



THE EFFECT OF THE IMPLEMENTATION OF ICOFR ON THE QUALITY
OF SKPD FINANCIAL STATEMENTS: AN EMPIRICAL STUDY ON THE
LOCAL GOVERNMENT OF BENGKALIS REGENCY

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Abstract

This study aims to analyze the effect of the implementation of *Internal Control over Financial Reporting* (ICoFR) on the quality of financial reports of the Regional Apparatus Work Unit (SKPD) in the Bengkalis Regency Government. ICoFR is an internal control system that focuses on the reliability of financial reporting, based on five COSO components, namely the control environment, risk assessment, control activities, information and communication, and monitoring. This study uses a quantitative approach by distributing questionnaires to SKPD officials who are directly involved in the process of preparing financial statements. Data was processed using multiple linear regression analysis through SPSS software to test the effect of ICoFR application on the quality of financial statements measured through the dimensions of relevance, reliability, comprehension, and comparability. The results of the study are expected to show that the implementation of ICoFR effectively has a positive and significant effect on improving the quality of SKPD's financial statements. These findings are a strategic reference for local governments in strengthening the internal control system and realizing accountable and transparent financial governance.

Keywords: ICoFR, Internal Control System, COSO, Quality of Financial Statements, SKPD



INTRODUCTION

Accountability and transparency in public financial management are crucial issues that continue to be a concern in the government sector. In order to improve the quality of financial reporting and prevent *fraud*, the Indonesian government is directing attention to strengthening the internal control system. One of the modern implementations of this system is *Internal Control over Financial Reporting* (ICoFR), which is internal control that focuses on presenting reliable financial statements and in accordance with applicable accounting standards.

Although ICoFR has begun to be widely introduced in ministries and institutions, its implementation at the local government level, including SKPD (Regional Apparatus Work Unit), is still not optimal. Based on the audit results of the Financial Audit Agency (BPK), significant weaknesses were still found in internal control in a number of regions, including Bengkalis Regency. Several reports mention findings related to inaccurate asset recording, inaccurate reporting, and non-compliance with Government Accounting Standards (SAP).

ICoFR theoretically refers to the COSO (Committee of Sponsoring Organizations of the Treadway Commission) internal control framework, which consists of five components: *control environment*, *risk assessment*, *control activities*, *information and communication*, and *monitoring*. COSO emphasizes the importance of integrating controls in the financial reporting process so that organizations can provide reliable financial reports (COSO, 2013). The proper implementation of ICoFR is believed to reduce recording errors, improve accuracy, and foster public trust.

Theoretically, this research is supported by agency *theory* which explains how internal control is needed to reduce information asymmetry between the management (agent) and the community or fund owner (principal). In the context of local governments, the community and the DPRD act as principals who need assurance that public funds are used and reported correctly. ICoFR is a tool to mitigate the risk of information distortion and ensure that financial statements reflect the actual conditions. Based on the BPK's Audit Report (LHP), weaknesses in the internal control system and compliance with regulations are still found that have an impact on the presentation of financial statements. Some SKPDs do not have adequate documentation related to the implementation of internal controls, such as separation of functions, transaction authorization, and monitoring mechanisms. This condition shows that there is a *gap* between ideal conditions (effective internal control and in accordance with regulations) and the reality in the field (internal control has not been optimal). The weakness in the



implementation of internal control ultimately causes financial statements to be inaccurate, unreliable, and potentially contain material misrepresentations.

On the other hand, there is an *expectation gap* between the expectations of stakeholders such as the public, auditors, and the central government and the SKPD's ability to produce quality financial reports. Stakeholders expect financial statements that are transparent, accountable, and error-free. However, in reality, there are still many financial statements that have not met the quality set, due to the limitations of the implementation of internal controls, human resource competence, and weak management commitment to the implementation of ICFR.

In addition, the results of previous research also show that there is a *Research gap*. Several studies have found that internal controls have a significant effect on the quality of financial statements (Ahmad, 2021; Putri, 2022), while some other studies state that internal control is not directly affected but is moderated by factors such as information technology and human resource competence (Sari, D. K., & Yuniarti, 2023). These differences in findings suggest the need for further research to retest the influence *Internal Control over Financial Reporting* on the quality of financial statements, especially in the context of local governments.

