Relationship between Internal Control, Internal Audit, 
and Organization Commitment with Good Governance: 
Indonesian Case

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The aims of this research is to examine the relationship between 
internal control, internal audit, and organization commitment with the 
good governance. The populations of this research are local 
government of Central Java province, Indonesia, consists of 35 
districts. The type of data in this research is primary data that could 
be collected by questionnaires distribution to the respondents. 
Exogenous variables are the internal control, audit internal, and 
organization commitment. Meanwhile endogenous variables is good 
governance. This research showed that internal control, internal audit, 
and organization commitment have positive significant relationship 
with the good governance. It means that when local government of 
Central Java province implements the internal control effectively, audit 
internal, and high organization commitment, therefore the good 
governance practices increase.

Keywords: Internal control, internal audit, organization commitment, good governance

Field Research: Governance and Financial Fraud

1. Introduction

The survey by Transparency International (2009), reported that the corruption 
rank of Indonesia is at the number of 111 from 180 nations with the score of 2.8. 
The low of good governance implementation and the high range of corruptions 
mean that there are no accountability in the government financial management 
(Mardiasmo, 2004).

Good governance and internal control became a highly pertinent and topical 
business issue at the beginning of the 21st century following a series of large 
corporate scandals and failures (PABC, 2006).

The government Internal auditors consist of general inspectorate, provincial 
inspectorate, district or city inspectorate, and indonesian financial regulatory 
body and the development (Mardiasmo, 2004).

The head of local governments must have a high commitment to regulate, 
identify, and understand the financial reporting mechanism. They also must 
responsible to prevent the fraud in enforcing the public funds, by implementing 
the effective internal control (Ratliff et al., 1996).
Cheung and Qiang. (2002) found the internal audit function in the organization improves the good corporate governance. Stewart and Kent (2006), who made a research at Australian also had a similar finding. The successfull of good governance implementation also depends on the organization commitment by all heads and staff of govermental agencies. Moday et.al. (1979) explains that organization commitment represents the stong blieveness on the all organization values and goals. Based on the explanation at above, problems on this research are as follows:

1. Does the internal control has a positive relationship with the good corporate governance?
2. Does the internal audit has a positive relationship with the good governance
3. Does the organization commitment have a positive relationship with the good governance?

This researach has been organized into five parts. After Introduction in the first part, the literature review has been given in the second section. The third section is devoted to methodology. Then, the findings and discussion are in section fourth. Conclusion is rendered in the fifth section. And finally, We presented the references.

2. Literature Review

2.1 Internal Control

Internal control consists of the organization planning that includes all methods used to safeguard the company assets, to insure the reliability of information, to support the efficiency and effectiveness of operations, and to insure the compliance with rules and regulations (Arens, 2010). The regulation of Indonesia Government number 60 (2008) paragraph 1 section 1 defines the government internal control system as follows: "an integrated process on activities and actions that enforced continuosly by managers and all employees to give adequate assurance in achieving the organization goals by efficient and effective manner, by the reliability of financial report, by safeguarding government assets, and by compliance with rules and regulations.

Mensah et al., (2003) found empirical evidence in Ghana that effective internal controll improve good governance practices and decrease the corrruptions. Pratolo (2007) found that effective internal controll has positive link with good corporate governance at State Owned Enterprises in Indonesia. Similar with this finding, Nila and Viriyanti (2008) also found that internal control has a positive relationship with good corporate governance at State Owned Enterprises in West Java, Indonesia.

2.2 Internal Audit

Internal audit is an organization function with the duties to assess and evaluate all activities within the organization. This function is very important to provide and support all information in managerial decision making process. Similar with external audit, an internal audit also has to be independent in conducting his/her duties. Internal auditors independence consist of two aspects,
i.e., (1) the separation of this function with the auditee, and (2) the status within the organization. Virginia et al. (2009) found that internal audit has a role to prevent the corruptions and support the good governance practices. Yasin et al. (2010) found the internal audit function has a significant role in supporting the good governance practices. This finding also similar with Wallace and Kreutzfeldt (1991); Carey et al., (2000); Gramling et al., (2004) and Carcello et al., (2005); and Coram and Moroney (2007).

