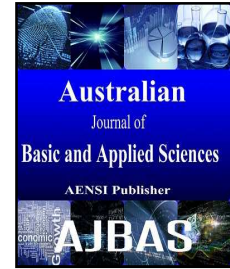




ISSN:1991-8178

Australian Journal of Basic and Applied Sciences

Journal home page: www.ajbasweb.com



Does Internal Control Effectiveness Affect Financial Reporting Quality? Evidence from Local Government of Bandung, West Java Province, Indonesia

ItaSalsalina

Student of Accounting Science Doctoral Program, Business and Economics Faculty, Padjadjaran University in Bandung, Indonesia.

ARTICLE INFO

Article history:

Received 10 October 2015

Accepted 30 November 2015

Available online 31 December 2015

Keywords:

internal control effectiveness, financial reporting quality, performance accountability.

ABSTRACT

Background: Based on phenomenon of poor quality of financial reporting and lack of accountability at most of all central and local government in Indonesia, so the Government of Indonesia needs to improve the effectiveness of internal control as noted by the audit board of the Republic of Indonesia in order to achieve reliability of financial reporting. **Objective:** This research aims to examine the effect of internal control effectiveness on financial reporting quality and its impact on performance accountability. **Results:** The results revealed that internal control effectiveness affects financial reporting quality, and thus gives an impact on performance accountability of the local government. **Conclusion:** Based on research findings, it can be concluded that internal control effectiveness will provide reasonable assurance on the reliability of financial reporting, and thus enhance performance accountability.

© 2015 AENSI Publisher All rights reserved.

To Cite This Article: ItaSalsalina., Does Internal Control Effectiveness Affect Financial Reporting Quality? Evidence from Local Government of Bandung, West Java Province, Indonesia. *Aust. J. Basic & Appl. Sci.*, 9(37): 65-75, 2015

INTRODUCTION

Public accountability is an important issue especially for governmental organization. In accordance with Law No. 17 year 2003 on State Finance, Government Regulation No. 71 year 2010 on Governmental Accounting Standards and Regulation of the Minister of Home Affairs No. 59 year 2007 concerning Guidelines on Regional Financial Management, each local government in Indonesia is expected to manage finances economically, efficiently and effectively as well as to provide financial statements as a form of public accountability. Accountability requires that governments answer to the citizenry in order to justify the raising of public resources and the purposes for those resources (Ruppel, 2005). Government must be accountable for results (Callahan, 2007). According to Callahan (2007), accountability for results (performance) means holding government responsible not only for its expenditures, the quantity of services provided, and the fulfillment of reporting requirements, but also for the results of its actions. Therefore, governments need to show their constituents whether policies, programs and activities they deliver are producing the results that they were intended to introduce.

Governmental Accounting Standards Board (GASB) Concepts Statement No. 1 stated that

accountability is considered as the cornerstone of financial reporting (Martin and West, 2003). According to International Public Sector Accounting Standards Board (IPSASB, 2013), the objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users for accountability and for decision making purposes. Similarly, Gross *et al.*, (2005) stated that the purpose of financial reporting for governmental organization is to be publicly accountable, by providing useful, relevant, reliable, and understandable information that addresses the principal needs of a variety of users. As noted by GASB Concepts Statement No. 1 par. 56 that accountability is based on the general belief that the citizenry has a right to know, a right to receive openly declared facts that may lead to public debate by the citizens and their elected representatives, thus financial reporting plays a major role in fulfilling government's duty to be publicly accountable (Wilson *et al.*, 2010). In other words, financial reporting quality is an important factor for the success of governmental organization in terms of the quality of financial information being provided as well as its accountability. According to Webster, accountability is an obligation or willingness to accept responsibility or to account for one's actions (Callahan, 2007).

Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities

(IPSASB) noted that accounting and financial reporting provides important accountability information. By providing a financial report of high quality, governmental entities can also satisfy one some of the information needs of organizations and users that have the authority to require reports tailored to meet their own specific information needs (Budding *et al.*, 2015). Performance accountability of governmental institutions, as noted by the Institute of Public Administration in Indonesia (LAN, 2000) is the embodiment of the obligation of governmental institutions to be responsible for the success of organizational mission in achieving its goals and objectives that have been determined periodically through the system of responsibility. According to Wilson *et al.* (2010), the need to report on management's accountability to citizens, creditors, oversight bodies, and others has played a central role in shaping the accounting and reporting practices of governmental and not-for-profit organizations. From this point of view, we can conclude that accountability of public institutions is a must and also a main objective of the governmental financial reporting, as also noted by Ruppel (2005), that accountability is the foundation for governmental financial reporting based on the existence of citizenry has the right know and receive an explanation in terms of the use of public funds.

The phenomenon of poor quality of financial reporting and lack of public accountability at most of all central and local government in Indonesia are noted by The Minister of Finance, Sri Mulyani (2009). She argued that poor quality of financial reporting of governmental institutions is due to the lack of internal control effectiveness. Therefore she asked for all head of ministries and institutions, to implement an effective internal control in order to improve the quality of financial reporting. Meanwhile the head of The Audit Board, Hadi Poernomo (2010) stated that the government has not successfully managed in improving financial reporting quality, effectiveness of programs and activities implementation, compliance with legislation, and effectiveness of internal control. Furthermore, the minister of home affairs, Gamawan Fauzi (2011), argued that financial reporting of local government did not efficient in terms of time and budget. According to the vice president, Boediono (2011), transparency and accountability of public financial management has

not been satisfactory. Over twenty financial statements of ministries and state institutions did not get "unqualified" opinion from the Audit Board. Similarly, Indonesian President, Susilo Bambang Yudhoyono (2012) stated that he was not satisfied with audit opinion from the Audit Board concerning performance accountability of governmental institutions in Indonesia for the year 2011. The problem related to the poor quality of financial reporting was caused by the weaknesses of internal control as noted by the head of The Audit Board, Hadi Poernomo (2013). According to The Minister of Finance, Chatib Basri (2013), the government should consider the way to solve the problem of financial reporting quality in terms of transparency and accountability.

