

Internal Control System, Internal Audit, and Good Corporate Governance to Produce Quality Financial Reports in Banking Companies

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Abstract

Introduction/Main Objectives: The purpose of this study is to determine the influence of the internal control system, internal audit, and good corporate governance on the quality of financial statements in banking companies listed on the IDX partially and simultaneously. **Methods:** The research was conducted based on quantitative methods. The determination of this research sample uses the purposive sampling method so that a research sample of 8 banking companies registered on the IDX was obtained. The data of this study uses the financial statements of banking companies for the 2019-2023 period. The data analysis method used is multiple linear regression. **Results/Findings:** The results of the study prove that the internal control system has a significant effect on the quality of financial statements with t count = 4,726, internal audit has a significant effect on the quality of financial statements with t count = 3,970 and good corporate governance has a significant effect on the quality of financial statements with t count = 4,487. The results of the joint internal control system, internal audit, and good corporate governance have a significant effect on the quality of financial statements in banking companies listed on the IDX with a value of F count (13,605). **Conclusions:** The importance of quality financial reports lies in helping stakeholders in making economic decisions.

Keywords: Banking; Good Corporate Governance; Internal Audit; Internal Control System; Quality of Financial Statements

JEL Classification: M4; M42

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INTRODUCTION

Financial statements constitute a primary source of financial data utilized by stakeholders to assess an entity's financial position and operational performance. Properly prepared reports present an accurate representation of the organization's financial condition and serve as a fundamental reference for economic decision-making. The information disclosed should fulfill qualitative attributes, including relevance, reliability, comparability, and clarity of understanding. Consequently, the quality of financial reporting plays a vital role in promoting organizational transparency and accountability.

In the increasingly competitive and complex modern business environment, the quality of corporate financial reporting plays a crucial role in determining a company's credibility and long-term sustainability. Deficiencies in financial report quality frequently arise from ineffective internal control systems, inadequate internal audit functions, and limited adherence to good corporate governance principles. Several banking sector cases illustrate these issues. In 2018, Bank Bukopin was found to have altered financial statements through modifications to credit card data, resulting in substantial restatements of revenue, operating income, and equity

figures. Earlier, in 2017, Bank Summa was suspected of manipulating reports by overstating assets and concealing losses. Furthermore, in 2020, a major case involving the disappearance of significant customer funds was linked to alleged financial reporting fraud. These incidents demonstrate structural weaknesses in internal control mechanisms and governance frameworks.

An internal control system represents one of the key mechanisms that plays an essential role in generating high-quality financial reporting. This system consists of a set of policies and procedures established to safeguard organizational assets, maintain the accuracy of financial information, and promote efficient as well as effective operational activities. According to Risnaningsih (2020), a properly implemented internal control framework is capable of minimizing material misstatements and fraudulent practices while ensuring adherence to established regulations and organizational policies. The core elements of this framework include the control environment, risk assessment, control activities, information and communication processes, and monitoring functions. Empirical findings from studies conducted by Risnaningsih (2020), Mulyati et al. (2019), and Putri & Rahmah (2023) indicate that internal control systems significantly affect the quality of financial statements.

In contrast, studies conducted by Kartika & Ningsih (2024) as well as Purba et al. (2021) found that internal control systems do not significantly influence the quality of financial reporting. Beyond internal control mechanisms, the internal audit function also holds a strategic role in fostering transparency and accountability within financial reporting practices. Internal auditing refers to an independent assessment of organizational operations and financial reporting processes aimed at evaluating the effectiveness of internal controls and governance structures. According to Risnaningsih (2021), internal audits contribute substantially to maintaining the accuracy of financial statements, enhancing operational efficiency, and enabling early detection and prevention of irregularities. Empirical evidence from studies by Putri & Triandi (2020) and Was'an & Rokhmawati (2025) indicates that internal audit activities positively influence financial reporting quality. Conversely, research conducted by Emay et al. (2019) and Wahyuni (2024) suggests that internal audits do not have a significant effect on financial report quality. Nevertheless, a robust and independent internal audit function is generally regarded as capable of improving reporting quality and strengthening compliance with applicable financial regulations and policies.

