



## The Effect of Internal Control System and Human Resources Quality on Report Quality Finance with the Internal Environment as Intervening Variables in Regional Companies Tirtanadi Medan Drinking Water

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### **Abstract**

The purpose of this study is to determine whether the internal control system has an effect on the internal environment through the quality of financial reports. To find out whether the quality of human resources has an effect on the internal environment through the quality of financial reports. Small populations such as 100 or less than 100 should all be used as samples. This technique is known as the census technique. Thus, the number of samples in this study were 38 employees at PDAM Tirtandi Medan. The conclusions of this study are: The internal control system for the internal environment through the quality of financial reports is 0.064, with a T statistic value of 0.559 ( $< 2,028$ ) and a significance value (p-values) of 0.576 ( $> 0.05$ ). hypothesis (H6) in this study was rejected. This shows that internal factors, for example: advances in information technology, changes in reporting standards, changes in government regulations with good internal controls can help employees to work more enthusiastically to prepare financial reports as well as possible, so that the quality of financial reports can be improved. The quality of human resources on the internal environment through the Quality of Financial Reports is 0.357, with a T Statistic value of 2.770 ( $> 2,028$ ) and a significance value (p-values) of 0.006 ( $< 0.05$ ). Thus, the seventh hypothesis (H7) in this study is accepted. With the recruitment of employees in accordance with their fields and holding training, it will create the readiness of these human resources to face the development of rapidly increasing internal dynamics and produce good quality financial reports.

**Keywords:** *Internal Control System; Quality of Human Resources; Quality of Financial Reports; Internal Environment*

### **Introduction**

The internal control system at PDAM Tirtanadi Medan or referred to as the Internal Supervisory Unit saves to be able to carry out strict supervision in every transaction of income and company expenses. Thus, the internal unit also has the task of monitoring and calculating the cash contained in the accounting

records periodically. However, in carrying out internal inspections of PDAM Tirtanadi, it has never been carried out directly, periodically every 6 months.

Developments in the quality of human resources at PDAM Tirtanadi in terms of the readiness of human resources or employees by assuming high responsibilities within the company can be said to have not been maximized due to the slow handling of employees in complaints of pipe leaks, causing losses in the water supply which are quite high. <https://kumparan.com/sumutnews>

Development of the quality of human resources in PDAM Tirtandi Medan in the preparation of human or dependent employees who are higher in the organization or company. It is stated that it is not maximized. One of the problems that occur in the quality of human resources in slow handling is carried out when there are complaints related to leaky pipe connections, even sometimes in the area where PDAM Tirtanadi employees live, it is an important thing to be addressed. In addition, the poor awareness of employees to be responsible for the company and when a pipe connection error occurs to be repaired immediately is PDAM Tirtadi's "homework" in coaching to improve the quality of human resources. <https://kumparan.com/sumutnews>

The Regional Drinking Water Company (PDAM) Tirtadi is a Regional Government Owned Company of North Sumatra Province in the field of drinking water services. PDAM Tirtanadi consists of air revenue receipts, non-air revenue receipts and other money receipts, it is necessary, an internal control system and good quality human resources so that the quality of financial reports in its internal environment can be managed properly. PDAM as a regional company must always be professional in running its business, because this company was formed to continue running. In addition, company leaders also need a tool to monitor the tasks entrusted to them and to know the progress that the company will achieve. For that we need a system that is better known as the internal control system. The internal control system includes elements such as organizational structure, coordinated methods and measures to safeguard organizational assets, check accuracy and accounting data, promote efficiency and adhere to management policies.

Many previous studies related to this phenomenon have been carried out. Several researchers also concluded several factors in internal control in the quality of security reports in the study (Trio & Dewi, 2020) the quality of control on the quality of local government financial reports. This means that controls need to be improved and optimized, this can be done by: The formation of the organizational structure is in accordance with the needs. It has realized the integration (unification) of all components in the regional apparatus. Enforcement of integrity and ethical values has been done well. create conducive leadership. interact intensively with performance-based management officials.

