THE STUDY OF DEVELOPING STRATEGY MODEL OF QUALIFIED FINANCIAL STATEMENT

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Abstract

The high quality financial statement is a report which presents the right, honest, relevant, reliable, comparable, and understandable information. This research aimed at analyzing the effects of the management capability and the quality of the internal auditor on the information quality of the financial statement.

The research method used was the explanatory research. The population included all the local work units (Satuan Kerja Perangkat Daerah, further called SKPD), who has prepared the financial statements. The research also used questionnaire as an instrument. The hypotheses were analyzed using the Structural Equation Model.

The results of the research revealed that the management capacity had a positive effect on the information quality of the financial statement, and that the service quality of the internal auditor had a positive effect on the information quality of the financial statement. Thus, it is concluded that in order to improve information quality of the financial statement, the commitment of both the management and the internal auditor is required if the quality of the management capability and the service must be improved.

Key words: financial statement, management, internal auditor.

Introduction

A high quality financial statement is a financial report which presents the right, honest, relevant, reliable, comparable, and understandable information. Such a financial statement is important because it will be used as the basis in decision making (Governmental Accounting standards Board – GASB, Concepts Statement No. 1, 1999). A financial statement of no-quality (of a bad quality) will facilitate deviation and wrong doings in financial affairs, such as fraud, corruption and collusion. If all these wrong-doings are kept going on, it is the people who will certainly suffer the consequences, like they have to pay for the high-cost transactions and receive very bad public services. Furthermore, it will result in trust crisis of both the local societies and foreign investors who will hesitate to invest their money in Indonesia, except with the high cost of money. Thus, it is expected that the local government to pay attention and improve the information quality of their financial statements. Yet, the fact is contrary to the expectation; there is a discrepancy between (1) the theory and the phenomenon in the field and (2) the expectation and the reality.

Theoretically, the information of the financial statement is good, if it can be used as the basis of the decision making. If a financial statement is to be used as the basis in the decision making, its information should be of high quality (Hongren et al., 2003; Financial Accounting Standard Board (FASB), 2010; GASB, 1999). The fact in the field is that the Financial Statement of the Local Government (FSLG) is not of high quality; generally, they are still bad or weak (91% of FSLG is bad, according to BPK). In fact, a reformation has been carried out through the quality development of the Human Resources (HRD) and the regulation quality using high costs, starting from the draft of the law and its socialization to the preparation of the human resources and the supporting infrastructures.

The reformation through the development of the human resources (HR) can be seen in the budget portion of the education which has been increased from year to year. In 2007 it was Rp 74.114 billion has been increased to Rp 101.217 billion in 2010 (Directorate General of Financial Balance, Department of Finance, Republic of Indonesia – DGFB, Depfin, RI, 2011). The reformation in the legal regulation has been carried out through the installment of the law packages, such as Law No. 17 in 2003, Law No. 1 in 2004, and Law No. 15 in 2004, and some other supporting regulations.

Eight years after the reformation of the regulations of the financial management, there has not been any significant improvement in the information quality of the Financial Statement of the Local Government (FSLG) in the regions of West and South Sulawesi Province, Maros Regency during the period of six consecutive years (Budget Year (BY) 2005 to 2010), Palopo city during the period of three consecutive years (BY 2009 to 2011), Selayar regency during the period of two consecutive years (BY 2010 to 2011), Tana Toraja, and Jeneponto regencies and Pare-Pare city in BY 2011, all got the TMP opinion from BPK. The quality of the FSLG in West and South Sulawesi province is still disappointing; in fact, the number of the
regencies and cities which got the TMP opinion has continued to increase: from two regencies/cities in 2009 to five regencies/cities in 2010 and 2011 BY’s (BPK, IHP 2006 up to 2012).

The above field phenomenon causes the gap between the expectation and the reality. It is actually expected that with the increase of the human resource quality and the improvement of the regulations of the local financial management, the high-quality information of the financial statement will be achieved. Nevertheless, the fact is that the information quality of the financial statement of the local governments, particularly of South Sulawesi province, has not shown any significant development. Such a gap has arisen a question about the information quality of the financial statement of the local government: Why has the information quality of the financial statement of the local government of South Sulawesi province not shown any improvement? What is the cause and how will it be tackled?