Besides these two aspects, the implementation of good corporate governance (GCG) principles constitutes a vital element in ensuring the integrity and transparency of financial reporting. GCG represents a framework of mechanisms and organizational structures used to direct and supervise corporate activities so they operate in accordance with ethical standards, legal requirements, and social responsibility principles. Risnaningsih (2020) explains that the adoption of GCG principles-namely transparency, accountability, responsibility, independence, and fairness can reinforce reporting systems and enhance investor trust. Nevertheless, prior research by Kalsum et al. (2021) found that good corporate governance does not significantly influence financial reporting quality. In contrast, studies conducted by Putra & Gea (2022) as well as Zelovena et al. (2023) indicate that GCG has a direct effect on the quality of financial statements. These differing findings suggest that the effectiveness of GCG implementation may depend on consistency in practice and the prevailing organizational culture. Accordingly, further empirical examination remains necessary, particularly within banking institutions in Indonesia. Based on this background, the present study aims to examine the roles of internal control systems, internal audit functions, and good corporate governance in improving the

quality of financial reporting among banking companies listed on the Indonesia Stock Exchange.

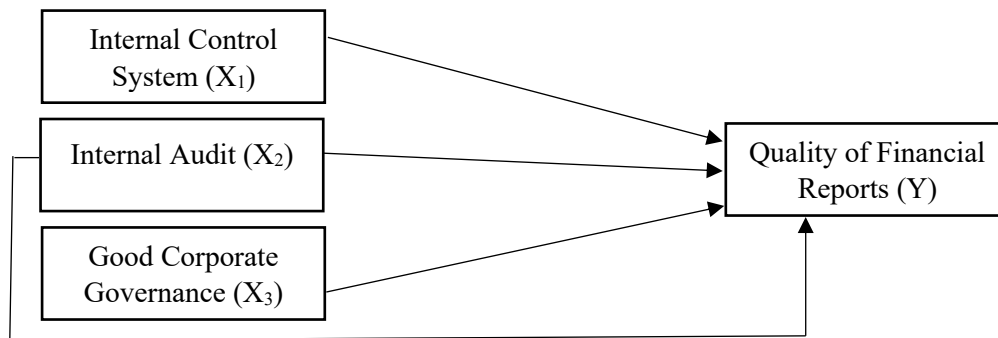


Figure 1. Framework of Hypothesis
 Source: data processing, 2025

RESEARCH METHODS

This research applies a quantitative research design. The study population consists of banking companies observed during the 2019-2023 period. The selected sample includes banking institutions that did not report losses in 2020 within the 2019-2023 observation timeframe. The analysis relies on secondary data sourced from the Indonesia Stock Exchange. Sample selection was conducted using a purposive sampling method, in which samples were chosen based on specific predetermined criteria as proposed by Sugiyono (2013). The detailed sampling criteria are presented in Table 1 below.

Table 1. Sample Criteria

Criteria	Total
Banking companies listed on the IDX during the period 2019-2023.	10
Banking companies that experienced losses in 2020 in the period 2019-2023.	2
Number of samples (8 x 5 years)	40

Source: data processing, 2025

The dependent variable in this study is the Quality of Financial Reports (Y). The independent variables used in this study are the Internal Control System (X1), Internal Audit (X2), and Good Corporate Governance (X3). The following are the definitions and measurements of the variables in this study:

Table 2. Variable Measurement Indicators

Variabel	Indicator	Scale
Quality of Financial Reports (Y)	Code 1 = Complete	Nominal
	Code 0 = incomplete	Dummy
Internal Control System (X1)	Code 1 = there is a risk assessment	Nominal
	Code 0 = no risk assessment	Dummy
Internal Audit (X2)	Internal audit = number of internal auditors	Ratio
Good Corporate Governance (X3)	The number of shares owned by the institution (Total number of shares outstanding)	Ratio