(Syahadatina & Fitriyana, 2016) also conducted research on the influence of human resources on the quality of human resources possessed by this book as well as improving the competence of human resources to understand accounting or finance. to improve the ability in financial reporting as well as all matters relating to activities and programs that can support the objectives of the agency or organization. This research is a development of research conducted by (Tanjung & Sonia, 2021) which examines the effect of the quality of human resources on the quality of local government financial reports. The results of the study stated that the internal control system in the Cimahi City Government was in the quite adequate category, the quality of human resources in the Cimahi City Government was in the fairly good category, and the quality of local government financial reports in the Cimahi City Government was in the fairly good category. However, in terms of looking at the results of the study, there are still problems that must be overcome in internal control in the form of improvements in risk assessment, risk prevention, information and communication and monitoring dimensions in the assessment of performance quality, then with the addition of internal environmental variables that become intervening variables to be able to overcome problems that occur in internal control and the quality of human resources on the quality of financial reports. Based on the research gap, previous research, and phenomena that occur in the field, this

is the reason the researcher conducted a research entitled "The Effect of Internal Control System and Quality of Human Resources on the Quality of Financial Statements with Internal Environment as an Intervening Variable at PDAM TIRTANADI MEDAN".

The hypotheses of this study are:

- H1: The internal control system has a positive and significant effect on the quality of financial reports at PDAM Tirtanadi Medan
- H2 : The quality of human resources has a positive and significant effect on the quality of the financial statements of PDAM Tirtanadi Medan
- H3 : The internal environment has a positive and significant effect on the quality of the financial statements of PDAM Tirtanadi Medan
- H4 : The internal control system has a positive and significant effect on the internal environment of PDAM Tirtanadi Medan
- H5 : The quality of human resources has a positive and significant effect on the internal environment of PDAM Tirtanadi Medan
- H6: The internal control system has a positive and significant effect on the quality of financial reports through the internal environment of PDAM Tirtanadi Medan
- H7: The quality of financial reports has a positive and significant effect on the quality of financial reports through the internal environment of PDAM Tirtanadi Medan

### **Method**

This research is associative because it only aims to see the relationship between two or more variables. The study was carried out at the Regional Water Company Tirtanadi Medan, having its address at Jl. S.M.Raja No.1 (Jl. Pandu), Medan, North Sumatra.

The population is a generalization area consisting of objects/subjects that have certain quantities and characteristics determined by researchers to be studied and then drawn conclusions (Sugiyono). This is done because the variables used by the researcher are employees who are directly related to the financial sector of a work unit, so that not all employees at PDAM Tirtanadi Medan can be used as respondents to fill out the distributed questionnaires. The population of this research is the employees in the finance department and the internal control division at PDAM Tirtanadi as many as 38 people.

The sample is part of the number and characteristics possessed by the population. While the sample size is a step to determine the size of the sample taken in carrying out a study. The sampling technique used is the census technique, if it is known that the number of small populations, for example 100 or less than 100, the entire population should be used as a sample. This technique is known as the census technique. Thus, the number of samples in this study were 38 employees at PDAM Tirtanadi Medan.

The data analysis technique in this study used Partial Least Square (PLS). PLS is a Structural Equation Modeling (SEM) equation model with an approach based on variance or a component-based structural equation model. The aim of PLS-SEM is to develop a theory or build a theory (prediction orientation). PLS is used to explain whether there is a relationship between latent variables (prediction). PLS is a strong analytical method because it does not assume current data with certain scale measurements, small samples (Ghozali, 2018). This study has a complex model and a limited number of samples, so that in analyzing the data using SmartPLS software. SmartPLS uses bootstrap method or random multiplication. Therefore the assumption of normality will not be a problem. In addition, with bootstrapping, SmartPLS does not require a minimum number of samples, so it is applied to small samples. PLS-SEM analysis consists of two sub-models, namely the measurement model or the external model and the structural model (structural model) or the internal model.