The poor quality of governmental financial reporting is a main problem, because financial reporting quality is a key element in the accountability of public sector bodies (Henley *et al.*, 1989), and its objective is for decision making (Engstrom and Copley, 2004). Therefore, Indonesian Vice President, Boediono (2011), asked for all governmental agencies at the central and local levels to improve the quality of financial statements, due to the target of all ministries and institutions to obtain an "unqualified opinion". The quality of financial reporting is associated with the internal control effectiveness as one of the criteria in awarding audit opinion in accordance with Law No. 15 year 2004 regarding audit of state financial management responsibility. Criteria in awarding the opinion are: (a) compliance with Governmental Accounting Standards, (b) adequate disclosures, (c) compliance with laws and regulations, and (d) effectiveness of the internal control system.

One of the influential factors for the success of both central and local government is reflected through the presentation of financial statements that have a good quality. Governmental financial statements are considered qualified if they receive "unqualified opinion". Each central and local government, are required to publish financial statements as a form of accountability and should be audited by the The Audit Board. Financial audit carried out by the Audit Board has a purpose to provide an opinion on the fairness of the financial statements.

This following data shows the audit opinion of financial statements conducted by the Audit Board for the year 2012:

Table 1: Opinion based on the examination of Financial Statements By the Audit Board of Republic of Indonesia for the Year 2012.

Type of Financial Information	OPINION								
	Unqualified Opinion	%	Qualified Opinion	%	Adverse Opinion	%	Disclaimer Opinion	%	Total
LKPP	0	0	1	100	0	0	0	0	1
LKKL	68	74	22	24	0	0	2	2	92
LKPD	113	27	267	64	4	0.01	31	8	415
LK Badan Lainnya	4	66	1	17	0	0	1	17	6

Source: Summary of Examination Result (IHP) Semester I for the year 2013

Where: LKPP = Financial Statements of Central Government

LKLL = Financial Statements of Ministry and Institutions

LKPD = Financial Statements of Local Government

LK Badan Lainnya = Financial Statements of Others Bodies

Based on Table 1 above we can see that the majority of audit opinion on financial statements of

the central government, ministries and institutions, local government, and other bodies are "fair with exception" (*qualified opinion*), while the government's target is to achieve an "unqualified opinion". Results based on the examination of financial statements of local government for the year 2012 conducted by the Audit Board, discovered the existence of 4,412 cases of weaknesses in internal control system categorized in three groups as described below in table 2:

Table 2: Findings Group of Internal Control System Based On Examination Results for the year 2012.

No.	Sub of Group Findings	Number of Cases
1	Weaknesses in Accounting Control System and Reporting	1.586
2	Weaknesses in Control System of Budget Implementation	1.935
3	Weaknesses in Internal Control Structure	891
	Total	4.412

Based on the evaluation of internal control system by the Audit Board, we can see several cases of internal control weaknesses can be grouped into weaknesses of accounting control systems and reporting, weaknesses of budget control system, weaknesses of revenue and expenditure control system, as well as weaknesses of internal control structure. Each group along with the findings of the cases are described as follows:

1. A total of 1,586 cases of weaknesses in accounting control system and reporting, consist of:

- 895 cases of inaccurate recording;
- 498 cases of preparing report is not in accordance with provisions;
- 16 cases of late reporting;
- 163 cases of inadequate accounting information systems; and
- 14 cases of accounting information system are not supported with competent human resources.

2. A total of 1,935 cases of weaknesses in controlling the implementation of revenue and expenditure budget, consist of:

- 617 cases of inadequate activities planning;
- 249 cases of collecting, depositing and reporting mechanism of local revenue and grants is not in accordance with provisions;
- 570 cases of irregularities against specific legislation or internal regulations of the organization;
- 58 cases of expenditure execution is out of budget;
- 324 cases of inappropriate in determining policy that result in a loss of potential revenue;
- 83 cases of inappropriate in determining policy that result in an increase in cost or expenditure; and
- 34 cases of weaknesses in controlling the implementation of revenues and expenditures budget, including physical asset management and security.

3. A total of 891 cases of weaknesses in internal control structure, consist of:

- 485 cases of entities do not have a formal Standard Operational Procedures (SOP);
- 277 cases of existing SOP does not run optimally;
- 4 cases of entities do not have internal watchdog unit;

- 99 cases of an existing internal watchdog unit are inadequate; and
- 26 cases there was no segregation of duties and functions adequately.

According to the Audit Board, financial statements which obtain unqualified and qualified opinion, are basically supported by an adequate system of internal control, whereas those which obtain adverse and disclaimer opinion are not supported by an adequate internal control system, therefore need improvement in terms of reliability of financial reporting. In other words, the existence of an effective internal control will affect the quality of financial reporting and thus the quality of financial information itself.

Based on the examination of performance accountability report (LAKIP) in year 2013 toward 88 ministries or institutions and 33 provincial governments, we can see that from 88 ministries only 6 institutions (7.14%) awarded A predicate (excellent), 33 institutions (39.29%) awarded B predicate (good), while as many as 40 institutions (47.62%) awarded CC predicate (quite average), 3 institutions (3.57%) awarded C predicate (average), and 2 institutions (2.38%) awarded D predicate (poor). From 33 provincial governments, none have achieved A predicate, but only 9 provinces (27.27%) awarded B predicate, 19 provinces awarded CC predicate (57.58%) which is one of them is West Java provincial government and 5 provinces awarded (15.15%) C predicate. The evaluation results indicate that the overall performance accountability of governmental institutions in Indonesia have not achieved excellent or good predicate and thus need improvement.