Source: data processing, 2025

Multiple linear regression test is used to determine the relationship between independent and dependent variables. Multiple linear regression test is used in this study to test the effect of

financial report quality on internal control system variables, internal audit, and Good Corporate Governance. The following are the equations in this study:

$$Y = \alpha + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \varepsilon$$

Condition: Y = quality of financial reports, α = constant, β = regression coefficient, X1 = internal control system, X2 = internal audit, and X3 = good corporate governance., ε = error

RESULTS AND DISCUSSION

Based on table 3, the results of descriptive statistics of the variables prove that the *mean* value of the internal control system (X1) is 0.8250, meaning that the internal control system of the banking company is stated to be high, the mean internal audit (X2) is 40.6500, meaning that the number of internal audits in the banking company is stated to be large, around 40 people, the mean good corporate governance (X3) is 34.7665, meaning that the value of good corporate governance of the banking company is high or has high institutional shares, and the *mean* quality of financial reports (Y) is 0.7500, meaning that the banking company has high quality financial reports.

Table 3. Descriptive Test

Variabel	N	Minimum	Maximum	Mean
Internal control system (X1)	40	0,00	1,00	0,8250
Internal Audit (X2)	40	14,00	189,00	40,6500
Good corporate governance (X3)	40	11,00	66,56	34,7665
Quality of financial reports (Y)	40	0,00	1,00	0,7500

Source: data processing, 2025

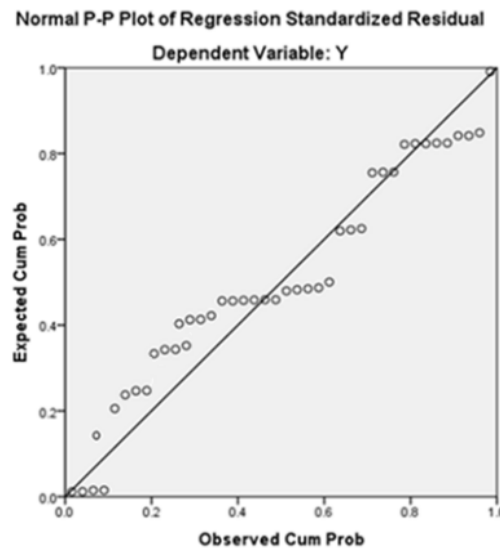


Figure 2. Normality Test

Source: data processing, 2025

Based on Figure 2 above, the data is stated to meet the normality test (normal), because the distribution of data (points) on the diagonal source of the normal *P-Plot Of Regression*



Standardized Residual graph is around the diagonal line and follows the direction of the diagonal line.

Table 4. Multicollinearity Test

Variabel	Tolerance	VIF	Description
(X1)	0,930	1,075	There are no symptoms of multicollinearity
(X2)	0,920	1,087	There are no symptoms of multicollinearity
(X3)	0,908	1,101	There are no symptoms of multicollinearity

Source: data processing, 2025

The results of the multicollinearity test concluded that the variables of the internal control system (X1), internal audit (X2) and good corporate governance (X3) did not show symptoms of multicollinearity as indicated by a tolerance value of 0.1 and a VIF of less than 10,000, which means that the data did not show symptoms of interference from each independent variable.

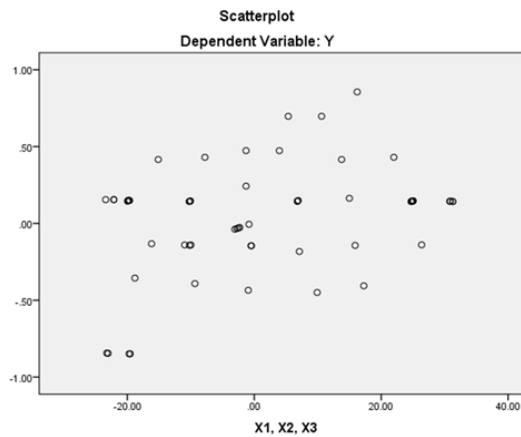


Figure 3. Heteroscedasticity Test

Source: data processing, 2025

The results of the heteroscedasticity test show that the data does not show symptoms of heteroscedasticity because the distribution of data in the diagram is between the value 0 of the X axis and the Y axis and the distribution of data has no clear pattern.

