



Analysis of the Effectiveness of Internal Control Systems on Regional Financial Management in the North Maluku Provincial Government

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ABSTRACT: This study examines the performance of the Internal Control System (ICS) in the management of regional finance in the North Maluku Provincial Government. The research employed a descriptive qualitative methodology, utilizing primary data gathered through direct observation and interviews, alongside secondary data acquired from the BPK Audit Report (LHP). This study determined that the implementation of ICS has not been fully effective, based on the analysis of the five components of ICS as per Government Regulation (PP) No. 60/2008, aligned with the COSO framework. Notwithstanding attempts to enhance the control environment, the disparity between employees' credentials and their responsibilities, along with deficiencies in risk assessment and control activities, suggests the presence of issues. Critical findings indicated that the assets were inaccurately documented, and the potential for unregulated budget management persisted. Furthermore, there was little communication among authorities within the responsibility transfer system. This study found that inadequate ICS can elevate the probability of misstatements in financial reports and obstruct local government initiatives aimed at attaining transparency and accountability in fund administration. This research aims to assist stakeholders in enhancing the future implementation of ICS.

KEYWORDS: COSO Framework, Internal Control System (ICS), Management of regional fund allocation.

INTRODUCTION

The continuing reform era in Indonesia is characterized by increased transparency in government management. This reform era exemplifies regional authority and the decentralized control of regional financial management. Regional autonomy seeks to enhance public welfare, facilitating the expedited attainment of community objectives while preserving cultural norms and communal requirements. Local government funding distribution mechanisms enable municipalities to enhance their economies and augment their revenues to elevate community wellbeing. Nababan and Shahrullah, 2021. (Nababan & Shahrullah, 2021).

Preparation, allocation, implementation, structuring, reporting, accountability, and regulation constitute the management of regional budget allocation (PP, 2019). Efficient budget allocation management relies on a responsible, transparent local government that meets societal needs.

Law No. 15/2006 mandates that the Supreme Audit Agency (BPK) assess the accountability and management of state finances executed by the central government, local governments, other state institutions, Bank Indonesia, state-owned enterprises, public service agencies, and any other entities managing state funds. Moreover, the DPR, DPD, and DPRD receive a report on the examination results by virtue of their power. (Law No 15, 2006).

The examination of the Local Government Funding Report (LKPD) constitutes a verification process conducted by BPK. The results of BPK's LKPD audit are presented as a professional assertion in the form of an opinion. This professional statement evaluates the validity of the data in the fund allocation report according to criteria including regulatory compliance, sufficient disclosure, efficacy of internal controls, and adherence to governmental accounting standards. (Law No 15, 2004).

The Semester Inspection Results Summary (IHPS), the conclusion of the Inspection Results Report (LHP), is produced by BPK every semester. Regional-owned enterprises (BUMD) and local governments (pemda) cover 545 items examined in IHPS I of 2023. There are 543 results of checks on the allocation of funds and two results of special checks. BPK's examination of 542 LKPDs in 2022 showed that 496 (99%) LKPDs received an unqualified opinion (WTP), 41 (9%) LKPDs received an unqualified opinion (WDP), and 5 (9%) LKPDs received a negative opinion (TMP).

BPK's examination of 542 LKPDs in 2022 not only resulted in an opinion but also found 7,661 findings, with 12,855 problems related to disobedience to regulations and weaknesses in the ICS. Among these findings were 7,227 issues of disobedience and



5,628 issues of ICS weaknesses, with a finding value of Rp3.07 trillion. Of the 5,628 ICS issues, 1,695 (30%) were related to accounting and reporting control system issues, 2,974 (53%) were related to revenue and expenditure budget execution control system issues, and 959 (17%) were related to internal control structure issues. (IHPS, 2023).

The findings of BPK's evaluation of ICS deficiencies reveal persistent issues that may impact the opinion on the financial statements that are prepared as a means of accountability for regional financial management. A reliable financial statement is the foundation for a favorable opinion, and the implementation of an effective internal control system can enhance this opinion. (Suhendro, 2024).

A solid internal control system is needed to ensure that regional finances are managed effectively. A study conducted by Bulan, Tinangon, and Mawikere (2017) found that SPIP considerably influences how effectively regional financial management. The study found that well-used SPIP resulted in better regional financial management, while poorly used SPIP resulted in less effective regional financial management. (Bulan et al., 2017).