**Results and Discussion**

Results of Data Analysis

A. Evaluation of the Measurement Model (Outer Model)

A1. Convergent Validity

**Average Variance Extracted (AVE) Value**

Variable	Average Variance Extracted (AVE) Value
Internal Control System	0,645
Quality Of Human Resources	0,732
Financial Report Quality	0,682
Internal Environment	0,720

Source: Processed secondary data, 2022

Based on table, it can be seen that the AVE results obtained are above 0.50 so that it can be stated that the indicators used in this study are valid or have met the criteria of convergent validity.

A2. Discriminant Validity

**Cross Loading Value**

Indicator	Internal Control System	Quality Of Human Resources	Internal Environment	Internal Environment
X1	0,755	0,147	0,320	0,085
X2	0,810	0,382	0,555	0,285
X3	0,806	0,321	0,487	0,161
X4	0,801	0,355	0,427	0,026
X5	0,762	0,558	0,584	0,195
X7	0,879	0,387	0,596	0,185
X3	0,469	0,819	0,512	0,555
X4	0,468	0,890	0,467	0,449
X5	0,327	0,853	0,571	0,682
X6	0,363	0,859	0,471	0,568
Y1	0,427	0,581	0,784	0,578
Y2	0,372	0,693	0,771	0,623
Y3	0,534	0,329	0,859	0,492
Y4	0,705	0,437	0,859	0,486
Y5	0,572	0,438	0,841	0,355
Z1	-0,033	0,479	0,271	0,788
Z2	0,379	0,593	0,639	0,852
Z3	0,129	0,618	0,581	0,903

Source: Processed secondary data, 2022

Each indicator has the highest loading factor value when associated with the target construct compared to when associated with other constructs. For example, the loading factor value for internal control system indicators (X1 to X7) has a higher loading factor value for the internal control system construct than with other constructs. As an illustration, the loading factor X1 for the internal control system is 0.755 which is higher than the loading factor X1 for the quality of human resources (0.147), the quality of financial reports (0.320), and the internal environment (0.085). The same can be seen in other indicators. Thus it can be concluded that the indicators used in this study are valid or have met the criteria for discriminant validity.

**AVE Root Value**

	Internal Control System	Quality Of Human Resources	Financial Report Quality	Internal Environment
Internal Control System	0,803			
Quality Of Human Resources	0,470	0,855		
Financial Report Quality	0,639	0,597	0,826	
Internal Environment	0,212	0,671	0,614	0,849

Source: Processed secondary data, 2022

The AVE root value on the diagonal is greater than the correlation value between constructs and other constructs in the model. This indicates that the model with its indicators has met the criteria for discriminant validity.

**A3. Composite Reliability**

**Composite Reliability**

Variabel	Composite Reliability
Internal Control System	0,916
Quality Of Human Resources	0,916
Financial Report Quality	0,915
Internal Environment	0,885

Source: Processed secondary data, 2022

The value of composite reliability for all constructs is above 0.70 which means that all constructs in the estimated model meet the internal consistency reliability criteria.

**A4. Cronbach's Alpha**

**Cronbach's Alpha**

Variabel	Cronbach's Alpha
Internal Control System	0,891
Quality Of Human Resources	0,878
Financial Report Quality	0,883
Internal Environment	0,808

Source: Processed secondary data, 2022

Based on table it can be seen that the Cronbach's Alpha value for all constructs is above 0.70, so it has met the Cronbach's Alpha criteria and is acceptable.

**B. Evaluation of the Structural Model (Inner Model)**

**B1. Direct Effects**

**Direct Effects**

Variable	Direct Effects
Internal Control System → Financial Report Quality	0,525
Internal Control System → Internal Environment	-0,132
Internal Environment → Financial Report Quality	0,487
Quality Of Human Resources → Financial Report Quality	0,024
Quality Of Human Resources → Internal Environment	0,733

Source: Processed secondary data, 2022

The quality of financial reports, the internal control system and the quality of human resources each have a direct positive and significant influence. The magnitude of the direct influence of the internal control system on the quality of financial reports is 0.525 and the magnitude of the direct influence of the quality of human resources on the quality of financial reports is 0.024. The magnitude of the influence of the internal control system is greater than the quality of financial reports ( $0.525 > 0.024$ ).