Table 5. Autocorrelation Test

<i>Model Summary^b</i>	
Model	<i>Durbin-Watson</i>
1	1,962

Source: data processing, 2025

Table 6. Multiple Linear Regression Test

Variabel	Standardized Coefficients (Beta)	Value Sig.	Significant Value Provisions	Description
Constant	0,847	0,000	0,05	Positive influence
X1	0,638	0,000	0,05	Positive influence
X2	0,401	0,000	0,05	Positive influence
X3	0,507	0,000	0,05	Positive influence

R square = 0,531

Source: data processing, 2025

Based on the autocorrelation test, it is known that the Durbin Watson value (d) is 1.962, thus the value (d) is between -4 to 4, so the data is stated as not showing signs of autocorrelation.

From the direct influence test, the results of the multiple linear regression equation can be shown as follows:

$$Y = a + b_1X_1 + b_2X_2 + b_3X_3 + e$$

$$Y = 0,847 + 0,638 X_1 + 0,401 X_2 + 0,507 X_3 + e$$

The value of the financial report quality variable of a constant value of 0.847, it means that the quality of the financial report is high before being influenced by the internal control system, internal audit, and good corporate governance. If the value of variables X1, X2, and X3 is 1.546, then the total influence value is 2.393. This means that over all there is a high influence between the internal control system, internal audit, and good corporate governance on the quality of financial reports in banking companies listed on the IDX. Based on this equation, each influence between variables can be explained as follows.

The regression coefficient (X1) of 0.638 means that there is a positive influence between the internal control system variable (X1) on the financial report quality variable (Y), meaning that the better the support of the internal control system is able to improve the quality of financial reports in banking companies listed on the IDX. This proves that the internal control system has a dominant influence on the quality of financial reports in banking companies.

The regression coefficient (X2) of 0.401 means that there is a positive influence between the internal audit variable (X2) and the financial report quality variable (Y), meaning that the better the internal audit support, the better the quality of financial reports in banking companies listed on the IDX.

The regression coefficient (X3) of 0.507 means that there is a positive influence between the good corporate governance variable (X3) and the financial report quality variable (Y), meaning that the higher the value of good corporate governance, the better the quality of financial reports in banking companies listed on the IDX.

The results of the analysis obtained an r square value of 0.531, meaning that the internal control system, internal audit and good corporate governance have a contribution to the influence on the quality of financial reports in banking companies listed on the IDX of 53.1% and the remainder of 0.469 or 46.9% by other variables that were not studied such as company size and audit opinion.

Table 7. t-test (Parsial)

Variabel	t count	t table	Sig t	Description
(X1)	4,726	2,023	0,000	Significant
(X2)	3,970	2,023	0,000	Significant
(X3)	4,487	2,023	0,000	Significant

Source: data processing, 2025

The internal control system variable (X1) has a significant effect on the quality of financial reports (Y) in banking companies listed on the IDX with a calculated $t = 4.726$ (greater than $t_{table} = 2.023$) and a significant value = 0.000 (smaller than 0.05), so that hypothesis 1 can be accepted. This means that the better the internal control system is able to improve the quality of financial reports in banking companies.

Internal audit variable (X2) has a significant effect on the quality of financial reports (Y) in banking companies listed on the IDX with $t_{count} = 3.970$ (greater than $t_{table} = 2.023$) and a significant value = 0.000 (smaller than 0.05), so that hypothesis 2 can be accepted. This means



that the better the internal audit support is able to improve the quality of financial reports in banking companies.

The good corporate governance variable (X3) has a significant effect on the quality of financial reports (Y) in banking companies listed on the IDX with a calculated $t = 4.487$ (greater than $t_{table} = 2.023$) and a significant value = 0.000 (smaller than 0.05), so that hypothesis 3 can be accepted. This means that the higher the good corporate governance, the better the quality of financial reports in banking companies.

