with existing regulations. HR competence is needed to ensure that stewards understand regulations and are experts in their knowledge to work optimally to achieve public welfare as principals.

Research by Syahadatina & Fitriyana (2016) that the internal control system has a significant positive effect on the quality of regional financial reports. These findings are consistent with the results obtained by Alzeban (2019); Darmawan (2019); Ridzal et al. (2022). On the other hand, Rizka et al. (2021) found that the internal control system has a significant and negative effect on the financial report quality. In contrast to Ardianto & Eforis (2019) and Gustina (2021) who found that the internal control system did not affect the local government financial reports quality. As with human involvement in the managerial sphere, previous research García-Meca & García-Sánchez (2018); Muda et al. (2017); Soleh et al. (2020); Umar et al. (2018) factually has a significant and positive effect on the financial reports quality in both the MSME, large business, and government sectors.

This study examines how the internal control system affects financial reports quality in government institutions. Previous research relied on various factors as variables that affect financial reports quality in both the private and the public sector including HR capabilities (García-Meca & García-Sánchez, 2018; Ma et al., 2019; Muda et al., 2017; Ridzal et al., 2022; Rizka et al., 2021; Soleh et al., 2020; Umar et al., 2018) technology utilization (Muda et al., 2017; Ridzal et al., 2022; Soleh et al., 2020), governance (Al-Khonain & Al-Adeem, 2020; Alzeban, 2019; Lennox & Wu, 2022), ethical accounting practices (Aifuwa et al., 2018) and investor distrust (Irwandi, 2020). Ma et al. (2019) stated that the low quality of financial reporting, especially in developing countries, is due to ineffective governance. Furthermore, Ma et al. (2019) also stated that managerial academic careers help to form an effective leadership character which includes thoroughness, proper and honest communication habits,

thus it produces better quality financial reports. It is hoped that the results of this study will become a reference for managerial stakeholders in government institutions in understanding the antecedents of quality financial reporting as a form of accountability for the public fund's management.

Previous research stated the importance of an internal control system for reliable financial reports (Al-Mashhadi, 2021; Darmawan, 2019; Gal & Akisik, 2019; Irsutami et al., 2018; Limbong & Irawan, 2016; Umar et al., 2018). An effective internal control system reduces the need for assurance over other types of disclosure (Lennox & Wu, 2022), such as sustainability reports. A comparative study of publicly listed companies in China and the United States by Wang et al. (2020) shows that SPI is one of the variables affecting financial performance. Rafindadi & Olanrewaju (2019) tested the effect of ICS on financial reports quality for Non-Governmental Organizations (NGO's) in Nigeria. In this test, it was found that ICS can improve financial reports quality. As one of the functions of ICS is to ensure the reliability of financial and accounting information and increase accountability, thus financial reports quality relies heavily on ICS. ICS includes mechanisms, rules, and procedures that help organizations prevent potential errors and abuse. Thus, the stronger the implementation of ICS in the organization, the better financial reports quality. Based on the previous studies, Therefore, the first hypothesis is stated as follows:

H1: *ICS has a positive effect on the financial report quality.*

The implementation of an effective internal control system which has a good impact on organizational performance requires human resources who have a good understanding of the system itself (Agustiawan & Rasmini, 2016). The question of "how internal control is implemented", "who are the parties that need to be involved", as well as "how the control system can function", demands adequate competency from managers who run an organization. Research by Agustiawan & Rasmini (2016) proves that competent human resources are able to strengthen the internal control system so that it can influence the organization in producing qualified financial reports. This study found that HR competence is able to moderate positively the influence of the internal control system on the quality of financial reports. However, Ulisanti & Asrori (2021) found that HR competence actually weakened the influence of internal control system on the quality of financial reports. The other studies state that the more competent the human resources are in an organization, the better the financial reports quality (Ma et al., 2019; Rakhman & Wijayana, 2019). Research that examines the moderating effect of HR Competencies on the effect of ICS on financial report quality is still limited. However, referring to the effect of ICS and HR competence from previous research on financial reports quality, this study argues that HR competence strengthens the positive effect of ICS on financial reports quality. Organizational commitment in improving their staff competencies, will strengthen their performance through having a good ICS. As a result, organizations with higher HR competencies have effective and efficient ICS, thereby increasing their financial report quality. Therefore, the second hypothesis is stated as follows:

