

The Effect of Total Quality Management Application on Internal Audit Function and Its Impact on the Financial Reporting Quality

(A Survey on the Bandung Municipal Government, West Java Province)

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Abstract

This study is aimed to determine the effect of Total Quality Management (TQM), which consists of Customer Focused, Continuous Improvement and Employee Empowerment, as well as the Internal Audit Function on the Financial Reporting Quality on SKPD (Regional Working Units) that have obtained ISO 9001:2008 certification in Bandung Municipal Government. Data were collected using a questionnaire instrument distributed to the relevant head of SKPD. The study was conducted by an explanatory research method. The collected data were tested for validity and reliability. The analytical method used was path analysis. Based on findings, it is found that Total Quality Management, which consists of Customer Focused, Continuous Improvement and Employee Empowerment, simultaneously affect the Internal Audit Function. The effect of each variable is significant between: (a) Customer Focused on Internal Audit Function; (b) Continuous Improvement on the Internal Audit Function, and (c) Employee Empowerment on Internal Audit Function. Furthermore, it is also found that Total Quality Management and the Internal Audit function directly and indirectly affect the Financial Reporting Quality. The effect of each variable is significant between: (a) Customer Focused Internal through Audit Function affects the Quality Financial Reporting, (b) Continuous Improvement through the Internal Audit Function affects the Financial Reporting Quality, (c) Employee Empowerment through Internal Audit function affects the Financial Reporting Quality, and (d) Internal Audit function directly affects the Quality Financial Reporting.

Keywords: Total Quality Management (TQM), Customer Focused, Continues Improvement, Employee Empowerment, Internal Audit Function, Financial Reporting Quality

1. Introduction

A new paradigm in the exercise of government has been rolling since the last decade starting in the 2000s as marked by the granting of authority to autonomous regions. The management processes of governance was changed from input minded to output minded. Performance measurement becomes important, so that in 1999 the President issued a Presidential Instruction No. 7/1999 on Government Institution Performance Accountability. The Presidential Instruction No. 7/1999 stresses that the government should be able to provide the best service to the public. The government should give priority to the interests of society and strive to meet public expectations with emphasis on service excellence and continuously improve service quality.

In order to meet the public's expectations, quality improvement should always be the goal and focus towards the wishes and expectations of the customer. This has to be burned into employee activity in every entity. All employees in these entities must work together to meet the desires and expectations of internal and external customers (Deming in Hawkes and Adams; 1994). One of the wishes and expectations of the public is the reliability of information entities.

Traditionally, the internal audit function is designed to safeguard company assets and ensure the reliability of accounting information as a basis for making decisions (Ebaid, 2011). Currently the internal audit function is dramatically shifted from the Compliance Assurance and asset safeguarding to the guarantor and value-added consulting service through its role in monitoring, evaluation, and risk management, control and governance processes to preserve and enhance stakeholder value (Bou-Raad, 2000 in Ebaid 2011). Thus, the internal audit function should be proactively focus on consumers with important issues of control, risk management and governance (Haas et al, 2006; Chapman and Anderson, 2002 in Ebaid 2011). In addition, the internal audit function must have an independent attitude and a focus on internal control. (Hawkes, and Adams, 1995). Thus at this time, the improvement of the quality of the internal audit function is critical in the success of the internal auditor.

This is consistent with the concept of Total Quality Management (TQM), such as the empowerment of the community, where the involvement of all employees to achieve organizational goals will be better. Implementation of TQM in the internal audit can improve the quality and internal audit functions (Rezaee, 1996). Implications of TQM for internal auditors should be viewed as a management philosophy and a systematic

process to improve services in the achievement of organizational goals.

Improvement in the quality of the overall aspects and scope of internal audit activities through the implementation of TQM will further support the performance of the internal auditors to ensure the reliability of financial information and non-financial, operational, and compliance with various regulations. Implementation of TQM in improving the function of the internal auditor is seen as adequate measures in the face of environmental demands that are dramatic and turbulent.

Through the involvement of all organizational units that exist, the internal audit function as one system of appraisal services and activities of the organization also plays a role through the provision of information for decision-making further. Such information is in the form of information on the effectiveness and efficiency of systems that support the implementation of the system, so that the system can meet customer satisfaction through the quality of products/services produced (Zainal and Young, 2009).

Rand (1994) conducted a study with a survey of 40 chief internal auditor and 25 quality directors in Ireland regarding respondent's understanding of TQM, showing the lack of understanding of the respondents on the principles of TQM and the low application of TQM methods in performing the internal audit function. Consequently, the relative contribution of the internal audit function will not provide a value-added in the form of suggestions and recommendations to support the efforts of management to provide optimal service to "customers".

The above conditions also occurred in Indonesia. Hiro (2003) explains that unoptimized contribution of internal auditors in Indonesia is still relatively low due to the competence and professionalism of most of the internal auditor. In general, the focus of the internal audit function activity in Indonesia is still in the old paradigm in which the internal audit function is limited to the aspects of the financial audit. In addition, due to the limited understanding of independence is still an internal audit function also affects the low contribution of internal audit. So the information is expected to improve the performance of the organization in the future because of the relative lack of optimal contribution to the internal audit function relative to actively involve themselves as an integral part of management.