To answer these questions is not easy. Conceptually, there are various factors determining the quality of the financial statement. Rezaee (2003; 26) has identified 6 factors which determine the quality of the financial statement, namely: the board of directors, the internal auditor, the audit committee, the external auditor, the top management team, and the governing bodies. This research uses: (a) the quality factor of the internal management mechanism which is represented by the management capacity variable and the quality factor of the external management mechanism which is represented by the service quality of the internal auditor as the factor influencing the information quality of the financial statement.

The management capability factor of the local government in South Sulawesi province is still weak based on the result of the performance assessment of how the local government was run in 2012. None of the regencies/cities in South Sulawesi province was included in the big five. North Luwu Regency was in the sixth position only; The City of Makassar was satisfied being in the ninth position, while Wajo Regency was in the twelfth position. Whereas conceptually, the management capability is a very important factor in carrying out the local governance. The management capability is a skill needed in coordinating resources and putting them into productive uses. The success of the local government is more determined by the managerial capability of the leader compared to any other factors. Nevertheless, it must be admitted that it is still difficult to find a leader who can act as a leader and as a government administrator at the same time. This is evident from the many findings that from time to time starting from 2008 until the first semester of 2012 the same problems have not yet been overcome by the leader/manager of the local government. These findings prove that the manager or the leader has not yet fully implemented the management functions, such as planning, implementing, coordinating, and controlling; consequently, the information quality of the financial statement has not yet shown any improvement.

Thus, the above findings indicate that the management capability is correlated with the information quality of the financial statement. This fact is supported by the researches done by Argyris (1992), and Yadyana (2008). The results of their studies indicated that the management capability affects the information quality of the finance statement. The more capable the management to put the various functions into operation, the higher the information quality of the financial statement achieved by an organization.

Another factor that affects the information quality of the financial statement is the service quality of the internal auditor. The result of the evaluation by BPK on the FSLG in 2011 stated that the information quality of the financial statement has not yet been improved because the audit element (internal auditor) of the local government has not acted optimally. This can be seen in the fact that what has been recommended in the audit report has not been adequately acted upon; hence the recurrent findings are still encountered and slow followed up (BPK, IHP the First Semester of 2011:35). The internal auditor should have done an optimal, continuous analysis, starting from the process of the budget preparation, the budget implementation, and the reporting. The purpose is to identify from the beginning the errors, and to correct them so that when the FSLK is examined by BPK, all substantial faults affecting the appropriateness will not be detected anymore.

The research that examined the correlation between the internal auditor and the information quality of the financial statement was conducted by Nassir et al. (2001) and Al-Shetwi et al. (2011). Nassir et al. found that the internal auditor affects the information quality of the financial statement. Therefore, it is the responsibility of the internal auditor to convince that the information of the financial statement should be presented as a whole in line with the criteria prescribed in the accounting standard and the current regulations. While the research by Al-Shetwi et al. (2011) indicates a distinctive result; they concluded that the correlation between the auditor and the information quality of the financial statement is insignificant. This is happened...
because the company used the internal auditor in order to provide a symbol of loyalty to the regulations of the capital market authority in Saudi Arabia.

Based on the above phenomenon, the research problem raised is that though the human resource development has increased and the reformation of the regulation has also improved, the information quality of the financial statement has not met the expectation. In order to respond the problems, it is necessary to strengthen various parties, such as the management and the internal auditor. For this purpose, this research is conducted, since the previous similar studies are still limited in number and it the first research in West and South Sulawesi province in particular. Thus, this research aims at examining and analyzing the influence of the management capability and the service quality of the internal auditor on the information quality of the financial statement. Therefore it is expected that the result of this research will provide contributions to: (a) the theoretical perspective, i.e. the science development in general, and the public sector of the governmental accounting in particular; (b) the methodological perspective, i.e. to explore empirically the effect of the interaction between the management capability, the quality of the internal auditor, and the information quality of the financial statement; and (c) the operational or implementation perspective, i.e. it is a contribution and reference to the local government that can be used in making an operational policy related to the information quality of the financial statement in realizing good financial governance.