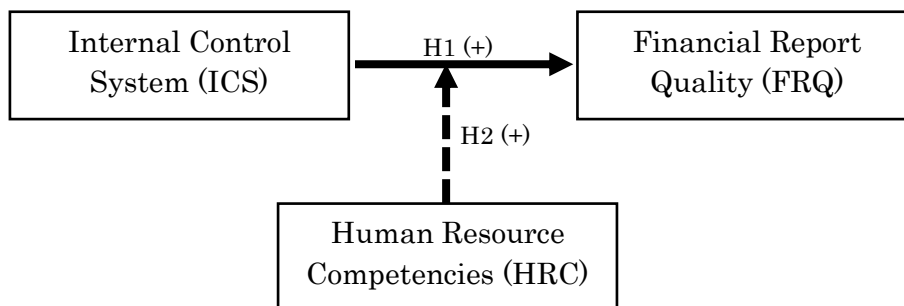


Figure 1.
Hypothesis
Development
Framework

H2: HR competence moderates positively on the effect of the internal control system towards the financial report quality.

METHODS

Variables	Definition	Indicators
Independent Variable (X) – Internal Control System (ICS) based on Integrated Framework by COSO (2012)	a control system within an organization that ensures that organizational activities are carried out effectively and efficiently in order to build good governance. <i>(Gustina, 2021; Irsutami et al., 2018)</i>	<ol style="list-style-type: none"> 1. Control Environment, 2. Risk Assessment, 3. Control Activity, 4. Information and Communication, 5. Monitoring Integrated Framework by COSO (2012)
Dependent Variable (Y) – Financial Reports Quality (FRQ) –	Usefulness level of financial reports in stakeholder decision making. <i>(Ridzal et al., 2022; Umar et al., 2018)</i>	<ol style="list-style-type: none"> 1. Understandable, 2. Relevant, 3. Reliable, 4. Comparable Government Regulation of the Republic of Indonesia number 71 of 2010
Moderating Variable (Z) – Human Resource Competence (HRC)	A person's intelligence that is integrated with physical abilities that are formed by hereditary and environmental factors in an employee as an HR of the organization. <i>(Rizka et al., 2021; Umar et al., 2018)</i>	<ol style="list-style-type: none"> 1. Knowledge aspects, 2. Skill aspects, 3. Behavior aspects The National Civil Service Agency (BKN RI) policy

Table 1.
Operational
definition and
measurements

This type of quantitative research relies on processed primary data to examine the effect of ICS on the financial report quality and the effect of HR competence as a moderating variable in this relationship. The sampling method used is census, that is all populations are involved as the object of research and became the target of filling out the questionnaire. They were taken from all local bureaucracy in Kudus Regency with 45 local bureaucracies in total consisting of 15 service offices, 6 government agencies, 8 regional secretariat sections, 1 inspectorate, 1 national and political unity office, 1 police unit, 3 expert staff offices, 1 regional general hospital, and 9 district offices. The data were obtained from the results of the questionnaires, which were distributed and filled out by the financial staff at each local bureaucracy containing 1) Financial Administration Officer, 2) Revenue treasurer, 3) Expenditure Treasurer. Of the 135 distributed questionnaire, only 110 questionnaires were returned with 4 of them are incomplete, so that there were 106 responses could be processed using the PLS application. This means that the response rate of returned questionnaire reaches 81.4% (110 out of 135) while the usable data is 78.5% (106 out of 135). We use a 5-point Likert scale (i.e., 5 = strongly agree, 1 = strongly disagree) to obtain precise perception with the appropriate range for the questions needed to achieve the research objectives.

There were three variables used here, namely ICS (X), FRQ (Y), HRC (Z). Each variable is measured following previous research as shown in table 1.

Tests were conducted to assess the validity, reliability, structural models, and hypotheses.

RESULT AND DISCUSSION

Statistic Descriptive

Based on the descriptive statistics table, the average value of the internal control system (ICS) variable is 43,887, with a maximum value of 49 and a minimum value of 37. The average value of the HR competency variable (HRC) is 38,406, with a maximum value of 45 and a minimum value of 33. The financial reports quality (FRQ) variable has an average value of 39,821 with a maximum value of 45 and a minimum value of 34.