2.3 Organization Commitment

Organization commitment is defined as the individual relative power to identify his/her self into the organization (Moday et al., 1979). It is categorized in three dimensions, i.e., (Meyers and Alen, 1997) : (1) affective, namely, denoting an emotional attachment to, identification with, and involvement in the organization. (2) continuance, namely, denoting the perceived costs associated with leaving the organization; and (3) normative, namely, reflects a perceived obligation to remain in the organization. Stanton et al., (2003) found an empirical evidence that individuals whose organizational commitment is high, they may be spending more time on productive work activities. Brown (2003) found that Relations-oriented leadership behaviors explained the greatest amount of variance in affective commitment, somewhat less variance in normative commitment, and no variance in continuance commitment. Other prior researchs have found relationships between organizational commitment and attitudes and behaviors in the workplace (Porter et al., 1974, Steers, 1977; and Angle and Perry, 1981).

2.4 Good Governance

Governance has been variously defined as “the exercise of authority or control to manage a country’s affairs and resources” (Schneider, 1999). Good governance requires that the government is governed in accordance with the governance principles, namely: transparency, accountability, reasponsibility, participation, fairness, and independency. The National Committee of Governance Polecy (NCGP, 2008), argues that the implementation of good governance principles would like to give strategies contribution in: (1) increasing social welfare, (2) creating conducive business environment, (3) improving the bargaining power, and (4) preventing from all frauds in running the governmental duties. Mensah et. Al., (2003) reported that corporate governance is one of the most effective tools to reduce the incidence of corruption, especially in the corporate sector. Kajola and Sunday (2008) found an empirical evidence in Nigeria that chief executive status as one proxy of corporate governance has positive significant relationship with firm performance that proxied with profit margin.

Based on explanation at above, the framework of thinking on this research is shown in the following figure:
Base on explanations at above, the hypotheses in this research are as follows:

H1 : The internal control has a positive significant relationship with the good governance.
H2 : The internal audit has a positive significant relationship with the good governance.
H3 : The organization commitment has a positive significant relationship with the good governance.

3. Methodology

3.1. Research Method

This research uses a survey method, with the respondents on this research are head of local government inspectorate, head of monitoring division in local government inspectorate, head of internal audit team, and head of district. There are 35 districts in Central Java province, Indonesia. Therefore, 35 sets of questionnaires were distributed to respondents during February until July 2011.

3.3. Variables and Measurement

1. Internal control ($X_1$), is measured by instrument developed by COSO (1999), namely control environment, risk assessment, control activity, information and communication, and monitoring.
2. Internal audit ($X_2$), is measured by instrument developed by Moeller (1999) in Sawyers (2003), namely independence, professional competency, scope of work, examination process, and audit internal management.
3. Organization commitment ($X_3$), is measured by instrument developed by Meyer and Allen (1997), namely affective, continuance, and normative.
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4. Good governance (Y), is measured by instrument developed by World Bank (2003), and ADB (1999), namely transparency, participation, accountability, independency, and responsibility.

3.4. Analysis

(1) Validity Testing

The purpose of validity testing is to know how far the instruments measured correctly and accurately. Validity testing use product moment correlation, with the criteria of acceptance as the following:

The item of questioner is valid if $r_{\text{statistic}}$ higher than critical value at degree of freedom 95% ($\alpha = 0.05$).

(1) Reliability Testing

The purpose of reliability testing is to examine the consitency of the data. On this research the reliability is measured by internal consistency approach, that is the concept stressing on the consistency between items in the questionnaires. A construct or variable is reliable if the Croanbach’s Alpha is more than 0.6 (Ghazali, 2006).

After all instruments were tested, then the classical assumption of multiple linier regression was tested for the following aspects (Ghazali, 2006):

(1) Normality Testing

The purpose of normality testing is to know that all data of independent and dependent variables have normal distribution. In this research, normality testing is used based on Kolmogorov-Smirnov, in which if the assymptotic significant (two tail) is higher than alpha ($\alpha = 0.05$), so all data have normal distribution.

(2) Multicolinearity Testing

Multicolinearity is a condition in which one or more indepedent variables are in a linear contribution with other independent variables. Multicolinearity testing can be analysed from variance inflation factor (VIF), in which if VIF is less than 10, meaning that there is no multicolinearity.