This study was conducted to examine the problem related to the poor quality of financial reporting at governmental institutions especially the influential factor of it which is the effectiveness of internal control system. Problems in this study can be formulated as follows:

1. How is the effect of internal control effectiveness on financial reporting quality.
2. How is the effect of financial reporting quality on performance accountability.

2. Literature Review:

2.1 Financial Reporting Quality:

Financial reporting is basically the process of communicating financial accounting information about the company that is useful to external users in making decisions about providing resources to the entity (Nikolai et al., 2010; Briton and Waterston, 2010; Kieso et al., 2012; Wahlen et al., 2012). The objective of financial reporting is to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions (Porter and Norton, 2010; Atrill and McLaney, 2011; Elliott and Elliot, 2011; Libby et al., 2011; Kieso et al., 2012). In other words, it can be concluded that financial reporting is a process that encompasses all aspects relating to the preparation and presentation of financial information that will be useful for investors, creditors and other users in making decisions. Financial reporting for governments is based primarily on pronouncements issued by the Governmental Accounting Standards Board (GASB). The GASB recommends each government issue a comprehensive annual financial report (Bogui, 2008). Therefore financial reporting for public sector organization aims to produce financial information that serves as a means of accountability and evaluation of financial performance. In order to meet the desired quality of governmental financial statements, thenormative prerequisites are needed. Qualitative characteristics of financial statements are normative measures to assess the quality of financial statement relating to its purpose.

According to Kieso et al., (2012), the qualitative characteristics of accounting information consists of the fundamental characteristics and enhancing characteristics. Fundamental characteristics are divided into two types: (1) relevance which consists of predictive value, confirmatory value, and materiality; and (2) faithful representation which consists of completeness, neutrality, and free from error, while enhancing characteristics which is intended to improve fundamental qualities consist of comparability, verifiability, timeliness, and understandability. According to Beest et al. (2009), the quality of financial reporting can be measured by qualitative characteristics of financial information, such as: relevance, reliability, understandability and comparability. Similarly, Cheung et al. (2010) and Statement of Governmental Accounting Standards No. 01 (Governmental Regulation No. 71 year 2010), stated that qualitative characteristics of financial statements are required by the government in order to meet the desired quality such as: relevant, reliable, comparable, and understandable. Stickney et al. (2010) stated that reliability of financial reporting refers to the faithfulness of which accounting information represents what it purports to represent and the extent of which the information is both verifiable by independent measures and neutral with respect to the interest of a particular user group.

2.2 Internal Control Effectiveness:

Internal control can be defined as a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in each of the following categories: (a) effectiveness and efficiency of operations; (b) reliability of financial reporting; (C) compliance with applicable laws and regulations (COSO, 2009; Agami, 2006; Needles et al., 2008; Porter and Norton, 2010; Narayanaswamy, 2011; Gelinas, 2011). Effectiveness of internal control refers to the existence of an adequate system of internal control relevant to the design of policies, rules and procedures (Wittayapoom et al., 2011). Effectiveness of internal control can be achieved when managers design a reasonable assurance that the goals and objectives can be achieved. There are five key control components that must exist to achieve the effectiveness of internal control: (1) control environment which is defined as actions, policies, and procedures that reflect the overall attitude of top management, directors, and owners of an entity about internal control and its importance; (2) risk assessment which is defined as management's identification and analysis of risks relevant to the preparation of financial statements in accordance with GAAP. Risk assessment processes identify factors affecting risks; assess significance of risks and likelihood of occurrence; and determine actions necessary to manage risks. (3) control activities which is defined as policies and procedures that management has established to meet its objectives for financial reporting, (4) information and communication which is defined as methods used to initiate, record, process, and report an entity's transactions and to maintain accountability for related assets; and (5) monitoring which is defined as management's ongoing and periodic assessment of the quality of internal control performance to determine whether controls are operating as intended and are modified when needed (Arens et al., 2006; Needles et al., 2008; Bodnar and Hopwood, 2010; Jones et al., 2011; Considine et al., 2012).

2.3 Performance Accountability:

According to Webster, accountability is an obligation or willingness to accept responsibility or to account for one's actions. Accountability requires that governments answer to the citizenry in order to justify the raising of public resources and the purposes for those resources (Ruppel, 2005). To be accountable means that there is an obligation to answer for one's actions and decisions which arises when authority to act on behalf of an individual or body (*the principal*) is transferred to another (*the agent*) (Funnell et al., 2012).

Accountability always related to performance. Accountability for results (performance) means holding government responsible not only for its expenditures, the quantity of services provided, and the fulfillment of reporting requirements, but also for the results of its actions (Callahan, 2007). According

to Wilson *et al.* (2010), accountability for operating performance is accomplished by providing report users information on service efforts and accomplishments (SEA). Martin and West (2003) noted that SEA reporting is intended to provide information to users about services provided and accomplishments and then use measures to link the two together. Hence, the relationship between service efforts and accomplishments should provide citizens and other users valuable information about governmental performance and provide information to hold managers accountable.

The level of success achieved by the governmental apparatus in performing their duties is described in the performance report. Disclosure of performance report of governmental organization is a form of public accountability. The government obligation to perform accountability is based on agency theory which is known as principal-agent relationship (Jensen and Meckling, 1976, Eisenhardt, 1989). According to agency theory, apparatus of local government in this research is considered as an agent where the governor or mayor is considered as a principal. In the perspective of agency theory, the principal delegate decision-making authority and the use of resources to the agent to be carried out or managed in the interests of the principal. To find out the achievement of its agent, then the principal requires performance report from its agent.