TQM implementation through ISO 9000 certification has now become a vital requirement in all organizational units. According Fandi and Anastasia (2002), one of the keys to success in order to compete in the global marketplace is the ability to meet or exceed the applicable standards. One of the most important standard is ISO 9000, which is awarded by the International Organization for Standardization in Geneva, Switzerland.

Regulation of Bandung Municipality No. 09 of 2009 on Medium Term Development Plan (RPJMD) 2009-2013 states that to improve performance is to use the ISO quality standard series that is useful to develop guidelines for standards of work, enhance the image, professionalism, and increase the investment attractiveness. Based on the official website of Bandung Municipality (www.bandung.go.id) from 2007 to 2011 there have been 31 regional work units, hereinafter abbreviated as SKPD (including Office, Technical Institutions, and District) that are certified ISO of 60 SKPDs in Bandung. SKPD in Bandung has implemented ISO quality management by adopting the principles of Total Quality Management (TQM) to improve the quality of government services. The application is in the form of the ISO series.

Nursya'bini (2005) stated that TQM has a close connection with ISO. Most companies that apply the principles of ISO at the same time also adopted the principles of TQM. Many experts argue that the quality management ISO implementation is the first step implementation of TQM. This view came to be known as an optimistic outlook. Gotzamani and Tsotras (2001) in Nursya'bani (2005) stated that according to an optimistic view of ISO 9000 and TQM although there are differences, but the implementation of ISO is the first step towards TQM.

Hawkes et.al (1994) explains that the implications of TQM through the involvement of all levels of the organization that is supported by a variety of facilities and programs related impact on the order of culture, attitudes and activities of the organization as well as implications for the internal audit profession. A research by Hawkes et.al (1995) on the company's ISO 9000 certified manufacturing in New Zealand found that the results of the application of TQM has changed the roles and responsibilities of the internal audit function which in addition to focusing on the previous function, i.e. only on compliance auditing and assessing internal control companies but also more focused on the review of the quality management system. In general, it was concluded that although the application of TQM does not conflict with the role of internal auditors, but by implementing TQM the internal auditor must adjust its role in the implementation of TQM. This was done through a review of the quality assurance and process improvement work is directed through the implementation of TQM.

Researches by Shetwi et al. All (2011) and Gil Gras et al (2012) on the topic of the effect of the Internal Audit Function of the Financial Reporting Quality; Al-Shetwi found that there is a weak relationship between the Internal Audit Function Quality Financial Reporting, the implications of the research findings is that the Internal Audit Function only as a symbol of compliance with capital market regulations, which is why the company/organization in Saudia should increase the role of the Internal Auditor Function performance internal control and global recognition. Gras Gil also found in his research that the organization has a good quality of financial reporting should involve internal audit in reviewing the financial statements in order to improve the

quality of their financial reporting.

Fundamental phenomena underlying this study include the lack of understanding of top management in the low TQM and TQM implementation in the activity of the internal audit function in providing value-added information to the organization. These conditions will be identified in SKPD in Bandung that is ISO 9001:2008 certified, the population of this study, because according to the description above that ISO 9000 certified entity has applied the principles of TQM. Supported by the internal audit function within the Government of Bandung as certified ISO 9000, due to both ISO 9000 and TQM requires reconsideration or internal quality audit to be one of the principles of TQM and ISO 9000 and internal audit function is one tool that can accommodate this. Based on the description on the background above, the formulation of the problem in this study are: (1) How does Total Quality Management, which consists of Customer Focused, Continuous Improvement and Employee Empowerment, simultaneously and partially affect the Internal Audit Function; (2) How does Total Quality Management, which consists of Customer Focused, Continuous Improvement and Employee Empowerment, as well as the Internal Audit function, directly and indirectly affect the Financial Reporting Quality?

2. Literature Review and Research Hypothesis

2.1 Definitions and Principles of Total Quality Management

Vincent (2011) defines Total Quality Management as a way to improve performance continuously at every level of operation or process, in each functional area of an organization, using all human resources and capital available. This philosophy is most evident in TQM as taught by Deming, which is very good for basic in implementing continuous quality improvement.

Nursya'bani (2005) stated in his research that the International Organization on Standardization (ISO) and TQM are two things that have a close relationship. Most companies that implement ISO also adopted the principles of TQM. Nursya'bani (2005) also said that many of the experts who argue that the quality management ISO is the first step of the implementation of TQM. This view was later known as the optimistic view. This optimistic view states that the ISO and TQM although there are differences, but the implementation of ISO is the first step towards TQM.

According to Vincent (2011), ISO 9001:2008 is an international standard for quality management systems to establish requirements and recommendations for the design and assessment of a quality management system. The ultimate goal is to ensure that the organization will provide products (goods/services) that meet the requirements. Further Vincent (2011) explained that ISO 9001:2008 is based on eight structured quality management that is focused on the customer, leadership, involvement of people, process approach, system approach to management, continual improvement, factual approach to decision making, and relationships with suppliers favorable.

TQM principles are applied in the ISO standard by Rao et al (1996:20) stated that three (3) basic concepts of total quality management is the key to successful implementation of TQM, namely: (1) Customer focus; the value of the work done is determined by the customer; (2) Total participation; the person closest to the task is the most qualified to suggest improved ways of working. That person should be encouraged to the make and implement those suggestions as part of his or her daily work, (3) Continual improvement; the quality of work can always be improved, and this can be done or through gradual breakthroughs.