Hypothesis

Based on the background of the problem, study objectives, theoretical basis, and the formulated conceptual framework, the study hypothesis is proposed as follows:

1. The management capability has a positive effect on the information quality of the financial statement.
2. The service quality of the internal auditor has a positive effect on the information quality of the financial statement.

Research Question

Based on the background and the problem raised in the introduction above, the research question is broken down as follows:

1. Does the management capability affect the information quality of the financial statement?
2. Does the quality of the internal auditor affect the information quality of the financial statement?

Research Method

This research uses a quantitative method. It also makes use of the explanatory research. For this purpose, the respondents in this research are the structural leaders or officials who are directly involved in the processes of the formulation, execution, and report of the information of the financial statement; they are the local financial coordinators (the secretaries of the regencies), and those who are responsible for the local government financial matters (the regents/mayors, vice regents/vice mayors and heads of SKPD).

The population includes all the Local Government in West and South Sulawesi Province (803 SKPD). The samples were chosen by using the purposive sampling technique and covered SKPD which have prepared the complete financial statements according to criteria prescribed by the Accounting Standard of the Indonesian Government (Standar Akuntansi Pemerintahan - SAP). Accordingly, the minimum sample needed for 37 observations/indicators is 5 x 37 = 185 SKPD to fulfill the minimum requirements of the sample, i.e. 5 for each group/cell (Hair et al., 2006: 112). For this purpose, the researcher has sent out 500 questionnaires. However, the respondents have returned only 406 and from these, 29 were discarded because they are incomplete. Thus, only 377 or about 92.86% were used. This number has met the required number as prescribed by Sekaran (2003: 237), that the minimum number of the returned questionnaires which is considered reasonable is 30% as he stated: “However, the return of mail questionnaires are typically low. A 30% response rate is considered acceptable”

The data used in this study are primary data. The data were collected through close and open questionnaires, supplemented by interviews and discussion with the competent parties if the conditions require in order supporting the research findings.

The technique of data analysis begins with testing its validity using a confirmatory factor and its reliability using the construct reliability and Variance Extracted (VE) on each latent variable. The data are valid when they have a loading factor larger than 0.50 (Hair et al., 2006; 779), and they are reliable when their contract reliability value larger than 0.70 (Hair et al., 2006; 779), and the VE is larger than 0.50 (Ghozali, 2011). The next analysis is the causality test between the research variables through the structural equation model (SEM), the AMOS software version 20.

The variables in this research are all latent or construct variables (variables unobserved), i.e. variables that cannot be directly measured, but only estimated based on their indicators.
The management capability variable \((X_1)\) for this research is the ability or the skill to carry out the process of planning, organizing, directing, and controlling the use of the resources in order to achieve the goal/ target of performance. The management capability is measured using the dimensions proposed by Weihrich and Koonz (2005: 27), namely (a) the planning dimension with the indicators of determining the goals and selecting the best means to achieve the goals; (b) the organizing dimension with the indicator of coordinating and communicating; (c) the directing dimension with the indicator of directing, establishing, and motivating; and (d) the controlling dimension with the indicator of managing responsibility, authority, report and feedback.

The internal auditor’s service quality variable \((X_2)\) is the ability to meet the expectation or the stated standard. The internal auditor’s service quality is measured by the dimensions proposed by Boynton and Kell (1996:840) comprising: (a) the dimension of independence with the indicator of being independent of any activities he is auditing, receiving sufficient authority given by the organization to carry out his examination responsibility, being honest and objective when carrying out his jobs, being independent when planning his program, being independent when working and writing his report; (b) the dimension of professional expertise with the indicator of his education, his expertise and skills, and his position mastery; (c) the scope dimension of his examination work with the indicator of his evaluation on the adequacy and effectiveness of the organization internal control and the information quality of the financial statement, the execution quality when he carries out his responsibilities; (d) the dimension of executing the examination work with the indicator of planning the auditing work, analyzing and evaluating the information and communicating the results and their follow-ups; and (e) the dimension of managing the examination portion with the indicator of managing the examination portion accurately, dividing jobs, designing program for human resource selection and development and coordinating any internal auditing with the external auditor.