In shaping the internal environment, the system of internal control, the quality of human resources, and the quality of financial reports each have a negative and positive influence. The magnitude of the direct influence of the internal control system on the internal environment is -0.132. The direct influence of the quality of human resources on the internal environment is 0.733. The magnitude of the direct influence of the quality of financial reports on the internal environment is 0.487.

### B2. Indirect Effects

#### Indirect Effects

Variabel	Indirect Effects
Internal Control System → Financial Report Quality	-0,064
Quality Of Human Resources → Financial Report Quality	0,357

Source: Processed secondary data, 2022

The indirect effect of the internal control system on the internal environment through the quality of financial reports is -0.064 or it can be calculated by multiplying the direct effect of exogenous variables on the mediating variable with the direct effect of the mediating variable on endogenous variables ( $X1 y$ ) \* ( $x1 z$ ) =  $0.525 * 0.487 = -0.064$ . The magnitude of the indirect effect of the quality of human resources on the internal environment through the quality of financial reports is 0.357 or can be calculated  $x2 y$ ) \* ( $y Z$ ) =  $0.248 * 0.487 = 0.357$ .

### B3. Total Effects

#### Total Effects

Variabel	Total Effects
Internal Control System → Financial Report Quality	0,460
Quality Of Human Resources → Financial Report Quality	0,381

Source: Processed secondary data, 2022

The total influence of the Internal Control System on the Quality of Financial Statements through the internal environment is 0.460 or it can be calculated by adding the direct and indirect effects of the independent variables on the dependent variable: ( $X1 Z$ ) + ( $X1 Y Z$ ) =  $-0.132 - 0.064 = 0.460$ . The total influence of HR quality on the quality of financial reports through the internal environment is 0.570 or can be calculated ( $X2 \rightarrow Z$ ) + ( $X2 \rightarrow Y \rightarrow Z$ ) =  $0.733 + 0.357 = 0.381$ .

### C. Hypothesis Test

The hypotheses proposed in the study were statistically tested using the bootstrap method on SmartPLS 3.0. Hypothesis testing is done by looking at the value of the path coefficient or inner model which shows the level of significance in hypothesis testing. The path coefficient or inner model score indicated by the T-statistic value must be greater than the t-table value of the two-way test ( $> 2.028$ ) with = 5%. While the path coefficient score or inner model indicated by the p-values must be below = 0.05, so that the research hypothesis proposed in the study can be accepted.

**Research Hypothesis Testing Results**

Hypothesis	Path Coefficient	T Statistic	P Values	Results
H1	0,525	3,859	0,000	Received
H2	0,024	0,142	0,887	Rejected
H3	0,487	3,289	0,001	Received
H4	-0,132	0,594	0,553	Rejected
H5	0,733	5,824	0,000	Received
H6	0,064	0,559	0,576	Rejected
H7	0,357	2,770	0,006	Received

Source: Processed secondary data, 2022

**Hypothesis test:**

1. H1 Hypothesis test

The Internal Control System (SPI) on the Quality of Financial Statements (KLK) is 0.525, with a T statistic value of 3.859 ( $> 2.028$ ) and a significance value (p-values) of 0.000 ( $< 0.05$ ). Thus, the first hypothesis (H1) in this study was accepted.

2. H2 Hypothesis Test

The influence of the Quality of Human Resources (KSDM) on the Quality of Financial Statements (KLK) is 0.024, with a T Statistic value of 0.142 ( $< 2.028$ ) and a significance value (p-values) of 0.887 ( $> 0.05$ ). Thus, the second hypothesis (H2) in this study was rejected.

3. H3 Hypothesis Test

The internal environment has a significant and significant effect on the quality of financial statements of 0.487, with a T statistic of 3.289 ( $> 2.028$ ) and a significance value (p-values) of 0.001 ( $< 0.05$ ) thus, the third hypothesis (H3) in this study is accepted.