Validity Testing

Validity testing aims to measure the extent to which the variables used actually measure what they are supposed to measure. The validity test used in this study is convergent validity and discriminant validity.

	N	Minimum	Maximum	Mean	Std. Deviation
ICS	106	37	49	43,887	2,755
HRC	106	33	45	38,406	2,587
FRQ	106	34	45	39,821	2,673
Valid N (listwise)	106				

Table 2.
Descriptive
Statistics Test
Results

Source: Primary data processed by SmartPLS, 2023

Variable	Indicator	Loading Factor
Internal Control System (X)	X1	(0,525)
	X2	(0,749)
	X3	(0,653)
	X4	(0,589)
	X5	(0,665)
	X6	(0,579)
	X7	(0,580)
	X8	(0,370)
	X9	(0,514)
	X10	(0,729)
Human Resource Competencies (Z)	Z1	(0,509)
	Z2	(0,460)
	Z3	(0,440)
	Z4	(0,370)
	Z5	(0,674)
	Z6	(0,617)
	Z7	(0,596)
	Z8	(0,669)
	Z9	(0,607)
Financial Report Quality (Y)	Y1	(0,601)
	Y2	(0,488)
	Y3	(0,366)
	Y4	(0,592)
	Y5	(0,666)
	Y6	(0,679)
	Y7	(0,662)
	Y8	(0,388)
	Y9	(0,669)

Table 3.
Convergent
Validity Test
Results

Source: Primary data processed by SmartPLS, 2023

Convergent validity

Convergent validity of the measurement model can be seen from the correlation between the indicator score and the construct score (loading factor) with the loading factor criteria for each indicator greater than 0,70 which can be said to be valid. Loading requirements

above 0,70 are often not met, especially for newly developed questionnaires. Therefore, a loading factor between 0,40 - 0,70 must be maintained (Sholihin & Ratmono, 2021).

The convergent validity test result shows that all indicators forming latent constructs fulfil the requirements of indicator reliability because all indicators forming latent constructs ideally $\geq 0,7$ but $\geq 0,4$ are still acceptable. It can be concluded that most of the answer items are valid and can be used for research. However, as the loading factor of some indicators shows the value below 0,4, we remove those indicators on the next tests.

Reliability Testing

A reliability test is a measurement used to determine how much the measurement value has a level of consistency and stability from the measurement model. According to [Sholihin & Ratmono \(2021\)](#), a variable can be declared reliable if it has a composite reliability and Cronbach's alpha value above 0,70 as a reliability requirement. The reliability test results can be seen in the table 4.

Structural Model Testing

This test is commonly referred to as an inner model. It sees the goodness-of-fit index or feasibility of the relationship between exogenous variables related to the assumptions [Sholihin & Ratmono \(2021\)](#). The results of the inner model test can be seen from the R-Square (R2) value, aiming to determine how much the independent variable affects the dependent variable. The R2 value can be seen in the table 5.

Based on the R-Square test (R2) results, the R-Square value of the financial report quality variable is 0,626 or 62,6%, which means that the internal control system variable and human resource competence as a moderating variable affects the financial report quality variable by 62,6 %. Other variables influence the remaining 37,4%.

Hypothesis Test Results

Hypothesis testing explains the direction of the relationship between the independent and dependent variables ([Sholihin & Ratmono, 2021](#)). The results of the correlation between constructs are measured by looking at the results of estimated path coefficients and their significance level (p-value), which are then compared with the research hypothesis. Based on the data processing results using the SmartPLS 3.0, namely testing the inner model or structural model, an overview of the final model is obtained as follows:

	ICS	FRQ	HRC	HRC*ICS
<i>Cronbach Alpha.</i>	0,799	0,748	0,712	1.000
<i>Composite Reliab.</i>	0,848	0,814	0,798	1.000