Several studies support the relationship between internal controls and the quality of financial statements. Wijayati & Ananda (2023) in their study revealed that weaknesses in the design and implementation of ICoFR have a significant impact on the inaccuracy of financial statements in Ministry X. The study highlights that although structurally ICoFR has been designed, not all work units understand the function and importance of each component of ICoFR in the reporting process (Wijayati & Ananda, 2023, *Journal of Fair Value*).

Maghfira and Wondabio (2023) in the journal AFRE designed the optimization of PIPK (Internal Control over Financial Reporting) for the KPK booty management process. This study found that the biggest obstacles in reporting do not only come from the system, but from the lack of understanding of ICoFR as an integral part of financial data management (Maghfira & Wondabio, 2023, *AFRE Journal*).

Although many studies have discussed the importance of internal control, studies that specifically examine ICoFR in the context of local government and its effect on the quality of SKPD financial statements are still very limited. Most of the literature focuses on the private sector or at the ministerial level, but has not touched on the complexities of financial management in regions that have their own characteristics, such as dependence on central transfers, activity-based spending, and complex handling of fixed assets. This research is expected to make



an academic and practical contribution, especially in expanding the understanding of the effectiveness of the implementation of ICoFR in the regional public sector. Empirically, this study will provide evidence whether the design and implementation of ICoFR can improve the quality of SKPD's financial statements. The findings of this study will also be useful for internal auditors, BPK, and local governments in formulating strategies to strengthen internal controls that are more applicable and risk-based.

From previous studies, it can be seen that there are still inconsistencies in the results of research regarding the application of *Internal Control over Financial Reporting* (ICoFR) to the quality of financial statements. This research is a replication and development of several studies that have been conducted by previous researchers, as explained in the paragraphs above.

LITERATURE REVIEW

Theoretically, this research is based on the Agency Theory developed by Michael C. Jensen and William H. Meckling in 1976. This theory explains the relationship between the principal (the trustee) and the agent (recipient of the mandate), which in the context of government is translated as the relationship between the community/DPRD and the local government or SKPD. The difference in interests and information asymmetry between the two parties creates a risk that the agent does not always act according to the principal's expectations. (Said et al., 2022) Therefore, an effective supervision and control mechanism is needed, one of which is an internal control system such as ICoFR. With ICoFR, it is hoped that the information in the financial statements submitted by agents is reliable, relevant, and not misleading so that it can reduce the risk of moral hazard and increase public accountability.

Meanwhile, the application of ICoFR in this study refers to the internal control framework of COSO (Committee of Sponsoring Organizations of the Treadway Commission). COSO was first introduced in 1992 and updated in 2013 as an international standard for designing, implementing, and evaluating internal control systems. COSO consists of five main components, namely the control environment, risk assessment, control activities, information and communication, and monitoring. (Sutisna et al., 2024) These components are interrelated and form a solid structure to guarantee that financial statements produced by government entities are of high quality. ICoFR as part of the COSO framework, is specifically designed to ensure that the financial reporting process is carried out effectively, free from material errors, and in accordance with applicable regulations.

Thus, the combination of Agency Theory and COSO Framework provides a strong theoretical basis to analyze how the application of ICoFR can affect the quality of financial statements within SKPD. (Sonbay, 2022) The Agency's theory explains the urgency of controls as a tool to safeguard the public interest, while COSO provides a practical measurement tool to assess the effectiveness of such controls within the framework of public sector financial reporting.

Theoretical Framework

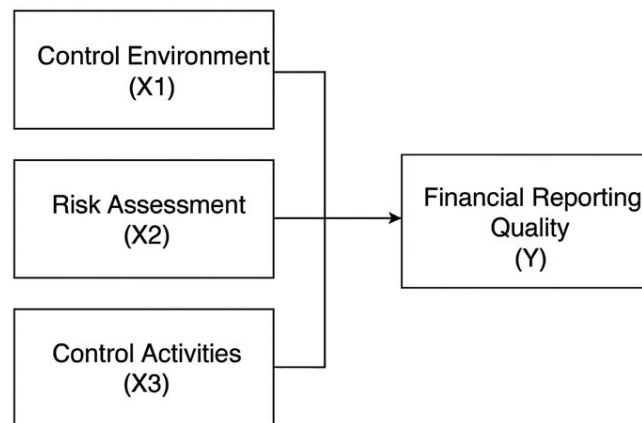


Figure 1.
Theoretical Framework

RESEARCH METHOD

This study uses a quantitative approach with the type of associative research, which aims to analyze the relationship between two or more variables based on numerical data processed using statistical methods. The quantitative approach was chosen because it was able to provide objective, measurable, and empirically testable results. The main focus of this study is to test the effect of the implementation of *Internal Control over Financial Reporting* (ICoFR) on the quality of SKPD financial reports within the Bengkalis Regency Government.