2.2 Internal Audit Function

Developments in audit, internal audit in particular, have embraced a variety of fields, not just the financial sector but also aspects of the achievement of the performance, operations, information systems, compliance, project management and effectiveness as well as other specialized tasks. As stated by Raider (2002): "..... that operational review of operations performed from a management viewpoint to evaluate the economy, efficiency, and effectiveness of any and all operations, limited only by management desires."

Sawyer (2003: 8-10), summarizes the new paradigm is based on the definition of the internal audit function of the IIA Board of Directors, as follows:

(1) An objective independent activity. The function and role of internal audit merely a slogan if the leadership and executor of the company's activities do not provide support performance form of action and commitment and actions that encourage the implementation of the company's internal auditor function as an independent part of the organization in support of corporate objectives. Furthermore, as the feedback from the existence of organizational independence of the internal audit, the internal audit function should be able to meet the demands and expectations of management through services rendered;

(2) An activity providing confidence and assurance consultancy. Internal audit activity is to examine and assess the effectiveness and adequacy of internal control systems that exist within the organization. Without the internal

audit function, the board of directors and or head unit does not have the internal resources that are independent of the performance of the organization. Thus, the existence of an internal audit function should be instrumental in the company's operations are expected to provide an assurance that can assure its customers especially corporate boards of directors and commissioners. That assurance can obtained through evaluation and testing results of the efficiency and effectiveness of the overall internal control and consulting services to improve the company's operating system in order to meet customer satisfaction;

(3) A function that is designed to provide an added value and improve an organization's activities. The emphasis is on the evaluation of internal audit performance from when planning to the final outcome of any decisions, policies and strategies implemented by management. According to the dynamics of today's business that has been accommodated by the IIA, internal audit concept is no longer simply to test whether undertaken by management in accordance with what is prescribed (compliance), but it is related to the analysis of an organization's ability to react to changing circumstances and to the provision of impartial advice to senior management on all aspects of policy that has been implemented. The analysis is presented through the provision of comprehensive advice that leads to the achievement of the company in both operational efficiently, economically and effectively. So the role of the internal auditor can provide an added value rather than just test and evaluate the compliance of internal controls implemented by management;

(4) A function that assist organizations in achieving their business objectives. In the past, the paradigm and mindset of internal auditors is still in a limited perspective which only focuses on the effectiveness and efficiency of existing systems. But now, paradigms and mindsets internal auditor should be a broader emphasis on business opportunities (opportunity) that can support the goals of the company and ensure its survival in the long term so as to survive and win the competition with its competitors. Each pursues of an opportunity always exposes to risk, so the risk becomes important. Internal audit function's interest is to see whether the risks have been well-managed by the management and also has reduced the impact;

(5) A function that provides a systematic disciplined approach to evaluate and improve the effectiveness of risk management, control and regulation processes, and organizational management. Risk management is a systematic and logical method for identifying, analyzing, evaluating, treating, monitoring and communicating risks associated with any activity, function or process that will enable organizations to minimize losses and maximize opportunities. The role of internal auditors in an organization to risk management has changed over time, and the role of internal auditors between the organizations with other organizations varies. This is because not all organizations view risk in the same way or not all organizations have a risk management complexity at the same level. In order for the risk management of the organization can run effectively, the internal auditor should determine the role of risk management in accordance with the conditions that exist in the organization through a systematic approach.

2.3 Financial Reporting Quality

The main objective of financial reporting in accordance with FASB (2008) and Beest et al (2009) is to present quality financial information and useful for decision making. These variables are measured using the properties characteristic of financial reporting.

Kieso et.al (2002:45) state that relevance and reliability are the two primary qualities that make accounting information useful for decision making. As stated in Concepts Statement No.. 2 FASB "primary qualities that distinguish information that is" better "(more useful) information from the" inferior "(less useful) is the relevance and reliability, as well as a number of other characteristics contained in both these qualities. Qualitative characteristics of financial statements in general by Indra Bastian (2006: 97) include Relevant, Reliable, Comparable, and Comprehensible.

2.4 Framework and Hypothesis

Total Quality Management (TQM) is a philosophy and approach developed by Deming and Juran in 1940 in USA. TQM states that all employees in each entity must work together to meet the desires and expectations of internal and external customers through to get it on the first time the true. Internal auditors who serve as unit activity and appraisal of existing systems in the organization also plays a role through the provision of information for decision-making further. Such information, in the form of information on the effectiveness and efficiency of existing systems within the organization that supports the implementation of the system, so that the system can meet customer satisfaction through the quality of products/services produced (Zainal and Young, 2009).

Improvement in the quality of the overall aspects and scope of internal audit activities through the implementation of TQM will further support the performance of the internal auditors to ensure the reliability of financial information and non-financial, operational, and compliance with various regulations. Implementation

of TQM in improving the function of the internal auditor is seen as adequate measures in the face of environmental demands that are dramatic and turbulent.

Globally, the International Organization on Standardization (ISO 9000) has set the standard measure of quality and provides guidance on quality assurance of products and services on an ongoing basis. In general, the goal of TQM is to create a competitive advantage by focusing on the business needs of customers/clients both internal and external to the organization.