The variable of the information quality of the financial statement \((Y_1)\) for this research is the quality or the fulfillment of the criteria or expectation which is there at the information of the financial statement. The criteria used to measure the information quality of the financial statement are the dimensions proposed by Bodnar and Hopwood (2003), GASB (1999), FASB (2010) namely: (a) the dimension of relevance with the indicator of having a feedback value, having a predictive benefit, being on time and complete; (b) the dimension of liability with the indicator of honest presentation, verifiability, neutrality; (c) the dimension of comparability with the indicator of the consistent implementation of accounting policy, the information in the financial statement being comparable to that in the previous financial statement; and (d) understandable dimension with the indicator of having the form and using the terms commonly used in the financial statement and adjusted to the understanding of the users.

The Results of the Research
Multivariate Results

The test is the causality test between the research variables using the structural equation model and the software of AMOS version 20. The estimation result shows (Figure 1) that the Goodness of Fit criteria indexes are as follows: the expected Chi-Square is small, i.e. 129.050, the CMIN/DF is below 2, i.e. 2.081, the probability is insignificant, i.e. 0.000, the GFI is above 0.90, i.e. 0.952, the AGFI is above 0.90, i.e. 0.929, the TLI is above 0.95, i.e. 0.970, the CFI is above 0.95, i.e. 0.977, and RMSEA is below 0.08, i.e. 0.054. The above criteria indicate that the research data are fit.

![Figure 1 estimation results](image)

The test of the hypotheses is conducted by examining the it’s significance level using the Critical Ratio (CR) value and probability (p) at the Standardized regression weights. If the p value is smaller than 0.05, the relationship between the variables is significant. The test results can be seen in Table 1.

Both proposed hypotheses show positive effects. That means that when the independent variables (the management capability and the internal auditor’s quality) are improved, the dependent variable (the information quality of the financial statement) will be improved, and vice versa, with the assumption that other factors which may affect the high or the low
information quality of the financial statement remain constant.

Table 1. Testing the hypothesis

<table>
<thead>
<tr>
<th>Hypothesis</th>
<th>Independent Variable</th>
<th>Dependent Variable</th>
<th>Standardize</th>
<th>CR</th>
<th>P-value</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>H1</td>
<td>The management capability (X₁)</td>
<td>The information quality of financial statement (Y₁)</td>
<td>0.307</td>
<td>4.625</td>
<td>0.000</td>
<td>Sig</td>
</tr>
<tr>
<td>H2</td>
<td>The service quality of the internal auditor (X₂)</td>
<td>The information quality of financial statement (Y₁)</td>
<td>0.162</td>
<td>2.658</td>
<td>0.008</td>
<td>Sig</td>
</tr>
</tbody>
</table>

Source: processed primary data.

Discussion

A. Hypothesis 1: The Effect of the Management Capability on the Information Quality of the Financial Statement

The test result shows that the management capability has a positive effect on the information quality of the financial statement at the work unit both of the province and the regency/city local governments. Thus, hypothesis 1 can be supported because it has been proven empirically.

This research result means that the management capability of the local government leaders in West and South Sulawesi province has been implemented properly in improving the information quality of the local government financial statement.

This finding is in line with the research result by Argyris (1992) which showed that the management capability/superiors that had chosen the accounting policy have a significant effect on the information quality of the financial statement. Argyris emphasized that the power of a leader making a decision to implement the accounting policy in order to obtain a high-quality financial statement. Thus, this research result has also revealed that the management capability of the leaders of the local government work units have implemented their functions in order to achieve a high-quality financial statement. For the organizing functions, for example, the majority of the respondents stated that the leaders of the work units when working on the accounting information policy, they always coordinate with the officials in each work unit of the local government in order to obtain inputs to improve the quality of their financial statement. Also for the directing function, the majority of the respondents stated that each work unit leader always involves all SKPD leaders, according to their respective jobs and responsibilities, in the writing process of the financial statement of high-quality information. Thus, it can be concluded that the management capability in carrying out its functions has affected the information quality of the financial statement.