(3) Heteroskedasticity Testing

Heteroskedasticity is occured when variance disturbance is not consistent to one to another time at all observations. Heteroskedasticity testing uses a park glejsjer method, in which if the probability value is higher than alpha ($\alpha = 0.05$), meaning that there is no heteroskedasticicy.

3.5. Hypothesis Testing
There is one dependent variable correlated to three independent variables. Therefore, this research will be analyzed based on multiple linear regression, with the following equation:

\[ Y = a + b_1X_1 + b_2X_2 + b_3X_3 + e \]

Explanation:
- \( Y \) = good governance
- \( a \) = value of \( Y \) if \( X_1, X_2, X_3 = 0 \)
- \( b_1, b_2, b_3 \) = coefficients of regression
- \( X_1 \) = internal control
- \( X_2 \) = internal audit
- \( X_3 \) = organization commitment
- \( e \) = residual value

Before all hypothesis are tested, the goodness of fit of the model in this research tested with \( F \)-test with the following formula (Gujarati, 1995; and Ghazali, 2006):

\[
F = \frac{R^2/(k-1)}{1 - R^2/(n-k)}
\]

Explanation:
- \( F \) = \( F \) value that is resulted from the calculation
- \( R^2 \) = coefficient of determination
- \( k \) = number of variables
- \( n \) = number of observations

The criteria of testing are as the following:

The model in this research does not have a goodness of fit if \( F_{\text{statistic}} \) is smaller than critical value (\( F_{\text{table}} \)), and the model have goodness of fit if \( F_{\text{statistic}} \) is higher than critical value.

(1) First hypothesis testing

First hypothesis is tested by \( t \)-test with the following formula (Ghazali, 2006):

\[
t = \frac{b_j}{S_{bj}}
\]

Explanation:
- \( t \) = \( t \) value that is resulted from the calculation
- \( b_j \) = coefficient of regression
- \( S_{bj} \) = standard error of regression coefficient

The criteria of testing are as follows:
- \( H_0 : b_1 \leq 0 \) (internal control does not have a positive significant relationship with good governance)
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H₀ : b₁ > 0 (internal control has a positive significant relationship with good governance)

Then, H₀ would be accepted if t_statistic is smaller than critical value, and H₀ would be rejected if t_statistic is higher than critical value.

(2) Second hypothesis testing

Second hypothesis is tested by t-test, with the following criteria of testing:
H₀ : b₂ ≤ 0 (internal audit does not have a positive significant relationship with good governance)
H₀ : b₂ > 0 (internal audit has a positive significant relationship with good governance)

Then, H₀ would be accepted if t_statistic is smaller than critical value, and H₀ would be rejected if t_statistic is higher than critical value.

(3) Third hypothesis testing

Third hypothesis is tested by t-test with the following criteria of testing:
H₀ : b₃ ≤ 0 (organization commitment does not have a positive significant relationship with good governance)
H₀ : b₃ > 0 (organization commitment has a positive significant relationship with good governance)

Then, H₀ would be accepted if t_statistic is smaller than critical value, and H₀ would be rejected if t_statistic is higher than critical value.

4. Finding and Discussion

4.1. Finding of Validity and Reliability Testing

The results of all corelation coefficient for questionnaire items have total scores of more than 0.3 (critical value), thus all data in this research are valid. While the result of reliability testing using croanbach’s alpha for internal control is 0.714; audit internal is 0.722; organization commitment is 0.759; and the good governance is 0.765. It means that all values of croanbach’s alpha are more than 0.6. Thus all data are reliable.

4.2. Finding of Clasical Assumption Testing

(1) Normality

The result of Kolmogorof-Smirnove shows that the value of asymptotic significance is 0.695 which is higher than alpha (α = 0.05). It means that all data have normal distribution.
Heteroskedasticity

Output of Park Glejser test shows that significancy of internal control (0.950), audit internal (0.554), and organization commitment (0.796), are higher than alpha (α = 0.05). It means that there is no heteroskedasticity in this model.

Multicolinearity

Output of variance inflation factor (VIF) shows that VIF for internal control (2.173), internal audit (1.119), and organization commitment (2.279), are smaller than 10. It means that there is no multicolinearity between independent variables.