This study is based on a research by Hawkes et.al (1995) and article by Rezaee (1996) on the topic of the effect of applying TQM to the Internal Audit Function, and researches by Shetwi et al. All (2011) and Gras Gil et al. (2012) on the topic of the effect of the Internal Audit Function on Quality Financial Reporting. Nursya'bani (2005) stated ISO and TQM are two things that have a close relationship. Most companies that implement ISO also adopted the principles of TQM. TQM variables in this study are translated into subvariables based on explanation from Rao et.al. (1996) and Vincent (2011), namely: (1) Customer Focus, (2) Continual improvement, and (3) Employee Empowerment.

Through the description of three (3) main components of TQM, namely Total, Quality, and Management, Rezaee (1996) describes the effect of TQM elements on the internal audit function. Total shows the overall internal audit function including the director and the internal audit staff should be involved in efforts to meet customer satisfaction, and make it a routine. Efforts to meet the customer satisfaction mainly lie in the scope of the internal audit customer fulfillment, ie stakeholders who need quality information. Quality is service organizing efforts aimed at internal audit function in order to meet customer satisfaction. Management is organizing efforts all available resources towards the improvement of the performance of the internal audit function on an ongoing basis. Adoption of TQM must be initiated by the head of internal audit. Patterns of leadership of the head of internal audit is a key factor in the successful implementation of TQM which can be done through the proper translation of TQM, the direction or management of the processes, and the internal audit staff training.

In this regard, referring to the case of World-Com, where the New York Stock Exchange (NYSE) listed company requires the overall increase its internal audit function to assist management and the audit committee by providing continuous information about the risks that occur during the process of management and control systems internal company. This condition is emphasized critically by Harrington (2004) that the internal audit function can meet the demands and expectations of the stakeholders who support a comprehensive assessment of the overall activity and is able to pass judgment on the optimization of value-added activities required towards customer satisfaction.

Sawyer (2003: 8-10), summarizes the new paradigm is based on the definition of the internal audit function of the IIA Board of Directors, are as follows: (1) An objective independent activity, (2) An activity providing confidence and assurance consultancy; (3) a function that is designed to provide an added value and improve an organization's activities, (4) a function that assists organizations in achieving their business objectives, and (5) a function that provides a systematic disciplined approach to evaluate and improve the effectiveness of risk management, control and the regulatory process, and organizational management.

Structure of the aforementioned internal audit function is a refinement of previous internal audit function which not only focuses on the role and purpose of the internal audit function but also include the identification of opportunities and responsibilities of the internal audit function as an integral part of the management of an entity. In addition to covering approaches related to risk management, compliance and supervision must be developed by the internal auditor; the above description also includes an emphasis on creating value-added activities in accordance with the philosophy of TQM.

The main objective of financial reporting is to present quality financial information about economic entities, especially financial information in real, useful in decision making (FASB, 1999; IASB, 2008). Presenting quality financial information is important because it can be a positive effect on stakeholder decisions (IASB, 2006: IASB, 2008). The implications of the above suggest that the focus of financial reporting quality measures relating to financial reporting properties. Based on Government Regulation No. 71 of 2010 Concerning Government Accounting Standards, the financial statements are prepared to provide relevant information regarding the financial position and all transactions are carried out by a reporting entity during the reporting period. Government financial reporting should provide information useful to users in assessing accountability and making good decisions in economic, social, and political with: (a) provide information regarding the adequacy of current period revenue to cover all the expenses, (b) provide information on the suitability way obtain economic resources and allocations within the budget set and regulations, (c) Provide information on the amount of economic resources that are used in the reporting entity's activities and the results achieved, (d) Provide information on how to fund the reporting entity its operations and meet its cash needs, (e) Providing

information regarding the financial position and condition reporting entities associated with the sources of revenues, both short term and long term, including those derived from taxation and borrowing, (f) Provide information on the change of position financial reporting entity, whether an increase or decrease, as a result of activities undertaken during the reporting period. A reliable financial statement is one of the qualitative characteristics of financial statements. Reliability of the financial statements are financial statements that are free from the sense of his information is misleading and material errors, presenting every fact to be honest, and verifiable. Reliably meet the characteristics of the information that is: (a) Presentation of honest, truthful means information describing the transaction and other events should be presented or that may reasonably be expected to be served, (b) can be verified, that the information presented in the financial statements can be tested, and if testing is done more than once by different parties, the results still indicate a conclusion that does not vary much, (c) Neutrality, means information aimed at the general requirements and are not in favor of the needs of a particular party.