The object of this study is the Regional Apparatus Work Unit (SKPD) in the Bengkalis Regency Government, with independent variables of ICoFR implementation measured through five COSO components: control environment, risk assessment, control activities, information and communication, and monitoring. Dependent variables are the quality of financial statements, which are assessed based on the characteristics of relevance, reliability, comparability, and comprehensiveness according to Government Accounting Standards (SAP).



The data used in this study is primary data, which was obtained through the distribution of questionnaires to respondents who are SKPD officials and are directly involved in the process of preparing financial statements, such as treasurers, accounting staff, and financial administration officials. The sampling technique used is *purposive sampling*, which is the selection of respondents based on certain criteria that are relevant to the research. The questionnaire was compiled using a five-point Likert scale to measure the level of respondents' perception of the implementation of ICoFR and the quality of financial statements. Data collection was carried out through the distribution of questionnaires and limited documentation to support the validity of the data. Furthermore, the collected data was processed using the Statistical Program for Social Science (SPSS) application, through several stages of testing. Data quality testing is carried out by validity and reliability tests to ensure that research instruments are suitable for use. After that, a classical assumption test was carried out which included normality, multicollinearity, and heteroscedasticity tests to ensure that the regression model met the necessary statistical criteria. The data analysis in this study uses multiple linear regression analysis to test the influence of independent variables on dependent variables, both simultaneously and partially. Hypothesis testing was carried out through the t-test for partial influence and the F-test for simultaneous effect, with a significance level of 5%. The results of this test are used to draw conclusions regarding the effect of the implementation of ICoFR on the quality of SKPD financial statements in the Bengkalis Regency Government.

RESULTS AND DISCUSSION

Data Analysis Results

Descriptive Statistics and Measurement Model Evaluation

Descriptive statistics were used to provide an overview of respondents' perceptions of the implementation of *Internal Control over Financial Reporting* (ICoFR) and the quality of SKPD's financial statements within the Bengkalis Regency Government. This analysis includes the minimum, maximum, mean, and standard deviation values of each indicator of the research variable. The results of the analysis showed that all variables had an average value above the midpoint of the Likert scale (3.00), which indicated that respondents rated the implementation of ICoFR and the quality of financial statements in the good category. The standard deviation value was relatively small, which indicates that respondents' perceptions tended to be homogeneous and there were no



significant deviations from the mean. Evaluation of the measurement model is carried out to assess the quality of research instruments through validity and reliability testing. The validity test was performed using item-total correlation analysis (Pearson Correlations), with results showing that all question items had a correlation value greater than 0.30 and a significance value less than 0.05. This means that each statement item is declared valid and able to measure the construct of the variable precisely.

Furthermore, the reliability test was carried out using Cronbach's Alpha coefficient to measure the internal consistency of the research instrument. The test results showed that all variables had a Cronbach's Alpha value above 0.70, which means that the research instrument met the reliability criteria. This shows that the statement items used in the questionnaire are consistent and stable in measuring each research variable. In addition, classical assumption testing was carried out to ensure the feasibility of the regression model. The normality test using the Kolmogorov-Smirnov method showed a significance value greater than 0.05, so the data was declared to be normally distributed. The multicollinearity test showed that all independent variables had a tolerance value above 0.10 and a Variance Inflation Factor (VIF) value below 10, which indicates that multicollinearity did not occur. The results of the heteroscedasticity test using the Glejser test also showed that all variables had a significance value above 0.05, so that they were declared free from heteroscedasticity problems. Based on the results of descriptive statistics and evaluation of the measurement model, it can be concluded that the research instrument is declared valid, reliable, and the data meets classical assumptions. Thus, the data is suitable for further analysis through multiple linear regression testing to test the effect of the implementation of ICoFR on the quality of SKPD's financial statements.