4. H4 Hypothesis Test

The internal control system to the internal environment is -0.132, with a T statistic of 0.594 ( $< 2.028$ ) and a significance value (p-values) of 0.553 ( $> 0.05$ ). Thus, the fourth hypothesis (H4) in this study is rejected.

5. H5 Hypothesis Test

The quality of human resources on the internal environment is 0.733, with a T statistic of 5.824 ( $> 2.028$ ) and a significance value (p-values) of 0.000 ( $< 0.05$ ). Thus, the fifth hypothesis (H5) in this study is accepted.

6. H6 Hypothesis Test

Internal control system on the internal environment through the quality of financial reports of 0.064, with a T statistic value of 0.559 ( $< 2.028$ ) and a significance value (p-values) of 0.576 ( $> 0.05$ ). Thus, the sixth hypothesis (H6) in this study rejected.

7. H7 Hypothesis Test

The quality of human resources on the quality of financial reports through the internal environment is 0.357, with a T statistic of 2.770 ( $> 2.028$ ) and a significance value (p-values) of 0.006 ( $< 0.05$ ). Thus, the seventh hypothesis (H7) in this study is accepted.

### ***Discussion of Research Results***

#### **➤ The Effect of Internal Control System on the Quality of Financial Reports of PDAM Tirtanadi Medan**

The meaning of the findings of this study indicates that the internal control system has a positive and significant effect on the quality of the financial statements of PDAM Tirtanadi Medan. This finding proves that the implementation of an adequate internal control system is one of the main keys to the success of improving the quality of the financial reports of PDAM Tirtanadi Medan. The more adequate the internal control system in the company's organization will have an impact on improving the quality of the financial reports produced.

Internal control at PDAM Tirtanadi Medan which is used in the application of cash income and disbursements is designed in the form of an organizational structure that clearly separates functional responsibilities, each transaction only occurs on the basis of authorization from officials who have the authority to approve transactions, and good recording procedures. However, in terms of internal audits of revenue in PDAMs, the internal supervisors have never done it suddenly, but have been scheduled periodically every 6 months.

This research is in line with research conducted (Aldino & Septiano, 2021) The Internal Control System partially has a positive effect on the quality of the financial statements of Padang City Government Agencies. If internal control improves properly, it results in quality financial reports, and vice versa. So the hypothesis is accepted.

#### **➤ The Influence of the Quality of Human Resources on the Quality of the Financial Statements of PDAM Tirtanadi Medan**

The interpretation of the findings of this study proves that there is no strong relationship between the quality of human resources and the quality of the financial statements of PDAM Tirtanadi Medan. This indicates that the quality of financial reports must also be supported by the quality of human resources. This means that the more qualified a financial officer will support the improvement of the quality of the financial reports produced, even though it is not optimal. The quality of human resources is the main driver in an organization.

However, the preparation of financial statements must be carried out carefully, accurately and in accordance with (Financial Accounting Standards for Entities Without Public Accountability (SAK ETAP) in order to produce quality financial reports. However, apart from the HR factor, there are factors that affect the quality of the financial statements of PDAM Tirtanadi Medan, such as problems lack of directive education on management and budgeting and internal control systems, but in this case it is possible to get maximum results an agency or organization must have quality human resources to obtain quality financial reports.

This research is in line with research conducted (Animah et al., 2020) the quality of human resources does not affect the quality of financial reports, this is due to the low understanding of SAK ETAP on human resources owned by SMEs, so that the financial statements produced are still in doubt. relevance and reliability.

➤ **The Influence of the Internal Environment on the Quality of the Financial Reports of PDAM Tirtanadi Medan**

This indicates that PDAM Tirtanadi Medan is aware of the impact of the internal environment or internal factors that must be followed by the readiness of existing human resources to create quality financial reports. The internal environment itself has several indicators such as the progress of science and technology, the development of the web and internet technology, changes in the reporting system, changes in global regulations. When the company is able to take advantage of the impact of the internal environment as an opportunity, the company will indirectly be able to create quality financial reports.