Based on the above description, the framework in this study can be described as follows:

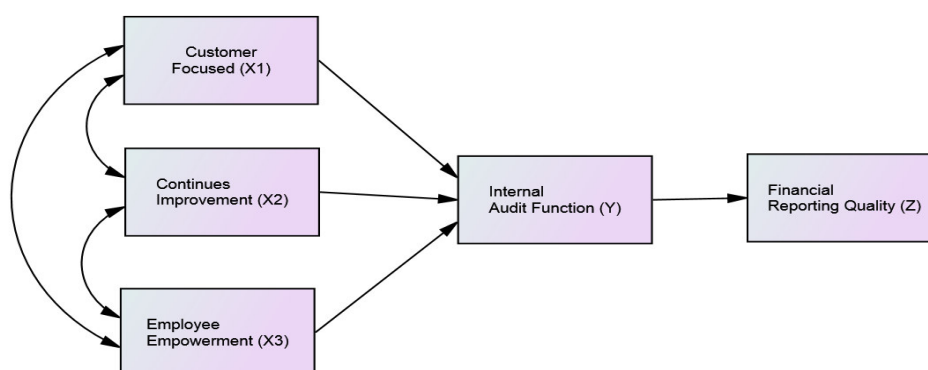


Figure 1
Framework

Hipotesis 1 : Application of Total Quality Management (TQM) by Customer Focused, Continuous Improvement, and Employee Empowerment simultaneously and partially significant effect on the Internal Audit Function.

Hipotesis 2 : Total Quality Management, which consists of Customer Focused, Continuous Improvement and Employee Empowerment, as well as the Internal Audit function directly and indirectly affect the Financial Reporting Quality.

3. Approach and Methodology

3.1 Research Methods and Data Collection Techniques

The method used is explanatory research method. Furthermore, to test the hypothesis, data were collected through questionnaires, interviews, and documentation.

3.2 Target Population and Research Sample

The study was conducted at all SKPD which has been certified ISO 9001:2008 in the Bandung Municipality Government. Purposive sampling was used as the sampling technique. Unit of analysis (respondent) in this study is the Head of SKPD as many as 31 persons. Selection of the unit of analysis refers to the study by Hawkes et al (1995) and Rezaee (1996) who explain that the authority of top management is the most competent to give an answer based on existing questions in the questionnaire based on the fact that the role of top management in the overall empowering all officers who were in line management role very important. Empowerment also includes an internal audit function, which is in the concept of TQM, which exist within the overall structure of the organization are involved in the fulfillment of customer satisfaction through continuous quality improvement.

3.3 Operation of Variables

Independent Variable in this study is Total Quality Management (X), which consists of sub-variables Customer Focused (X1), Continuous Improvement (X2), and Employee Empowerment (X3). This variable is measured by an instrument developed based on the basic philosophy of TQM, according to the explanation by Rezaee (1996), that one of the attributes and characteristics of TQM is directly related to internal audit is the basic philosophy of TQM adoption invoke the function/activity of internal audit. Each of these sub-variables is measured with 18 statements for Customer Focused, 15 statements for Continuous Improvement, and 9 statements for Employee

Empowerment.

Dependent Variable in this study is the Financial Reporting Quality (Y). The main objective of financial reporting in accordance with FASB (2008) and Beest et al (2009) is to present quality financial information and useful for decision making. These variables were measured using the properties characteristic of financial reporting. To measure this variable, 20 statements were used after being developed based on the characteristics of financial statements in accordance with FASB.

Intervening Variable in this study is the Internal Audit Function (Z). Internal Audit function is defined in this study in accordance with the definition of the Institute of Internal Auditors (1999) in Sawyer (2003: 8-10) that "internal auditing is an independent, objective, assurance and consulting activity designed to add value and improve an organization 'operations. It helps an organization Accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance process ". Aligned with the implementation of TQM in the organization that Rezaee (1996) emphasized, the internal audit function should be tailored to the principles of TQM which through internal improvements and responding to external customers, internal auditors can provide a new form of service for all levels of management. This variable is measured with an instrument that has been tested and promoted by Hawkes et.al (1995) that were modified based on the new paradigm of the internal audit function as described in the definition of the internal audit function which is developed by the IIA. To measure this variable, 10 statements were used.

These instruments above consist of item questions that are grouped into one construct with answer choices using 5 point Likert scale, which was modified in such a way with the conditions and objectives of this study.

3.4 Testing the Research Instruments

3.4.1 Data Validity Test

Validity test was conducted to determine whether the instruments used have been able to measure the actual. Product moment correlation was used in the calculation of validity. Table 1 shows the results of testing the validity of the Pearson product moment correlation (r):

Table 1 : Questionnaire Validity of Test Results

Variable	The Range of values r	R-Critic	Description
Customer Focused (X ₁)	0.374 – 0.654	0.355	All Valid
Continous Improvement (X ₂)	0.381 - 0.738	0.355	All Valid
Employee Empowerment (X ₃)	0.416 – 0.833	0.355	All Valid
Internal Audit Function (Z)	0.429 – 0.760	0.355	All Valid
Financial Reporting Quality (Y)	0.403 – 0.780	0.355	All Valid

3.4.2 Data Reliability Test

Reliability can be defined as a characteristic associated with the accuracy, precision and consistency. Cronbach alpha technique was used in testing the reliability of research data. Table 2 shows the results of reliability testing as follows:

Table 2 : Reliability Test Results Questionnaire Research

Variable	Reliability Coeficients	Significance N= 31	Description
Customer Focussed (X ₁)	0.818	0.355	Reliable
Continous Improvement (X ₂)	0.800	0.355	Reliable
Employee Empowerment (X ₃)	0.810	0.355	Reliable
Internal Audit Function (Z)	0.772	0.355	Reliable
Financial Reporting Quality (Y)	0.878	0.355	Reliable

3.5 Hypothesis Test

Hypothesis Test was conducted using path analysis with Amos Ver.19.0.