The result of this research is in line with that was conducted by Sjoblom (1998) which showed that one of the tools used in decision making is the information of the financial statement. Therefore, it is the obligation of the management to take care of the financial information quality. This research also shows that the management is capable of carrying out its functions well and maintaining the information quality of the financial statement. Take, for example, the planning function; the majority of the respondents stated that the leaders of the work units of the local government has designed financial plans/programs according to the community’s aspiration, so that its information are relevant to the community’s needs. This result indicates that the leaders of the work units have maintained the information quality according to its purposes. With the high information quality, the leaders are convinced when they made a decision because their decision has been based on the well prepared information. The management is aware that the high-quality information of the financial statement can be used to evaluate the performance of the local government; an audit on the financial statement is easier to carry out and will help achieve clean and good governance. Therefore, the management will always exert effort to improve its function quality in order to be able to produce high-quality information for the financial statement.

B. Hypothesis 2: The Effect of the Service Quality of the Internal Auditor on the Information Quality of the Financial Statement

The test result indicates that the service quality of the internal auditor has a positive effect on the information quality of the financial statement at the local government work unit both of the province and the regencies. Thus, hypothesis 2 can be supported because it has been proven empirically.

The interpretation of the finding indicates that there exists a correlation between the service quality of the internal auditor and the information quality of the financial statement at the local government. This fact indicates that the information quality of the financial statement is supported by the service quality of the internal auditor. This means the internal auditor’s service, which is one of the effective controlling media, can improve the information quality of the financial statement. In other words, the improvement of the service quality of the internal auditor will result in the
improvement of the information quality of the financial statement.

This finding is in line with the research conducted by Nassir et al. (2001) which tried to find out the effectiveness of the internal auditor and the information of the financial statement at companies in Malaysia. The result findings of their research indicated that the expertise, the commitment, the supports of the auditing committee and the board of directors, the auditing performance and integrity, the efficiency of the auditing section, the competence, the knowledge of the internal auditor about the operation of both companies and industries, and the independence are important attributes in improving the service quality of the internal auditor. Those attributes are in line with the internal auditor’s attributes in this research, namely the independence, the professional expertise, the examination work scope, the execution of the examination work, and the management of the examination part. Those attributes have a positive effect on the improvement of the information quality of the financial statement. The identification of those attributes is crucial when we want to find out the effectiveness of the internal auditor’s functions which will help the internal auditor in evaluating the procedures done by the company in order to produce high-quality information in the financial statement. The identification of the attributes itself is very important because it can help the internal auditor do the evaluation in order to produce high-quality information for the financial statement.

The result of the analysis revealed that the internal auditor at the local government has carried out his function to review the information of the financial statement in order to find out whether the financial statement is of high quality. This system must go on because the internal auditor as an internal supervisor is reflected in the information quality of the local financial statement. Some experts, among others, Meigs, et al. (1982: 254) stated the same thing that the primary function of an internal auditor aside from conducting an investigation and evaluation on the internal control of an organization, is to provide recommendations based on the findings in order to improve the information of a financial statement, instead of just looking for a mistake.

Conclusion and Suggestion

The conclusion of this research is that the management capability and the service quality of the internal auditor have positive effect on the information quality of the financial statement. This result is in line with the facts in the field which reveals that the inadequate quality of the internal auditor has caused the inadequate information quality of the financial statement. This means that the internal auditor has not yet helped improve the information quality of the financial statement optimally.

It is necessary to strengthen the functions of the internal auditor; this can be done by straightening up the Organization Structure and the Working Administration (OSWA) of the local government, especially the examination function, because so far, the internal auditor has found it difficult to maintain his independence. The internal auditor’s independence itself is required if the optimum control is desired by the local government. Therefore, its organization structure should be independent, for instance, the internal auditor can directly report his findings to the highest organization leader. This is possible, for example, if the provincial inspectorate is directly under the Inspectorate General (or the Central Government), while the inspectorates of the regencies/cities are under the provincial government. With this kind of structures, the intervention by the local governments can be minimized and any deviating actions as well as any illegal political policies can be avoided.

Reference
and Management’s”. Discussion and Analysis for State and Local Governments, Norwalk, 1999.