Tabel 8. F-Test (Simultaneous)

Variabel	F value	F table	Sig F
Internal Control System (X ₁)	13,605	2,866	0,000
Internal Audit (X ₂)			
<i>Good corporate governance</i> (X ₃)			

Source: data processing, 2025

The results of the F test obtained a calculated F_{value} (13.605) > F_{table} (2.866) with a significant value (0.000) which means that together/combined internal control systems, internal audits and good corporate governance have a significant effect on the quality of financial reports in banking companies listed on the IDX, so that H4 is accepted, meaning that the better the support of the internal control system, internal audit and good corporate governance, the better the quality of financial reports.

The first hypothesis of this research proposes that the internal control system has an influence on the quality of financial reporting. This implies that the greater the effectiveness of internal controls implemented within banking institutions, the better the quality of the financial statements generated. An effective internal control framework supports the reliability of financial information, reduces recording inaccuracies, and limits the risk of fraudulent reporting practices. These results are consistent with the findings of Risnaningsih (2020), which indicate that a well-structured and consistently applied internal control system enhances the integrity of accounting information and facilitates managerial decision-making. Within the banking sector, where financial and operational risks are inherently significant, robust internal controls become essential to maintaining accountability and transparency in financial reporting for stakeholders. Therefore, the implementation of internal control mechanisms directly contributes to improving financial report quality through effective process supervision, asset safeguarding, and adherence to applicable policies and regulatory requirements.

The second hypothesis of this study states that internal audit has an effect on the quality of financial reporting. These findings reinforce the argument of Risnaningsih (2021), which emphasizes that internal auditing functions as a mechanism for supervision and control while also enhancing the reliability of financial information disclosed by an organization.

The third hypothesis proposes that good corporate governance influences the quality of financial statements. This indicates that stronger implementation of good corporate governance principles within a company leads to higher-quality financial reporting outcomes. The application of governance principles such as transparency, accountability, responsibility, independence, and fairness establishes a managerial framework that supports the integrity of financial disclosures. This result aligns with the view of Risnaningsih (2020), who argues that consistent adoption of good corporate governance practices fosters greater trust and managerial accountability, ultimately improving the quality of financial information produced.

In the banking industry, the implementation of good corporate governance is particularly critical due to the sector's high level of regulation and reliance on public confidence. Effective governance practices help reduce the likelihood of data manipulation and biased financial presentation. Although some prior studies, such as those conducted by Kalsum et al. (2021),

reported that good corporate governance did not partially exert a significant effect on financial reporting quality, the findings of this research provide empirical evidence that governance practices remain a key determinant of reporting quality in banking institutions. This condition may arise because the banking sector operates under strict external oversight from authorities such as the Otoritas Jasa Keuangan and Bank Indonesia, which encourages more structured and consistent implementation of governance principles. Therefore, good corporate governance is demonstrated to make a positive contribution to improving the overall quality of corporate financial reporting.

The fourth hypothesis in this study is that the Internal Control System, Internal Audit, and Good Corporate Governance affect the Quality of Financial Reports. This shows that overall, the three independent variables in this study are able to explain 62.4% of the variation in the quality of financial reports. This finding reinforces the importance of integration between control systems, internal audit, and GCG in building quality and reliable financial reports.

CONCLUSION

The internal control system is proven to have a significant influence on the quality of financial reporting, indicating its crucial role in preventing and identifying fraudulent practices during the financial reporting process, thereby supporting the production of reliable financial statements. Internal audit also demonstrates a significant effect on financial report quality, reflecting its function as an independent evaluation mechanism within an organization that is responsible for examining and assessing financial reporting outcomes.

Furthermore, good corporate governance significantly affects the quality of financial reports. Good corporate governance represents a regulatory and supervisory framework that governs corporate activities, often reflected through institutional ownership structures, where higher institutional ownership indicates a greater proportion of shares held by institutional investors. The combined influence of internal control systems, internal audit functions, and good corporate governance shows that stronger implementation and support of these mechanisms contribute to improved financial reporting quality. Collectively, these three independent variables serve as consistent and comprehensive determinants in producing financial statements that are high-quality, accurate, and trustworthy for stakeholders.

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