4. FINDINGS AND DISCUSSION

4.1 Findings

Description of study variables was obtained from the value score, on average, percentage, and a category for each of the variables, dimensions, and indicators. Customer Focused variable (X₁), Continuous Improvement

(X2), Employee Empowerment (X3), the Internal Audit Function (Z), and Financial Reporting Quality (Y) was assessed by the 31 Heads of SKDP in Bandung Municipality Government. By using a range of provisions (r) = 5.00 to 1.00 (the highest average score minus the lowest average score), and many criteria (k) = 5, it was obtained length class (p) = $r / k = 4/5 = 0.8$.

Variable Total Quality Management (X) consists of three sub-variables, namely: (1) Customer Focused (X1), (2) Continuous Improvement, and (3) Employee Empowerment. Each sub-variables, consisting of dimensions / indicators that can be measured. Respondents' responses based on the average performance value, percentage, and sub-categories for each of these variables are presented in Table 3 below.

Table 3
 Achievements, Average, Percentage, and each sub-category variable
 the variable Total Quality Management

Dimension	Average	Percentage	Category
<i>Customer focused</i>	3.860	77.2	High
<i>Continous Improvement</i>	3.830	76.6	High
<i>Employee Empowerment</i>	3.240	64.8	Medium
Total Quality Management (X)	3.643	72.9	High

Source: Primary Data Processing (2013)

From Table 3, it can be stated that in general the average achievement of Total Quality Management variable is 3.643 (from the interval 1.000 - 5.000) with achievement percentage of 72.9%, which is considered as a high category. In other words, total quality management in the SKDP environment of Bandung Municipal Government has been effective. Sub-variable of the most prominent of these variables is Customer Focused, achieving an average of 3.860 followed by sub-variable Continuous Improvement at 3.830. The relatively low sub-variable in this variable is Employee Empowerment dimension with 3.240.

Internal Audit Function variable (Z) consists of five dimensions, namely (1) Independent activity, (2) Provision of Assurance (3) Value Added, (4) Achievement of the Organization, and (5) Systematic Approach. Respondents' responses based on the average achievement value, percentage, and categories are presented in Table 4 below.

Table 4
 Achievements Average, Percentage, and Categories for every Dimension on
 the Internal Audit Function Variables

Dimensi	Rerata	Persentase	Kategori
Independen Activity	4.500	90.0	Very High
Provision of Assurance	4.387	87.7	Very High
Value Added	4.016	80.3	High
Achievement of Organization	4.161	83.2	High
Systematic Approach	3.919	78.4	High
Fungsi Audit Internal (X2)	4.197	83.9	High

Source: Primary Data Processing (2013)

From Table 4, it can be concluded that in general the average achievement of the Internal Audit Function variable is 4.197 (from the interval 1.000 - 5.000) with a performance percentage of 83.9%, which is a high category. In other words, the internal audit function in the SKDP of Bandung Municipal Government has been going well. The most salient dimension of this variable is independent activity dimension with achievement of an average of 4.500, followed by the Assurance Provision of 4.387, and 4.161 for Organizational Achievement. The relatively low dimensions in this variable are value added dimension with 4.016 and 3.919 for Systematic Approach dimension.

Financial Reporting Quality variable (Y) consists of four dimensions, namely (1) relevant, (2) reliable, (3) comparable, and (4) comprehensible. Respondents' responses based on the average performance value, percentage, and categories are presented in Table 5 below.

Table 5
 Achievements Average, Percentage, and Categories for every Dimension
 on Financial Reporting Quality Variables

Dimension	Average	Percentage	Category
Relevant	4,013	80,3	High
Reliable	3,400	68,0	Medium
Comparable	3,355	67,1	Medium
Comprehensible	3,955	79,1	Medium
Financial Reporting Quality (Y)	3,681	73,6	High

Source: Primary Data Processing (2013)

From Table 5, it can be concluded that in general the average achievement Financial Reporting Quality variable is 3.681 (from the interval 1.000 - 5.000) with a performance percentage of 73.6%, which is a high category. In other words, the Financial Reporting Quality in the SKDP in Bandung Municipal Government is qualified. The most salient dimension of this variable is relevant dimension with an average of 4.013, followed by the comprehensible dimension with 3.955. The relatively low dimensions in this variable are reliable dimension with an average of 3.400 and comparable dimension with 3.355.

4.2 Discussion

First Hypothesis Test. The hypothesis is that Total Quality Management, which consists of Customer Focused, Continuous Improvement and Employee Empowerment, simultaneously and partially affects the Internal Audit Function. This hypothesis was stated in three (3) sub-Hypothesis, namely: (a) Customer Focused significantly affects the Internal Audit Function, (b) Continuous Improvement significantly affects the Internal Audit Function, and (c) Employee Empowerment significantly affect the Audit Function internal. To perform correlative relationship, this study used path analysis technique to find out the effect of each variable on other variables. Path calculation results for the first Hypothesis by using AMOS ver 19.0 are presented as follows.