Institute of Public Administration in Indonesia (LAN, 2000) states that performance is an overview of achievement level to the program/activity/policies implementation in order to achieve goals, objectives, mission and vision of the organization as stated in the formulation of organizational strategic. Performance accountability is a form of government's obligation to account for the success and failure in achieving various objectives that have been established by the government periodically through performance report which is known as performance accountability report of governmental institution (LAKIP). In other words, performance accountability report is a form of government's obligation to be publicly accountable for the success or failure of the mission of its organization.

3. Theoretical Framework:

3.1 The Effect of Internal Control Effectiveness on Financial Reporting Quality:

Issue of financial reporting quality supported by the existence of an effective internal control as management responsibility also noted by International Public Sector Accounting Standards Board (IPSASB, 2013). Internal control is used by management in order to achieve business goals. Thus the reliability (quality) of financial reporting is affected by the effectiveness of internal control. The relationship between internal control effectiveness and financial reporting quality is supported by theory. According to Rezaee and Riley (2010) an effective internal control system can assist in preventing, detecting and correcting material misstatements in financial reports. Furthermore,

Young (2012) argued that internal control systems operate at different level of effectiveness. Internal control can be judged effective if published financial statements are being prepared reliably, thus it can ensure reliability of financial reporting. Considine *et al.* (2012) also stated that a sound internal control system will assist in meeting the goal of preparing reliable financial report. Similarly Maher *et al.* (2012) stated that internal controls provide management with reasonable assurances that the company's assets are protected and the information that the accounting information in the company is reliable.

The relationship between internal control effectiveness and financial reporting quality is also supported by previous research findings. According to Skaife *et al.* (2007) internal control effectiveness strongly and significantly affects reliability of financial reporting because internal control is essential for corporate governance statement for the firms particularly in the Thai listed firms. Amudo and Inanga (2009) similarly stated that internal control system is responsible for organizations' failure to achieve reliability of financial reporting. Moreover Wittayapoom and Limsuwan (2011) stated that internal control effectiveness significantly positively affects reliability of financial reporting. Then, Tunji (2013) noted that an effective internal control system has a great impact on accuracy and reliability of records of banks.

3.2 The Effect of Financial Reporting Quality on Performance Accountability:

Issue of performance accountability which is supported by financial reporting quality is based on theory. According to GASB *Concepts Statement No. 1 concerning* objectives of Financial Reporting states that accountability is the cornerstone of all financial reporting in government (Wilson *et al.*, 2010). GASB notes that financial reporting should provide information useful in making economic and political decisions and in assessing accountability (Freeman *et al.*, 2011). Financial reporting in the public sector is a key element in the accountability of public sector bodies (Henley *et al.*, 1989). Similarly, Copley (2010) states that financial reporting plays a major role in fulfilling government's duty to be publicly accountable in a democratic society. Moreover Ruppel (2005) also states that in order to help fulfill a government's duty to be accountable, government financial reporting should enable the financial statement user to assess the extent to which operations were funded by nonrecurring revenues or long-term liabilities were incurred to satisfy current operating needs. Government and non-profit organizational accounting and reporting usually emphasize control of and accountability for expendable financial resources (Freeman *et al.*, 2011). SFAC No.1 identifies four objectives of federal financial reporting, all of which rest on the foundation of accountability (Wilson and Kattelus, 2010).

The relationship between financial reporting quality and performance accountability is also

supported by previous research findings. As noted by Mack and Ryan (2006), the research findings indicated that general-purpose of financial reports are used to satisfy financial accountability and public accountability rather than decision making. Eivani *et al.* (2012) also concluded that Financial reporting is the best index of accountability, while Afiah and Rahmatika (2014) stated that Internal Control have significant effect on the quality of financial reporting, both partially and simultaneously.

Furthermore the Quality of Financial Reporting has implications on Good Government Governance.

4. Research Model and Hypothesis:

Based on theory and previous research findings as discussed above, form a premise which shows the effect of internal control effectiveness on the quality of financial reporting. The conceptual model could be described in figure 1 below:

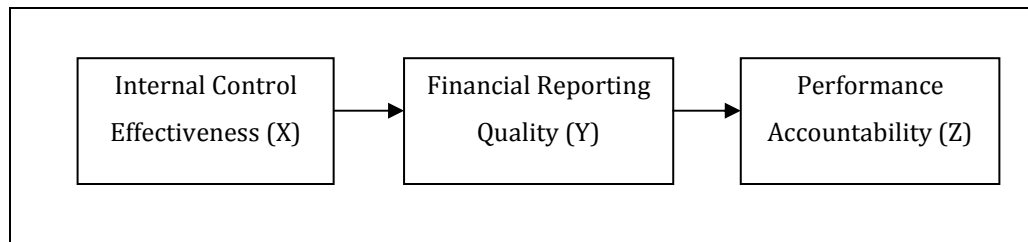


Fig. 1: Conceptual Model.

The proposed hypothesis in this research could be formulated as follow:

H1: Internal control effectiveness affects financial reporting quality.

H2: Financial reporting quality affects performance accountability

5. Methodology, Findings and Discussion:

In this study there are three variables and described into two models. Model I is intended to examine Internal Control Effectiveness as an independent variable where proxies of variable are: 1) control environment, 2) risk assessment, 3) control activity, 4) information and communication, and 5) monitoring and Financial Reporting Quality as a dependent variable (Y) where proxies of variable are: 1) relevance; 2) reliability; 3) comparability; and 4) understandability. Furthermore model II is intended to examine Financial Reporting Quality as an independent variable (Y) and performance accountability as a dependent variable (Z) where proxies of variable: 1) performance planning; 2) performance reporting; 3) performance evaluation; and 4) performance achievement.