This research is in line with research conducted by (Hinestroza, 2018). Based on the results of the moderation regression test with the Moderated Regression Analysis (MRA) approach, it shows that the internal control system does not moderate the relationship between good governance and the quality of financial reports.

The interpretation of the findings of this study proves that there is no strong relationship between the quality of human resources and the quality of the financial statements of PDAM Tirtanadi Medan. This indicates that the quality of financial reports must also be supported by the quality of human resources. This means that the more qualified a financial officer will support the improvement of the quality of the financial reports produced, even though it is not optimal. The quality of human resources is the main driver in an organization.

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➤ **The Effect of Internal Control System on the Internal Environment of PDAM Tirtanadi Medan**

Evaluation of the effectiveness of the internal control system is one of the management in the company's internal environment. The internal control system can be declared adequate if the elements in the internal control system provide an interrelated control and can assure users that the financial statements are free from material misstatement. The quality of the financial statements of PDAM Tirtanadi Medan concerned will be influenced by the internal control system in the internal environment. The internal environment is used to identify whether the internal control system is adequate and able to detect weaknesses, so that in the internal environment the company's internal control system has the following weaknesses:

1. Weaknesses in accounting and reporting control systems, namely weaknesses in control systems related to accounting records and financial reporting activities.
2. Weaknesses of the control system for the implementation of the revenue and expenditure budget, namely the weakness of controls related to the collection and deposit of receipts and the implementation of programs/activities in the audited entity.
3. Weaknesses in the internal control structure, namely weaknesses related to the presence or absence of an internal control structure or the effectiveness of the existing internal control structure in the entity being examined.

➤ **The Effect of Internal Control System on the Internal Environment Through the Quality of the Financial Reports of PDAM Tirtanadi Medan**

Basically, the effectiveness of the internal control system in a company is influenced by the company's internal environment. The internal environment that reflects the attitudes and actions of the owners and managers of the company regarding the importance of internal control in the internal environment on the quality of financial reports. Top management often has the wrong concept of the internal control system, as happened in PDAM Tirtanadi which lacks understanding of the internal control system in managing the internal environment on the quality of its financial reports.

Internal factors cause the internal control system to have no effect through the quality of financial reports. Internal factors, for example: advances in information technology, changes in reporting standards, changes in government regulations, even with good internal control can support employees to work more enthusiastically to prepare financial reports as well as possible, so that the quality of financial reports can be better.

➤ **The Influence of the Quality of Human Resources on the Internal Environment Through the Quality of the Financial Reports of PDAM Tirtanadi Medan**

With the recruitment of employees in accordance with their fields and the holding of training, it will create the readiness of these human resources to face the development of increasingly rapid internal dynamics. Developments from the internal environment such as advances in technology and the internet, changes in reporting systems, and changes in government regulations globally are no longer seen as a threat to the organization but with the readiness of good human resources and supported by an adequate internal control system, it will create an environment or These internal factors can be used as opportunities to provide maximum service such as creating increasingly quality financial reports for information users.

This research is in line with research conducted by (Yendrawati, 2018) External factors cannot be used as a moderator of the influence of the quality of human resources on the quality of financial statement information.

## Conclusion

From this research, it can be concluded that: (1) Internal Control System (SPI) on the Quality of Financial Statements (KLK) the first hypothesis (H1) in this study is accepted. every 6 months (2). The influence of the Quality of Human Resources (KSDM) on the Quality of Financial Statements (KLK) the second hypothesis (H2) in this study is rejected. (3) The internal environment has a significant and significant influence on the quality of financial statements. The third hypothesis (H3) in this study is accepted.(4). The internal control system on the internal environment of the fourth hypothesis (H4) in this study is rejected. (5) The quality of human resources on the internal environment of the fifth hypothesis (H5) in this study is accepted.(6) The internal control system on the quality of financial reports through the internal environment of the sixth hypothesis (H6) in this study is rejected (7). The quality of human resources on the quality of financial reports through the internal environment of the seventh hypothesis (H7) in this study is accepted.

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