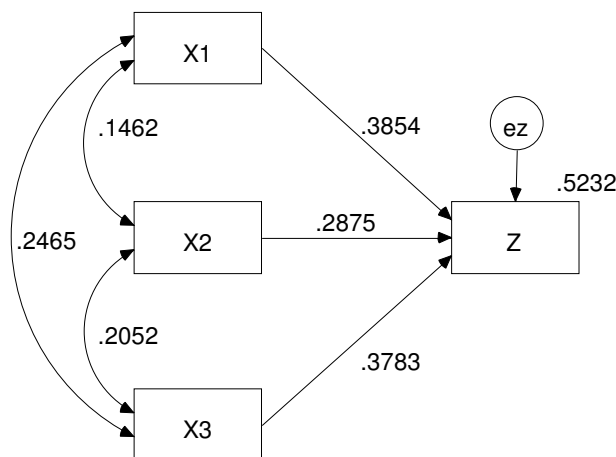


Figure 5
 Line Diagram X₁, X₂, and X₃ to Z

Line equation obtained is $Z = 0.3854 X_1 + 0.2875 X_2 + 0.3783 X_3 + ez$. Simultaneous effect (R²) being obtained amounted to 0.5232 or 52.32%. As for effects other than X₁, X₂, and X₃ to Z is equal to $1 - R^2 = 1 - .5232 = .4768$ or 47.68%. Based on the fit model, the values obtained FMIN and CMIN = 0.000, which indicates that the model is an excellent fit with the data (model fits perfectly).

To see the significance of each of the exogenous variables (X₁, X₂, and X₃) of the endogenous variables (Z), the test statistic used is the t-test, t-test value for the ZX₁, ZX₂ and ZX₃ is at 2.9476; 2, 2202 and 2.8621 which is greater than t-table value = 2.0484 with $\alpha = 0.05$. Significance can also be seen that all the p-value is in that 0.05. The calculations show that the pathway ZX₁, ZX₂ and ZX₃ significant, as presented as follows.

Table 6 : significance of each exogen variable (X₁, X₂, and X₃) on endogen variable (Z)

			Estimation	S.E.	t-count	P-value	Note
Z	<---	X1	0.3854	0.0914	2.9476	0.0032	Significant
Z	<---	X2	0.2875	0.1024	2.2202	0.0264	Significant
Z	<---	X3	0.3783	0.1169	2.8621	0.0042	Significant

Source: Primary Data Processing (2013)

This means that Total Quality Management, which consists of Customer Focused, Continuous Improvement and Employee Empowerment, has significant effect on the Internal Audit Function. Thus it can be stated that the first Hypothesis and sub-hypothesis is accepted.

Judging from the value of its path, the path of the Z X1 is greater than X2 or X3 line value to Z. This indicates that the sub-variable Customer Focused on Internal Audit Function has greater effect than the effect of the sub-variables Continuous Improvement and Employee Empowerment.

These results are consistent with the research by Hawkes et.al (1995) on the company's ISO 9000 certified manufacturing in New Zealand, who found that the application of TQM has changed the roles and responsibilities of the internal audit function which in addition to focusing on the previous function, that is only on audit and assessing compliance of internal control but also more focused on the review of the quality management system. In general, it was concluded that although the application of TQM does not conflict with the role of internal auditors, but with the implementation of TQM the internal auditor must adjust its role in the implementation of TQM. This was done through a review of the quality assurance and process improvement work is directed through the implementation of TQM. Hawkes et.al (1995) stated that Total Quality Management (TQM), such as the empowerment of the community, where the involvement of all employees to achieve organizational goals will be better. Implementation of TQM in the internal audit can improve the quality and internal audit functions. TQM implementation through ISO 9000 certification has now become a vital requirement in all organizational units. Nursya'bani (2005) stated ISO and TQM are two things that have a close relationship. Most companies that implement ISO also adopted the principles of TQM.

In accordance with Rezaee (1996), through the description of three (3) main components of TQM that is Total, Quality, and Management, the effect of TQM elements on the internal audit function is described. Total shows the overall internal audit function including the director and the internal audit staff should be involved in efforts to meet customer satisfaction, and make it a routine. Efforts to meet customer satisfaction is primarily located in the sphere fulfill the customer satisfaction of internal audit, the stakeholders who need quality information. Quality, service organizing efforts aimed at internal audit function in order to meet customer satisfaction. Management is organizing efforts all available resources towards the improvement of the performance of the internal audit function on an ongoing basis. Adoption of TQM must be initiated by the head of internal audit. Patterns of leadership of the head of internal audit is a key factor in the successful implementation of TQM which can be done through the proper translation of TQM, the direction or management of the processes, and the internal audit staff training.

The results support the research by Zainal and Young, (2009) who conducted a study on Manufacturing Companies certified ISO 9000 in North Sumatra, that the application of TQM is based on customer focus; continuous improvement, and employee empowerment, both simultaneously and partially have significant effect on the function internal audit.

Second Hypothesis Test. The second Hypothesis proposed is Total Quality Management, which consists of Customer Focused, Continuous Improvement and Employee Empowerment, as well as the Internal Audit function directly and indirectly affect the Financial Reporting Quality. This hypothesis test can be divided into four (4) sub-Hypotheses, namely (a) the Customer Focused through Internal Audit function has an effect on Quality Financial Reporting, (b) Continuous Improvement through Internal Audit Function has an effect on Quality Financial Reporting, (c) Employee Empowerment through Internal Audit Function has an effect effect on Financial Reporting Quality, and (d) Internal Audit Function has a direct effect on the Quality Financial Reporting. Path calculation results for the second Hypothesis using AMOS Ver 19.0 are presented as follows.