Surveyed design was used in this study, where primary data was obtained through questionnaires which were distributed to selected respondents. The questionnaire was prepared based on indicators that were intended to determine the effect of the effect of internal control effectiveness on financial reporting quality.

Unit of analysis in this study is local governmental unit (SKPD) at Bandung city, totally 33 SKPD. Respondents in this study are apparatus of SKPD who are carrying out daily duties, regarding financial reporting process in order to provide financial information as a means of accountability. Questionnaires were distributed to personnel directly related to the financial reporting process such as:

head of finance department, treasurer, budgeting staff and accounting staff. Data collected by using the survey method. A total of 110 questionnaires distributed to 33 SKPD. Of the total 110 questionnaires distributed, only 78 questionnaires from 22 SKPD could be collected and analyzed or with a respond rate of 70.9%.

Data was then analyzed using simple regression analysis. Simple regression analysis was intended to measure the effect of independent variable on dependent variable with a significance level 5% ($\alpha = 0,05$). Statistical hypotheses in this study are as follows:

- H_{01} : $\beta = 0$ means internal control effectiveness does not affect financial reporting quality.
- H_{a1} : $\beta \neq 0$ means internal control effectiveness affects financial reporting quality.
- H_{02} : $\beta = 0$ means financial reporting quality does not affect performance accountability.
- H_{a2} : $\beta \neq 0$ means financial reporting quality affects performance accountability.

In this research, the hypothesis testing is analyzed with a simple regression method. The structural regression model in this study could be described into two models as follows:

Model I:

$$FRQ = a + b ICE + e_1$$

Where:

FRQ = Financial Reporting Quality
 b = Coefficient of Regression
 ICE = Internal Control Effectiveness
 e_1 = error of term (model I)

Model II:

$$PA = a + b FRQ + e_2$$

Where:

PA= Performance Accountability
 b= Coefficient of Regression
 FRQ= Financial Reporting Quality
 e_2 = error of term(model II)

In this study, questionnaire was tested in two ways, validity and reliability test. Based on this research analysis using product moment technique obtained the following results:

Table 3: Validity Test of Variable X.

Statement	R (count)	R (table)	conclusion
1	0,632	0,2227	Valid
2	0,600	0,2227	Valid
3	0,527	0,2227	Valid
4	0,498	0,2227	Valid
5	0,697	0,2227	Valid
6	0,769	0,2227	Valid
7	0,580	0,2227	Valid
8	0,620	0,2227	Valid
9	0,616	0,2227	Valid
10	0,711	0,2227	Valid
11	0,687	0,2227	Valid
12	0,647	0,2227	Valid
13	0,665	0,2227	Valid
14	0,595	0,2227	Valid
15	0,650	0,2227	Valid
16	0,705	0,2227	Valid
17	0,694	0,2227	Valid
18	0,635	0,2227	Valid
19	0,564	0,2227	Valid
20	0,570	0,2227	Valid
21	0,658	0,2227	Valid
22	0,617	0,2227	Valid
23	0,714	0,2227	Valid
24	0,646	0,2227	Valid
25	0,213	0,2227	Not Valid
26	0,573	0,2227	Valid
27	0,619	0,2227	Valid
28	0,757	0,2227	Valid

Based on the analysis in Table 3, it is known that all statements other than statement item of number 25 has a correlation coefficient r

count greater than $r_{table}(0.05;76)$, meaning that all items are valid and could be analyzed except for the statement of number 25.

Table 4: Validity Test of Variable (Y).

Statement	R (count)	R (table)	conclusion
1	0,697	0,2227	Valid
2	0,721	0,2227	Valid
3	0,663	0,2227	Valid
4	0,670	0,2227	Valid
5	0,711	0,2227	Valid
6	0,776	0,2227	Valid
7	0,600	0,2227	Valid
8	0,694	0,2227	Valid
9	0,802	0,2227	Valid
10	0,637	0,2227	Valid
11	0,666	0,2227	Valid
12	0,799	0,2227	Valid
13	0,783	0,2227	Valid
14	0,797	0,2227	Valid

Based on the analysis in Table 4, we can see all items have correlation coefficient r count greater than $r_{table}(0.05;76)$, meaning that all items are valid; therefore all data can be further processed.

Based on the analysis in Table 5, we can see all items have correlation coefficient r count greater than $r_{table}(0.05;76)$, meaning that all items are valid; therefore all data can be further processed.

After validity test, then doing reliability test. Testing reliability of all items using Cronbach Alpha techniques (α) with the help of SPSS.

Based on the analysis in Table 6, we can see that Cronbach Alpha value of 0.943 is greater than 0.6, so

it can be concluded that all items in the statement of independent variable (X) are reliable.

Based on the analysis in Table 7, shows that the Cronbach Alpha value of 0.924 is greater than 0.6, so it can be concluded that all items in the statement of dependent variable (Y) are reliable.

Based on the analysis in Table 8, we can see that Cronbach Alpha value of 0.857 is greater than 0.6, so it can be concluded that all items in the statement of variable (Z) are reliable.

Table 5: Validity Test of Variable (Z).

Statement	R _(count)	R _(table)	conclusion
1	0,770	0,2227	Valid
2	0,766	0,2227	Valid
3	0,701	0,2227	Valid
4	0,791	0,2227	Valid
5	0,643	0,2227	Valid
6	0,667	0,2227	Valid
7	0,640	0,2227	Valid
8	0,662	0,2227	Valid

Table 6: Reliability Test of Independent Variable (X).