Table 4.
Reliability Test Results

Source: Primary data processed by SmartPLS, 2023

FRQ
<i>R-Squared</i> 0,626

Table 5.
R-Square (R2) Test

Source: Primary data processed by SmartPLS, 2023

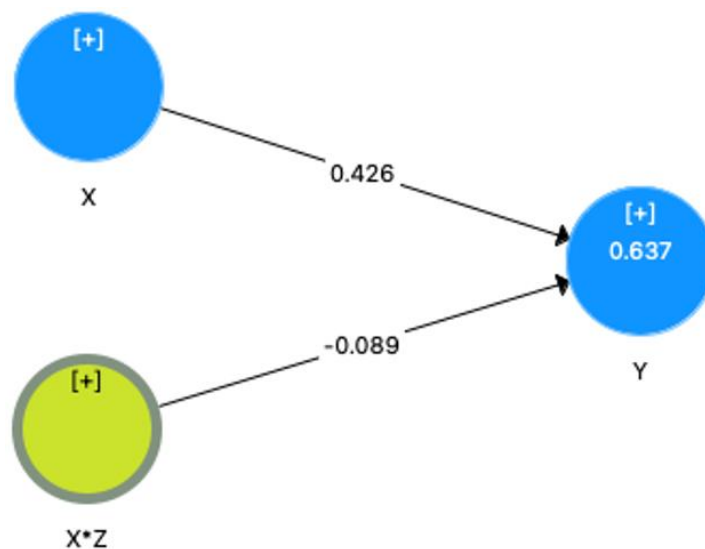


Figure 2.
Hypothesis Test Results

Table 6.
Hypothesis
Test Results

Variable	Path Coefficients	P-Values	Results
ICS → FRQ	0,426	0.004	Positive and Significant
ICS*HRC → FRQ	-0,089	0,026	Negative and Significant

To test the proposed research hypothesis, it can be seen from the amount of the probability value (p-value) with a significant level of 0.05. If the p-value < 0,05, the hypothesis is accepted, and vice versa. The hypothesis is rejected if the p-value is > 0,05 (Sholihin & Ratmono, 2021). The following is a table of results from hypothesis testing:

Based on the results of the path analysis in the table above, it can be explained as follows:

1. From testing the first hypothesis, the results of testing the internal control system on the financial report quality obtain a p-value of 0,004 with a path coefficient value (β) of 0,426, which shows a positive effect. It means the internal control system has a positive and significant effect on the financial report quality.
2. From testing the second hypothesis, the internal control system of the financial report quality with HR competence as the moderating variable obtains a p-value of 0,026. If the path coefficient (β) is -0.089, it indicates a negative effect. This means that HR competence is a significant moderator affecting the internal control system on financial report quality. However, the negative sign on moderation indicates a negative moderation effect. HR competence weakens the relationship between the internal control system and financial report quality.

Internal Control System has a significant positive effect on Financial Report Quality

Internal control is assumed to be an organisational effort to minimise the possibility of errors or acts of fraud. Therefore, companies also have confidence in disclosing various information to the public, including financial information in financial reports. In government agencies, the effectiveness and efficiency of internal control provide early warning of potential budget abuse. The implementation of ICS starts from setting policies, forming organisational structures, preparing budgets and their realisation, to monitoring and evaluating all organisational activities that reflect organisational performance and compliance with applicable laws. The results from Gamayuni & Setyawan (2020) stated that ICS, which is implemented through a series of SOPs in government institutions, can guarantee the reliability of financial reporting. The Regional Government Financial Report function as a form of local government accountability to the central government and the community as principals who must be prosperous according to the quality of the Regional Government Financial Report presentation. The more ICS discipline is applied, the higher the quality of the Regional Government Financial Report presented by the local government.

In this study the assessment of the internal control system refers to the Internal Control – Integrated Framework (2012) formed by COSO, which consists of 1) Control Environment, 2) Risk Assessment, 3) Control Activity, 4) Information and Communication, serta 5) Monitoring. The cases found from the test results at the Kudus Regency local bureaucracy proved that they had strictly implemented the ICS. The Unqualified Opinion that they have won consecutively shows the financial report quality that has been maintained. The five indicators used in this study are generally owned and disciplined by the local bureaucracy. These results show support for the statement in stewardship theory in which executives

within the local government of Kudus Regency have a strong motivation in providing the best service for the public as a form of compliance with their responsibilities. This motivation is the basis for implementing a strong internal control system so that it has positive impacts on the quality of financial reports which is one of the outputs of government services for the public. The findings of this first hypothesis also confirm the similarity of results from previous studies, including those found by [Irsutami et al. \(2018\)](#); [Rafindadi & Olanrewaju \(2019\)](#); [Ridzal et al. \(2022\)](#); [Wang et al. \(2020\)](#) The relationship between the effect of ICS on the financial report quality is positive and significant. Therefore, there is a unidirectional relationship between the internal control system and financial report quality. The financial report quality will improve if Internal control system implementation also increases. However, the findings are different from those produced by [Rizka et al. \(2021\)](#) the Internal control system actually has a negative effect on financial report quality.