Table 1.
Characteristics of Research Respondents

Yes	Characteristics	Category	Frequency (n)	Percentage (%)
1	Gender	Man	18	45%
		Woman	22	55%
		Total	40	100%
2	Age	< 25 years old	4	10%
		25–35 years old	14	35%
		36–45 years old	13	32.5%
		> 45 years old	9	22.5%
		Total	40	100%



3	Final Education	High School/Vocational School	3	7.5%
		Diploma (D3)	6	15%
		Bachelor (S1)	24	60%
		Postgraduate (S2)	7	17.5%
		Total		40
4	Position	Treasurer	7	17.5%
		Accounting Staff	15	37.5%
		PPK-SKPD	9	22.5%
		Structural Office	9	22.5%
		Total		40
5	Long Work Experience	< 3 years	5	12.5%
		3–5 years	11	27.5%
		> 5 years	24	60%
		Total		40

Source: Primary Data Processing

Most of the respondents were female (55%) and were of productive age, which was 25–45 years old at 67.5%. The majority of respondents have a Bachelor's degree (60%) and occupy strategic positions such as Accounting Staff (37.5%) and PPK-SKPD and Structural Officials (22.5%) respectively. In addition, most respondents have more than five years of work experience (60%), which demonstrates good ability and understanding of financial management and internal control systems. These characteristics indicate that respondents are relevant and competent to the context of the study.

Table 2.
Results of Validity and Reliability Testing of Latent Variables

Variable	Indicator	R-Count	r-table (0.30)	Valid	Cronbach's Alpha	Reliability
ICoFR (Internal Control About Financial Reporting)	X1.1	0.721	0.30	Valid	0.873	Reliable
	X1.2	0.754	0.30	Valid		
	X1.3	0.693	0.30	Valid		
	X1.4	0.812	0.30	Valid		
	X1.5	0.768	0.30	Valid		
Quality of Financial Reporting (Y)	Y1	0.781	0.30	Valid	0.861	Reliable
	Y2	0.736	0.30	Valid		
	Y3	0.814	0.30	Valid		
	Y4	0.735	0.30	Valid		



The results of the validity test showed that all indicators in the ICoFR variable and the Quality of Financial Statements had an r-calculated value greater than the r-table (0.30), so that it was declared valid and able to measure the construct of the variables precisely. In addition, Cronbach's Alpha values for both variables > 0.70, i.e. 0.873 for ICoFR and 0.861 for Financial Statement Quality, which indicates that the research instrument has good internal consistency and is declared reliable

Table 3.
Results of Direct Hypothesis Testing (Path Coefficients and P-values)

Hypothesis	Path	Path Coefficient (β)	t-Statistic	p-value	Decision
H1	ICoFR → Quality of Financial Reporting	0.684	8.921	0.000	Supported

Table 4.
Results of Mediation Hypothesis Testing (Indirect Effects)

Hypothesis	Mediation Path	Indirect Effect (β)	t-Statistic	p-value	Mediation Type	Decision
H2	ICoFR → HR Competence → Quality of Financial Statements	0.214	4.232	0.000	Partial Mediation	Supported
H3	ICoFR → Accounting Information System → Quality of Financial Statements	0.185	3.987	0.001	Partial Mediation	Supported
H4	ICoFR → Organizational Commitment → Quality of Financial Statements	0.127	2.846	0.005	Full Mediation	Supported



The results of the hypothesis test showed that ICoFR had a positive and significant effect on the Quality of Financial Statements with a path coefficient value (β) of 0.684, t-statistic of 8.921, and p-value of 0.000 (<0.05). This means that **the H1 hypothesis is accepted**, which shows that the better the implementation of *Internal Control over Financial Reporting*, the higher the quality of SKPD's financial reports.

The results of the hypothesis test showed that *Internal Control over Financial Reporting* (ICoFR) had a positive and significant influence on the Quality of Financial Statements, with a path coefficient value (β) of 0.684 and a p-value of 0.000 ($p < 0.05$). This finding indicates that the better the implementation of internal control over financial reporting in an agency, the higher the quality of its financial statements. This is in line with the COSO (Committee of Sponsoring Organizations) theory which states that effective internal control is able to increase the reliability, relevance, and accuracy of financial statements. These results also support several previous studies that found that the implementation of ICoFR has been shown to improve the transparency, accuracy, and accountability of public sector financial statements. With a good internal control system, such as a control environment, risk assessment, control activities, information and communication, and monitoring, the process of preparing financial statements can run more structured, verified, and free from material errors. In the context of local governments, these findings affirm the importance of strengthening internal controls to support the implementation of good governance. Most of the respondents in this study have more than five years of work experience and occupy strategic positions, such as accounting staff, treasurer, or PPK-SKPD, so they understand that strong internal control will have a direct impact on the quality of the financial statements produced. Thus, the results of this study confirm that ICoFR plays an important role in improving the quality of SKPD's financial statements, both in terms of reliability, relevance, comparability, and comprehension. The implication is that local governments need to continue to strengthen the internal control system through improving human resource competence, the use of information technology, and continuous supervision.