According to PP No 60/2008, control conditions, risk identification, control processes, information and communication systems, and internal control monitoring are part of the government's internal control system (SPIP) (Indonesia, 2008). The parts of SPIP use the internal control framework created by the Committee of Sponsoring Organisations (COSO) in 1992. (Nuha et al., 2021).

ICS is a comprehensive process of measures taken by leaders and all employees to ensure reasonable assurance that organizational objectives are achieved through effective and efficient operations, reliable reporting of funds allocated, protection of public property, and compliance with regulations. Reasonable internal control can create a government environment that encourages leaders and employees to perform well and demonstrate their commitment to transparent, accountable, orderly, and effective regional financial management.

Knowing how well ICS functions in regional financial management can help stakeholders to assess the accountability of regional financial management. It also provides a general idea of how unlikely financial reports will be incorrect if ICS is appropriately used. Nevertheless, the implementation and effectiveness of ICS often pose challenges in regional financial management.

RESEARCH REVIEW

Regional Financial Management

Managing regional funding in accordance with PP No 12/2019 and Minister of Home Affairs Regulation No 77/2020 necessitates highly methodical and controlled procedures. This management encompasses all actions pertaining to the rights, liabilities, and property of local governments. The regional financial management includes not only the distribution of financial resources but also all administrative tasks, including planning, allocation, implementation, and reporting, conducted with complete accountability. The objective is to utilize regional money in accordance with established regulations to efficiently and effectively achieve regional development objectives.

The goal of managing regional funds is to guarantee that the funding that is currently present is being managed properly, responsibly, and can be traced down. Regional financial management is executed by assessing regional requirements and developmental priorities, encompassing diverse elements such as infrastructure enhancement, public service improvement, and community empowerment. Local governments are anticipated to administer and allocate funds with utmost openness and prevent any misappropriation, ensuring that the resources directly benefit the community.

In addition, regional financial management also involves accountability mechanisms that ensure that every step in the use of funds can be monitored and evaluated. In practice, transparent and accurate reporting is critical to avoiding any misuse of funds that could harm the community. Therefore, good governance, including managing reports and records, is a very important aspect of managing regional fund allocation.

Internal Control System

The internal control system aims to maintain the sustainability of the organization's operations by minimizing the risks of managing funds or other resources. Hayes, Wallage, and Gortemaker (2017) quote an explanation from COSO, the internal control system is not only related to existing procedures and policies but also involves ongoing efforts from management and all elements of the organization to create an environment that supports operational efficiency and compliance with applicable rules (Rick et al., 2017). The internal control system comprises an organizational structure, methods, and integrated actions that are designed to



safeguard the organization's assets, verify the accuracy and reliability of accounting data, enhance efficiency, and guarantee adherence to management policies (Mulyadi, 2017). This system protects assets, improves efficiency, and ensures that financial reports are prepared legally, appropriately, and in accordance with relevant regulations (Espinosa, 2024)

The framework for internal control systems devised by COSO was initially introduced in 1992 and subsequently updated in 2013 (Akinleye et al., 2020). Implemented worldwide, the COSO framework serves as an essential reference for building and assessing the effectiveness of internal controls. It has five main elements: control environment, risk evaluation, control activities, information delivery and communication, and control monitoring (Rif'an et al., 2023). Each aspect must run in an integrated manner to produce optimal control. In addition, continuous monitoring and internal evaluation are also essential parts of the control system to ensure that the controls implemented are always relevant and effective in addressing current issues.

PP No 60/2008 provides the basic framework for internal control in government. The Government Internal Control System (SPIP) is implemented at all levels of government, from the center to the regions, to ensure that allocated funds are appropriately managed. SPIP is a comprehensive, integrated, and ongoing process that encompasses the planning, structure formulation, and implementation of internal control, as well as the achieving of organizational results or objectives within the organization.

RESEARCH METHODS

This research employs a descriptive qualitative methodology to investigate phenomena within a particular environment, aiming to achieve an extensive understanding of the perspectives, experiences, and perceptions of relevant individuals or groups. This methodology enables the researcher to comprehensively and thoroughly analyze data acquired from interviews, observations, and document reviews without altering or experimenting with the research subject. The analysis process is performed inductively, revealing significant patterns or themes derived from the acquired data, thereby providing a thorough representation of the global context beneath examination. This methodology is grounded in the research aims of obtaining deeper insights into the perspectives and experiences of respondents concerning the subject under analysis. (Sugiyono, 2013).