Reliability Statistics	
Cronbach's Alpha	N of Items
.943	27

Table 7: Reliability Test of Dependent Variable (Y).

Reliability Statistics	
Cronbach's Alpha	N of Items
.924	14

Table 8: Reliability Test of Variable (Z).

Reliability Statistics	
Cronbach's Alpha	N of Items
.857	8

5.1 The Effect of Internal Control Effectiveness on Financial Reporting Quality:

There are two types of conceptual model in this research. The aim of model I-test is to know the effect of independent variable (X) on dependent variable (Y), in this research is the effect of internal control effectiveness on financial reporting quality. This test result of model II (*t-statistic*) could be seen in the following table 9:

Based on the analysis presented in Table 9, the structural regression equation for model I is as follows:

$$FRQ = 15,302 + 0,385 ICE + e_1$$

Where:

FRQ= Financial Reporting Quality

ICE= Internal Control Effectiveness

e_1 = error of term

It is shown that the significance value (0.000) < α (0.05), therefore H_{01} is rejected and H_{a1} is accepted. It can be concluded that internal control effectiveness affects financial reporting quality.

In order to know the ability of model I to explain variation of dependent variable (Y) we could see from the following result of determination test (table 10):

Table 9: Statistical t-test (Model I).

Coefficients ^a						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	15.302	5.661		2.703	.008
	X1	.385	.050	.664	7.737	.000

a. Dependent Variable: Total_Y

Table 10: Coefficient of Determination Test (Model I).

Model Summary ^b				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.664	.441	.433	6.08233

a. Predictors: (Constant), X1
b. Dependent Variable: Total_Y

Based on the analysis, as described in Table 10, we could see that the R-Square value is 0.441; hence variation of financial reporting quality as of 44.1% may be explained by variation of internal control effectiveness, while the remaining 55.9% are explained by other causes from outside of the model. Internal control effectiveness within the government is proxied by control environment, risk assessment, control activities, information and communication, and monitoring.

5.2 The Effect of Financial Reporting Quality on Performance Accountability:

The quality of financial reporting in the government are measured by four dimensions namely: relevant, reliable, comparable and understandable (LAN, 2000) while performance accountability are measured by four dimensions namely performance planning, performance reporting, and performance evaluation and performance achievement.

The aim of model II-test is to know the effect of independent variable (Y) on dependent variable (Z), in this research is the effect of financial reporting

quality on performance accountability. This test result of model II (*t-statistic*) can be seen in this following table 11:

Table 11: Statistical t-test (Model II).

Model	Coefficients ^a					
	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	
	B	Std. Error	Beta			
1	(Constant)	20.386	3.926		5.192	.000
	Total_Y	.201	.066	.329	3.041	.003
a. Dependent Variable: Total_Z						

Based on the analysis presented in Table 11, the structural regression equation for model II is as follows:

$$PA = 20,386 + 0,201 \text{ FRQ} + e_2$$

Where:

PA = Performance Accountability
 FRQ = Financial Reporting Quality
 e_2 = error of term

It is shown that the significance value (0.003) $< \alpha$ (0.05), therefore H_{02} is rejected and H_{a2} is accepted. From this result we can conclude that financial reporting quality affects performance accountability.

In order to know the ability of model II to explain variation of dependent variable (Z) we could see from this following result of determination test (table 12):

Table 12: Coefficient of Determination Test (Model II) Model Summary^b.

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.329 ^a	.109	.097	4.69207
a. Predictors: (Constant), Total_Y				
b. Dependent Variable: Total_Z				

As described in Table 12, we can see that the R-Square value is 0.109, hence variation of performance accountability as of 10.9% may be explained by variation of financial reporting quality, while the remaining 89.1% is explained by other causes from outside of the model. Performance accountability is measured by performance planning, performance reporting, performance evaluation, and performance achievement.

6. Conclusions, Limitations and Recommendations:

6.1 Conclusions:

Based on the results of this research, we can conclude that:

1. The internal control effectiveness affects financial reporting quality. In other words, internal control system aims to achieve reliability on financial reporting. This supports the theory which has been stated previously that the internal control effectiveness affects the quality of financial reporting. Furthermore, it supports the result of previous studies which also stated that an internal control effectiveness affects the quality of financial reporting.
2. The quality of financial reporting affects performance accountability. In other words, financial reporting quality aims to provide performance accountability. This result supports the theory which has been stated previously that financial reporting quality affects performance accountability. Moreover the conclusion also supports the result of previous

studies which also stated that the quality of financial reporting affects performance accountability.

6.2 Limitations of Research and Recommendations:

This research has limitations in variability and sample size. As variability of SKPD are limited only in Bandung city, the results may not necessarily reflect the situations of SKPD in other provinces in Indonesia. Hence it is recommended that further research would be conducted to examine more SKPD in other provinces in Indonesia.

REFERENCES

- Alexander, D., A. Britton, A. Jorrissen, 2007. *International Financial Reporting and Analysis*. 3rd edition. Thomson
- Agami, M., Abdel, 2006. "Reporting on Internal Control Over Financial Reporting", *the CPA Journal*, 76 (11): 32-34.
- Amudo, A., E.L. Inanga, 2009. "Evaluation of internal control systems: A case study from Uganda", *International Research Journal of Finance and Economics*, 3: 124-144.
- Arens, A., Alvin, Elder, Randal, J. Beasley, S. Mark, 2006. *Auditing and Assurance Services: An Integrated Approach*. 11th edition. Pearson Education International.
- Atrill, Peter and Mc. Laney, Eddie, 2011. *Financial Accounting for Decision Makers*. 6th ed. Financial Times.