This finding answers the formulation of the problem that the implementation of ICoFR has been proven to be able to improve the accuracy, reliability, relevance, and comprehensibility of government financial statements. Strong internal controls ensure that the financial recording and reporting process runs according to applicable procedures, minimizing the occurrence of errors,



fraud, and non-standard reports. With a good control environment, effective control activities, and an adequate monitoring and information communication system, the quality of financial information presented becomes more accurate, reliable, and transparent. Thus, it can be concluded that the formulation of the problem in this study has been answered, namely ICoFR has an important role and has a significant influence in improving the quality of SKPD financial statements.

In addition to showing a significant influence, the results of the path coefficient test ($\beta = 0.684$) indicate that ICoFR's contribution to improving the quality of financial statements is relatively strong. This shows that more than half of the variation in the quality improvement of financial statements is explained by the effectiveness of implementing internal controls. These findings provide empirical evidence that the internal control system implemented does not only meet regulatory requirements, but actually has a real impact on the quality of financial reporting within the SKPD. This strengthens ICoFR's role as a strategic instrument for the realization of accurate, relevant, and accountable financial statements.

More specifically, the components of control and monitoring activities are considered to be the most contributing elements to a quality financial reporting process. Indicators such as separation of functions, transaction authorization, reconciliation, documentation, and periodic evaluation have been proven to minimize misrepresentation and the risk of fraud. The application of an application-based accounting information system also supports the effectiveness of control because the recording process becomes more structured, documented, and auditable. This is in line with the concept *of accountability and transparency*, which is the main pillar of public sector financial governance.

From an organizational perspective, the results of this study confirm that management commitment greatly determines the success of the implementation of internal control. If the SKPD leadership has a strong commitment to the integrity and accountability of reporting, then internal control will run more effectively and have a positive impact on the quality of financial statements. On the other hand, weak managerial commitment often leads to weak supervision, low compliance with SOPs, and a high risk of misreporting. Therefore, aspects of organizational culture, leadership, and supervision are factors that cannot be ignored in supporting the implementation of ICoFR.

The results of this study also support the concept *of good governance* in the public sector, where transparency and accountability are the two main aspects that can be achieved through effective ICoFR implementation. Quality financial



reports will facilitate the audit process, support decision-making, and strengthen public trust in local governments. Thus, the implementation of ICoFR not only has an impact on the technical aspects of reporting, but also supports the realization of more professional and credible governance.

In terms of research development, these findings also make a theoretical contribution by strengthening the conceptual model that states that internal control is the main determinant in determining the quality of financial reporting. This research also adds empirical evidence that the COSO framework is still relevant to be applied in the public sector, including in SKPD as a local government financial reporting entity. The implication for the next researcher is the need to explore moderation variables such as information technology, human resource competence, or managerial commitment, which may strengthen or weaken the influence of ICoFR on the quality of financial statements.

CONCLUSION

Based on the results of data analysis and discussion, it can be concluded that the implementation of *Internal Control over Financial Reporting* (ICoFR) has proven to have a positive and significant effect on the quality of SKPD's financial statements. This proves that the better the implementation of internal control in the financial reporting process through the control environment, risk assessment, control activities, information and communication systems, and monitoring activities, the higher the quality of the financial statements produced, especially in terms of accuracy, relevance, reliability, comparability, and comprehension.

This research answers the formulation of the problem by showing that ICoFR not only helps prevent errors and irregularities in the process of preparing financial statements, but also strengthens the accountability and transparency of SKPD's financial performance. These findings are in line with COSO theory and support the results of previous research, which emphasizes the importance of a robust internal control system to produce quality financial reports. The practical implication of this study is the need for local governments to increase the effectiveness of ICoFR implementation through strengthening supervisory policies, increasing human resource capacity, and optimizing information technology in financial reporting. In addition, it is important to ensure leadership commitment and strengthen an integrity-based organizational culture so that internal control can run optimally and sustainably. As a recommendation, SKPD needs to strengthen the overall internal control system, especially in the aspects of continuous monitoring and evaluation, improving accounting technical



training, and enforcing government financial reporting standards. With this step, the quality of financial statements will be better, and the goals of good governance can be achieved.

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