4.3. Finding of Hypothesis Testing

The output of multiple regression analysis is as in the following table:

<table>
<thead>
<tr>
<th>Variables</th>
<th>F-statistic</th>
<th>critical value</th>
<th>regressi</th>
<th>t-statistic</th>
<th>critical value</th>
<th>P-value</th>
<th>conclu</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Goodness of fit testing</td>
<td>7.486</td>
<td>2.87</td>
<td>.021</td>
<td>5.143</td>
<td>1.72</td>
<td>.002</td>
<td>Significant</td>
<td></td>
</tr>
<tr>
<td>Partially testing:</td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
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<td>---</td>
</tr>
<tr>
<td>- constant</td>
<td>.201</td>
<td>3.875</td>
<td>.005</td>
<td>Significant</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- independence</td>
<td>.123</td>
<td>4.463</td>
<td>.049</td>
<td>Significant</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- experience</td>
<td>.807</td>
<td>2.511</td>
<td>.023</td>
<td>Significant</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>- accountability</td>
<td></td>
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</tbody>
</table>

Dependent variable: good governance

Based on table 1, the regression equation is as follows:

\[ Y = 0.021 + 0.201X_1 + 0.123X_2 + 0.807X_3 + \varepsilon \]

Before hypotheses are tested, we have to test the goodness of fit of the model in this research. From the result of F-test, it is known that the F-statistic 7.486 is higher than the critical value (2.87) and the probability 0.002 is smaller than alpha (0.05). Therefore, the model is fit.

First Hypothesis Testing

The value of t-statistic for variable of internal control is 3.875 higher than critical value (1.72), and p-value of 0.005 is smaller than alpha (0.05). It means that internal control has a positive significant relationship with good governance.

Second Hypothesis Testing
The value of $t_{\text{statistic}}$ for variable of internal audit is 4.462 higher than critical value (1.72), and $p$-value of 0.049 is smaller than alpha (0.05). It means that internal audit has a positive significant relationship with good governance.

### (3) Third Hypothesis Testing

The value of $t_{\text{statistic}}$ for variable of organization commitment 2.511 is higher than critical value (1.72), and $p$-value of 0.023 is smaller than alpha (0.05). It means that organization commitment has a positive relationship with good governance.

### 4.4. Discussion

The finding of this research, in which internal control has positive significant relationship with good governance, is in accordance with Cheung et al., (2002), Mensah et al., (2003), Stewart and Kent (2006), Pratolo (2007); and Nila and Vitriyanti (2008). The rationalization of this finding is because the internal control can give assurance in the reliability of financial reporting, efficient and effective operation, and compliance with rules and regulations. Therefore, if the internal control within the organization run well, automatically the good governance practices improve.

Consistent with the prior study, this research shows that variable of internal audit has a positive significant relationship with the good governance. This finding is in line with Virginia et al (2009), Yasin et al., (2010), Wallace and Kreuzfeldt (1991); Carey et al., (2000); Gramling et al., (2004), Carcello et al., (2005); and Coram and Moroney (2007). The rationalization of this finding is because internal audit function has important roles in governing the organization, such as control, evaluate, monitor, and advise the head of local government. If the internal audit run his/her roles effectively, the governance mechanism will run well and the good governance practices improve.

The finding of this research, in which organization commitment has positive significant relationship with good governance, give new evidence to support the theoretical concept and future research. Because there were no research before that related the organization commitment and good government, particularly in public sector. The rationalization of this finding is because the organization commitment, especially from head of local government and all staff give strong power in governing the organization.

### 5. Conclusion and Implication

#### 5.1 Conclusion

Like another prior research, this research found that Internal control has a positive significant relationship with the good governance at Central Java Province, Indonesia. Similar finding also showed that internal audit has a positive significant relationship with good governance. Other finding showed that organization commitment has a positive significant relationship with the good governance. The finding gives new knowledge because there are not any other research before which related between organization commitment and good governance.
This research can contribute the arguments on similar ideas that may be used by anybody interested in this issue, particularly for the government agencies so that they can improve the implementation of good governance in running his/her duties. All of government aparatures and agencies should always improve the effectiveness of internal control and internal audit function and also improve the organization commitment because those factors improve the good governance. Future researchers can add other variables that has a link with good governance, such as, corporate culture, management style, enterprise risk management, etc.

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