- Beest, V., Ferdy, Geert Braam, B. Suzanne, 2009. "Quality of Financial Reporting: Measuring Qualitative Characteristics", Nice Working Paper, 09-108.
- Budding, Tjerk.Grossi, Giuseppe and Tagesson, Torbjorn, 2015. *Public Sector Accounting*, Taylor and Francis Group
- Boediono, 2011. "Pengelola Anggaran Diberi Tenggat Setahun Tuntaskan Anggaran", Tempo, Senin 19 September 2011, available at <http://www.tempo.co/read/news/2011/09/19/087356991/Pengelola-Anggaran-Diberi-Tenggat-Setahun-Tuntaskan-Anggaran>.
- Bodnar, H., George and Hopwood, S. William, 2010. *Accounting Information Systems*. 10th edition. Pearson Education, Inc.
- Bogui, B., Frederic, 2009. *Handbook of Governmental Accounting*. CRC Press, Taylor & Francis Group.
- Botosan, C., 2004. "Discussion of a framework for the analysis of risk communication" *The International Journal of Accounting*, 39, 289-295.
- Britton, Anne and Waterston, Chris, 2010. *Financial Accounting*. 5th edition. Pearson Education Ltd.
- Callahan, Kathe, 2007. *Elements of Effective Governance, Measurement, Accountability, and Participation*. Taylor and Francis Group, LLC.
- Chatib Basri, 2013. "DPR Terima Pertanggungjawaban APBN 2012", Tempo, Selasa 13 September 2013,
- Cheung, Esther, E. Elaine, Sue Wright, 2010, "An Historical Review of Quality in Financial Reporting in Australia", *Pacific Accounting Review*, 22(2): 147-169.
- Considine, Brett., Parkes, Alison, Olesse, Karin, Blount, Yvette., Speer, Derek, 2012. *Accounting Information Systems*. 4th edition. John Wiley & Sons, Australia, Ltd.
- Copley, A. Paul, 2011. *Essentials of Accounting for Governmental and Not-for-Profit Organizations*. 10th edition. Mc.Graw-Hill.
- Committee of Sponsoring Organizations of the Treadway Commission, 2009. *COSO-Internal Control, Integrated Framework*. Volume 1-3
- Daske, H., G. Gebhardt, 2006. "International Financial Reporting Standards and Experts' Perceptions of Disclosure Quality", *Abacus*, 42(3-4): 461-498.
- Dechow, P., I. Dichev, 2002. "The Quality of Accruals and Earnings: The Role of Accrual Estimation Errors", *The Accounting Review*, 77: 35-59.
- Eivani, Farzad, Nazari, Kamran and Emami, Mostafa, 2012. "Public accountability and government financial reporting", *Academic Journals*, 6(29): 8475-8482, ISSN: 1993-8233, available on <http://www.academicjournals.org/journal/AJBM/article-abstract/B603BC918448>
- Elliot, Barry and Elliot, Jamie, 2011. *Financial Accounting and Reporting*. 14th ed. Pearson Education Ltd.
- Emmanuel, K., G. Oseifuah, B. Agyapong, 2013. "Internal Control in Small and Micro enterprises in the Vhembe District, Limpopo Province, South Africa", *European Scientific Journal*, February 2013 edition, 9-4. ISSN: 1857-7881.
- Engstrom, H., John and Copley, A. Paul, 2004. *Essentials of Accounting for Governmental and Not-For-Profit Organizations*. 7th ed. Mc. Graw Hill. USA
- Freeman, J., Robert, Shoulders, D. Craig, Allison, S. Gregory, Patton, K. Terry and Smith, G. Robert Jr., 2011. *Governmental and Non Profit Accounting*. 9th ed. Pearson
- Funnell, Warwick. Cooper, Kathie and Lee, Janet, 2012. *Public Sector Accounting and Accountability in Australia*. 2nd edition. UNSW Press Book.
- Gamawan Fauzi, 2011. "MENDAGRI: Pelaporan Keuangan Pemda Tidak Efisien", Kompas, Rabu, available at <http://nasional.kompas.com/read/2011/11/09/20521763/Mendagri.Pelaporan.Keuangan.Pemda.Tidak.Efisien>.
- Gelinas, J., Ulrich, Dull, B. Richard and Wheeler, R. Patrick, 2011. *Accounting Information Systems*. 8th edition., South Western, Cengage Learning.
- Gross, J. Malvern, Gross, Mc. Carty, H. John, Selmon, E. Nancy, 2005. *Financial and Accounting Guide for Not-for-Profit Organizations*, 7th edition. John Wiley and Sons.
- Hadi Poernomo, 2010. "BPK: Pemerintah Belum Berhasil Perbaiki Kualitas Pengelolaan Keuangan", Tempo, Selasa 13 April 2010, available at <http://www.tempo.co/read/news/2010/04/13/087239926/BPK-Pemerintah-Belum-Berhasil-Perbaiki-Kualitas-Pengelolaan-Kuangan>.
- Hadi Poernomo, 2013. "BPK Laporkan Temuan Penyimpangan Anggaran ke Presiden SBY", detikfinance, Kamis 4 April 2013, available at <http://finance.detik.com/read/2013/04/04/135657/2211489/4/bpk-laporkan-temuan-penyimpangan-anggaran-ke-presiden-sby>.
- Heintz, J.A., R.W. Parry, 2010, *College Accounting*, 20th edition. South Western-Cengage Learning.
- Henley, D., C. Holtham, A. Likierman, J. Perrin, 1989. *Public Sector Accounting and Financial Control*. 3rd edition. Van Nostrand Reinhold (International). Institute of Public Finance Accounting.
- Ingram, R.W., T.L. Albright, 2007. *Financial Accounting: Information for Decisions*. 6th edition. Thomson South-Western.
- Jones, P., Jefferson, Heitger, L. Dan, Mowen, M. Maryanne and Hansen, R. Don, 2011. *Cornerstones of Financial and Managerial*

Accounting, 2nd edition. South Western, Cengage Learning.