HR competence has a significant and negative effect as a moderation in the effect of ICS on Financial Report Quality

A surprising result was obtained in the second hypothesis, which showed a moderating effect of HR competence as a variable that moderates the effect of ICS on financial report quality. The result, which concluded that HR competence has a significant negative moderate effect, means that the more competent the staff in the local bureaucracy, the weaker the influence of ICS on financial report quality. In previous research, many found a direct relationship between HR competence and financial institutions' quality. This indicates that HR competence has a significant positive effect on financial reports quality ([Ma et al., 2019](#); [Rakhman & Wijayana, 2019](#); [Soleh et al., 2020](#)). In its function as a moderator in this study, HR competencies do not provide as good benefits as direct relationships. It happens due to possible factors from the human side that make a more competent a person makes them ignores the rules and looks for loopholes for violations with the expertise he has. HR competence is the focus of the organization in response to stewardship theory. The organization only chooses competent and qualified human resources so that the interests of the organization are fulfilled, namely to become an organization that can be trusted by the community. In this case HR competence is seen as influencing the organization in creating an image in society so that it is able to produce quality financial reports in conditions of a weak internal control system.

Evidence from the results of this study that organizations tend to focus on creating a better internal control system when the quality of financial reports is assessed as low by not using HR competence as the only component that supports the improvement of the internal control system. Thus, stewardship theory captures the efforts of organizations with HR competencies to strengthen the results of good financial report quality in weak internal control system. Another condition is that human resource competence weakens the effective internal control system to present qualified financial reports. This explores that high (or low) HR competency weakens (or strengthens) the relationship of the internal control system to financial report quality. Another possible reason is, as they are competent, they already understand their duties and authorities so that the internal control system is not needed to be applied strictly. Therefore, a person's competence weakens the effect of ICS on financial report quality. A survey by the Indonesian Corruption Watch in 2018 reported mapping of cases based on institutions in which the local level government was the place where the most corruption cases occurred, with a total of 170 cases at the district government level, followed by village governments, city governments, and provincial governments. This is one of the indications that the people selected in government institutions, who are competent people selected from a series of selections, still need to be motivated especially in terms of their

integrity to comply with the implementation of the ICS to present increasingly high-quality FIs. This motivation can be applied by instilling spiritual values or rewards and punishments.

CONCLUSION

This study aims to examine the effect of the internal control system on the quality of financial reports with HR competency as a moderating variable. Best practice in the Government of Kudus Regency with the achievement of Unqualified Opinion for the tenth time in a row makes this research even more interesting and becomes a reference for other local governments. Stewardship theory (Davis et al., 1997a, 1997b) used in this study is the theoretical basis for executive responsibility as an agent motivation on the organizational success. The results prove that the better internal control system, the more quality the government financial reports is presented as is found in the Kudus Regency Local Government with their achievement of sequential Unqualified Opinion. However, HR competency has a significant negative effect in moderating the relationship between internal control system and financial report quality. The more competent the staff, the weaker the influence of internal control system on the quality of financial report. This is possible because competent staff tend to ignore regulations and look for loopholes for violations with their expertise. It is also possible that since they are competent, they already understand their duties and authorities so that the internal control system is not needed to be applied too strictly.

The implication of the results in this study are expected to guide the government officer in understanding the antecedents of quality financial reporting especially related to the internal control system with HR competence as its moderator as proven that the quality of financial reports is influenced by the implementation of the internal control system. However, with regard to HR competence, there should be an evaluation to ensure that the HR competency function within the organization becomes more optimal. This research is limited to the scope of local government as the phenomenon raised in the background of this research. Recommendations for further research can broaden the scope of government agencies with a higher level or other non-profit organizations, especially in testing the HR competency function which was found to weaken the relationship between internal control system and financial report quality in this study.

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