This research employs the triangulation method to gather data through three techniques: observation, interview, and documentation, all utilized with the same data source. Triangulation enhances the validity of study findings by integrating diverse data sources, methodologies, and pertinent theories (Sugiyono, 2019). This research was conducted in Sofifi City, part of North Maluku Province. The data used in the analysis came from interviews with relevant officials, observations of the implementation of the North Maluku Provincial Government's internal control system, and various secondary sources such as BPK reports, government regulations, and the results of semesterly checks by BPK. In addition, previous research in books, articles, or scientific journals is also used as a reference to enrich the analysis.

RESULTS AND DISCUSSION

PP No 60/2008 on the Government Internal Control System (SPIP), which adopts the COSO framework, emphasizes the importance of internal control in managing local fund allocations at the government level. In the North Maluku Provincial Government context, this system aims to ensure that all allocated funds and resources are used efficiently and accountable and to reduce the potential risk of misuse.

Control Environment

The Governor's Regulation on the Organization and Work Procedures of Regional Unit Organizations has regulated the details of duties and functions of each position, enabling the Provincial Government of North Maluku to implement a control environment. The Governor's Regulation outlines the main duties and functions of each Regional Unit Organization (SKPD) for employees and unit leaders. However, the educational qualifications and skills required to hold positions or perform certain tasks have not yet fully guided the placement of employees. Furthermore, some officials and employees still lack a complete understanding of their duties, authorities, and responsibilities. This is evident from the presence of employees in the accounting field who are responsible for preparing the Regional Government Financial Report (LKPD) but do not have an educational background in accounting.

The results of the checks showed several problems related to the management of the control environment, one of which was the non-optimal implementation of the code of ethics for civil servants (PNS). Despite a Governor's Regulation regulating the code of conduct, officials and staff still ignore regional property management policies and procedures, including misuse or unrecorded



regional property that is no longer under their jurisdiction, such as property owned by employees who have retired or moved. In addition, several officials involved in project procurement were implicated in legal issues related to the buying and selling positions. This indicates a lack of oversight of sensitive activities that should be closely monitored.

Risk Assessment

Regarding risk assessment, the North Maluku Provincial Government has not completed a comprehensive risk assessment process for allocating regional funds. This has led to risks that have not been appropriately identified and mitigated, particularly budget imbalances that are insufficient to pay for planned activities. The unrealistic allocation of funds and less rigorous monitoring have led to significant local expenditure debt. The mismatch between revenue and expenditure forecasts has also worsened local finances. Tiered arrangements made by technical officials, field implementers, and supervisors, while mitigating most of the risks associated with capital expenditure, cannot fully address other issues such as weather-related work delays or low quality of work in the field. This reflects the need for better risk management and implementing more effective mitigation strategies in budget planning and execution.

Control Activities

The Provincial Government of North Maluku has implemented control activity components, such as the signing of significant documents by designated personnel in accordance with the Regional Head's Decree. However, the implementation of control activities still exhibits some deficiencies. The Provincial Government of North Maluku has not yet conducted periodic reconciliations between bank statements and bookkeeping records in the financial information processing activities. Another issue with the control activity considered was an inadequacy in data management and physical supervision of regional assets. Regarding the North Maluku Provincial Government designating BPKAD's Accounting and Property Division to oversee local property, the documentation and administration of land and vehicle ownership records held by local authorities remain inadequately integrated. Each SKPD continues to manage car ownership documentation, while land ownership papers, including sale and purchase deeds and grants, are inadequately stored.

Information and Communication

The implementation of the information and communication control system is carried out using communication tools such as policy and procedure guidelines, correspondence, official government websites, and online communication to support regional financial management. To improve oversight and accountability, the North Maluku Provincial Government has also used various information systems to manage the allocation of regional funds, such as Regional Government Information System (SIPD), Financial Management Information System (FMIS), and Regional Management Information System-Regional Property (SIMDA-BMD). However, communication between old and new officials in terms of task transfers is inadequate, so replacement officials cannot adequately understand important information related to previous officials' work.

Monitoring Activities

The Inspectorate is responsible for monitoring activities as a supervisory element of regional government administration. Its primary responsibility is to assist the Governor in the supervision of the implementation of government affairs that are within the jurisdiction of the regional government and tasks that have been delegated by regional apparatus. Despite the oversight performed by internal entities, specifically the Inspectorate, monitoring is additionally executed by the follow-up on other audit or review outcomes conducted by the BPK. The BPK's audit of the North Maluku Provincial Government's governance, encompassing the LKPD Audit, Performance Audit, and Specific Purpose Audit (PDTT) through the second semester of 2023, yielded 2,318 audit recommendations. The North Maluku Provincial Government has addressed 1,493 of these recommendations, with a completion rate of 64.41%. Several BPK recommendations remain unresolved by the North Maluku Provincial Government.