Kieso, D.E., J. Weygandt, T.D. Warfield, 2012. *Intermediate Accounting: IFRS Edition*, Volume 1. John Wiley and Sons Inc..

Lembaga Administrasi Negara dan Badan Pengawas Keuangan dan Pembangunan (LAN), 2000. *Accountability and Good Governance*. Jakarta, Lembaga Administrasi Negara Republik Indonesia.

Libby, Robert, Libby, A. Patricia and G. Short Daniel, 2011. *Financial Accounting*. 7th edition. McGraw-Hill.

Mack, Janet and Ryan, Christine, 2006. "Reflections on the theoretical underpinnings of the general-purpose", *Accounting, Auditing & Accountability Journal*, 19(4): 592 – 612.

Maher, M.W., C.P. Stickney, R.L. Weil, 2012. *Managerial Accounting: An Introduction to Concepts, Methods, and Uses*. 11th edition. South Western Cengage Learning.

Martin, W., Susan and West, N. Ellen, 2003. *Today's Essentials of Governmental and Not-for Profit Accounting and Reporting*, Waveland Press, Inc.

Narayanaswamy, R., 2011. *Financial Accounting: A Managerial Perspective*. 4th edition. PHI Learning Private Limited, New Delhi.

Needles, Belverd, E. Powers, M. Powers, Susan V. Crosson, 2008. *Principles of Accounting*. 10th edition. Cengage Learning.

Nikolai, Loren, A. Bazley, John, D. Jones, P. Jefferson, 2010. *Intermediate Accounting*. 11th edition. Cengage Learning.

Parker, L.D., J. Guthrie, 1993. "The Australian Public Sector in the 1990s: New Accountability Regimes in Motion", *Journal of International Accounting*.

Peraturan Menteri Dalam Negeri (Permendagri) Nomor 59 tahun, 2007. tentang Pedoman Pengelolaan Keuangan Daerah.

Peraturan Pemerintah Nomor 71 Tahun, 2010. tentang Standar Akuntansi Pemerintahan.

Pfister, 2009. *Managing Organizational Culture for Effective Internal Control: From Practice to Theory*. Springer-Verlag.

Porter, G.A., C.L. Norton, 2010. *Financial Accounting: The Impact on Decision Makers*. 7th edition.

Rezaee, Z., R. Riley, 2010. *Financial Statement Fraud Defined*. John Wiley and Sons Inc.

Ruppel, Warren, 2005. *Governmental Accounting Made Easy*. John Wiley and Sons, Inc.

Schipper, K., L. Vincent, 2003. "Earnings Quality", *Accounting Horizons*, 17: 97-110 (Supplement).

Sekaran, U., R. Bougie, 2010. *Research Method for Business: A Skill Building Approach*. Fifth Edition, John Wiley & Sons Inc. New York.

Skaife H.A., D.W. Collins, W.R. Kinney Jr., 2007. "The Discovery and Reporting of Internal

Control Deficiencies Prior to SOX-mandated Audits". *Journal of Accounting and Economics*, 44: 166-192.

Sri Mulyani, 2009. "Menteri Keuangan Desak Perbaikan Laporan Keuangan", *Tempo*, Selasa 11 Agustus, available at <http://koran.tempo.co/konten/2009/08/12/173658/Menteri-Keuangan-Desak-Perbaikan-Laporan-Keuangan>.

Stickney, Clyde, P. Weil, R. Roman, K. Schipper, F. Jennifer, 2010. *Financial Accounting: An Introduction to Concepts, Methods and Uses*. 13rd edition, South-Western, Cengage Learning.

Susilo Bambang Yudhoyono, 2012. "SBY Tidak Puas Atas Laporan Keuangan Pusat", *Tempo*, available at <http://bisnis.tempo.co/read/news/2012/05/30/087407185/sby-tidak-puas-atas-laporan-keuangan-pusat>.

Tunji, T., Siyanbola, 2013. "Effective Internal Controls System as Antidote for Distress in the Banking Industry in Nigeria", *Journal of Economics and International Business Research (JEIBR)*, ISSN: 2328-5907, 1(5): 106-121, available at <http://www.projournals.org/JEIBR>.

Undang-Undang Republik Indonesia Nomor 17 tahun 2003 tentang Keuangan Negara.

Undang-Undang Republik Indonesia Nomor 15 tahun 2004 tentang Pemeriksaan Pengelolaan dan Tanggung Jawab Keuangan Negara.

Wahlen, J.M., J.P. Jones, D.P. Pagach, 2012. *Intermediate Accounting: Reporting and Analysis*. South-Western Cengage Learning.

Wilson, Earl R. Reck, Jacqueline L. Kattelus, C. Susan, 2010. *Accounting for Governmental and Nonprofit Entities*, 15th edition. Mc.Graw-Hill Irwin.

Wittayapoom, K., S. Limsuwan, 2011. "How does internal control effectiveness create reliability of financial reporting? An empirical research of Thai listed firms", *Journal of Academy of Business and Economics*, 11-3 available at <http://www.freepatentsonline.com/article/Journal-Academy-Business-Economics/272484647.html>.

Young, R., Michael, 2012. *Financial Reporting Handbook*. APEN Publishers-CCH Incorporated financial reports of Australian government departments", *Accounting, Auditing & Accountability Journal*, 19(4): 592-612.