Despite efforts to improve ICS, audit results and BPK reports show that the internal control system still needs significant improvement to manage regional funds better. Between 2023 and the first half of 2024, the BPK conducted an audit of the North Maluku Provincial Government, resulting in the issuance of five audit reports.

1. Regional Government Financial Statements Audit for Fiscal Year 2022 (Qualified Opinion)
2. Compliance Audit of Fixed Asset Management for Fiscal Years 2022 and 2023 (First Semester)



3. Compliance Audit of RSUD Dr. H. Chasan Boesoirie's Budgeting and Execution of Revenue, Expenditure, and Debt Management for Fiscal Years 2022 and 2023 (until October)
4. Compliance Audit of Regional Budget Preparation and Expenditure for Fiscal Years 2022 and 2023 (until October)
5. Regional Government Financial Statements Audit for Fiscal Year 2023 (Qualified Opinion)

The examination results reveal deficiencies in the execution of the Internal Control System of Regional Financial Management within the Provincial Government of North Maluku, which are detailed as follows:

Table 1. Recapitulation of the Number of Findings of Weaknesses in the Internal Control System

No.	Weaknesses of the Internal Control System	Number of Findings
1.	Failed or invalid logging	7
2.	Procedures do not make reports	11
3.	Poor activity preparation	9
4.	Deviations from the audited organization's internal rules regarding income and expenditure or the rules of a specific technical field	10
5.	Inappropriate policy setting or execution can reduce revenue or income.	6
6.	Determination and execution of policies that are not appropriate or have not been carried out increases payments and payments	8
7.	The entity's current SOPs are not working correctly or are not adhered to	7
8.	The organization does not have a formal standard operating procedure (SOP) for any procedure or all procedures.	1
	Total	59

The table above shows that there are still 59 findings of weaknesses in the Internal Control System, indicating that the Government of North Maluku Province has not fully implemented the Internal Control System for the Management of Regional Fund Allocation.

An effective internal control system will enhance the quality of fund allocation reports in the administration of regional fund distribution. Studies indicate that implementing an internal control system might reduce appropriation reporting inaccuracies and enhance the quality of appropriation reports. (Awaliya et al., 2022).

CONCLUSION

The investigation of the Internal Control System (ICS) implementation within the North Maluku Provincial Government indicates that the management of regional funding allocations is intricate due to numerous outstanding difficulties. According to PP No. 60/2008, which was modified from the COSO framework, five key ICS components are still not being used effectively. Initially, within the Control Environment component, despite the government's establishment of obligations and norms of behavior for each role, there exists a disparity between employee competency and assigned tasks, particularly concerning property management and budget allocation reports. This leads to inefficiency and inability to perform tasks properly, which can worsen the allocation of regional funds. Secondly, in the Risk Assessment component, there are still shortcomings in identifying and managing risks related to ineffective budgeting and sub-optimal capital expenditure. The inability to achieve appropriate local revenue budgets has led to expenditure debt, illustrating a lack of attention to adequately assessing and mitigating the risks of allocating funds.

Third, in the Controlling Activities component, despite some efforts to properly manage the allocation of funds, there were problems with poor physical property management and failure to conduct regular bank reconciliations and bookkeeping. This exacerbates the likelihood of errors or inaccuracies in reports on fund allocation, which could risk reducing accountability and transparency in fund management. Fourth, in the Information and Communication component, although information technology such as SIPD and SIMDA have been used to assist in the management of regional funds, there were problems in communication between the outgoing and incoming officials. This suggests weaknesses in the transfer of responsibilities system that could disrupt smooth operations and affect efficiency in fund management. Finally, in the Reconnaissance component, BPK's checks indicated



that the completion of follow-up on advice given was inadequate, especially those involving unknown third parties. This suggests that supervision and follow-up on audit recommendations are ineffective, potentially hindering improvements and progress in ICS implementation.

The analytical results indicate that the implementation of ICS in the North Maluku Provincial Government has not been entirely effective. The ineffectiveness of ICS may result non inaccurate fund allocation reports, heighten the probability of irregularities in local financial management, and decrease public confidence in the transparency and accountability of local government. The North Maluku Provincial Government must implement extensive enhancements in the execution of ICS to guarantee more effective, precise, and accountable financial management.

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