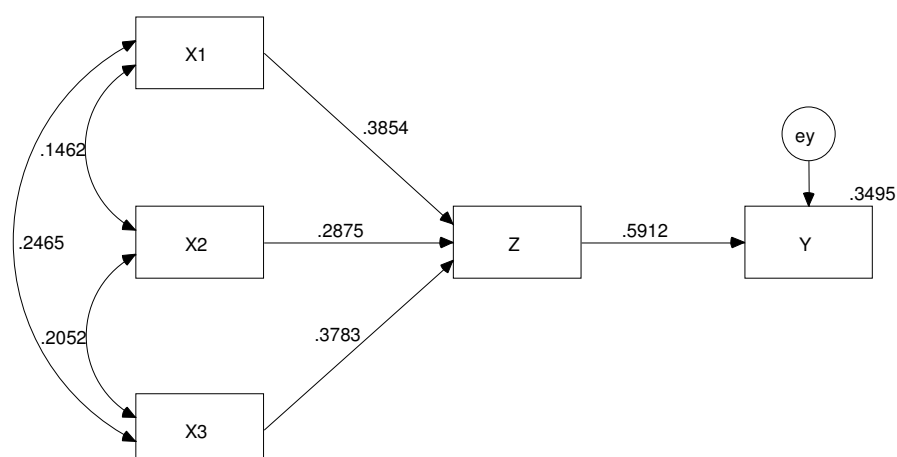


Figure 6
 Line Diagram of X1, X2, X3 through Z to Y

Line equation obtained was $Y = 0.5912 Z + ey$. Effect (R^2) obtained amounted to 0.3495 or 34.95%. The other effect on Y is equal to $1 - R^2 = 1 - 0.3495 = 0.6505$ or 65.05%. Based on the fit model, a score based on the fit model, value $CMIN/df$ obtained = 0.456 under 5. This indicates that the model fits with or suit the data. Significance of each path is calculated using t-test. T-test calculation results are presented as follows.

Table 7 : Significance calculation of each path

			Estimation	S.E.	t-count	P	Note
Z	<---	X1	0.2694	0.0914	2.9476	0.0032	Significant
Z	<---	X2	0.2273	0.1024	2.2202	0.0264	Significant
Z	<---	X3	0.3347	0.1169	2.8621	0.0042	Significant
Y	<---	Z	1.2098	0.3013	4.0148	0.0000	Significant

Source: Primary Data Processing (2013)

The calculations show that the value of t-count-and P-values for each path is significant. Thus it can be stated that the second Hypothesis and sub-hypothesis are accepted. Calculation of direct and indirect effects is presented as follows.

Table 8 : calculation of direct and indirect effect between variables

Path	Effect		Total
	Direct	Indirect (through Z)	
X1	0.0000	0.2279	0.2279
X2	0.0000	0.1699	0.1699
X3	0.0000	0.2236	0.2236
Z	0.5912	0.0000	0.5912

Source: Primary Data Processing (2013)

The calculations showed that the direct effect of the Audit Function on Financial Reporting Quality is relatively significant, and that the most significant indirect effect on Financial Reporting Quality is the path X1, namely Customer Focused, followed by Employee Empowerment and Continuous Improvement.

Overall, the entire model in this study can be described as follows.

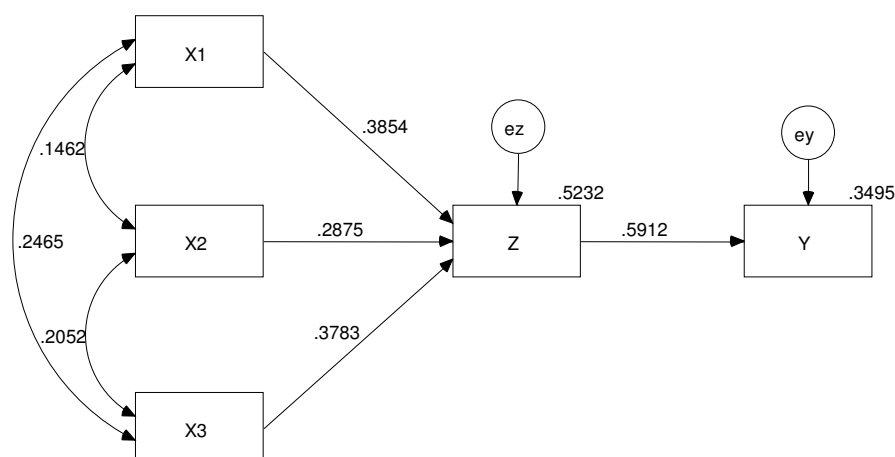


Figure 7
 Path Analysis Model of X1, X2, X3 through Z to Y

Based on the analysis of data, there is some objective information that indicates the suitability of the proposed model (fit) to the data. Based on the results of t-test against empirical path coefficient, the second Hypothesis can be accepted for testing based on path coefficients X1, X2, X3 through Z to Y are statistically significant. Effect (R²) Z to Y is equal to 0.3495. This means that the variable Y can be explained by the variable Z at 34.95%.

The results support the research by Hawkes et.al (1995) on the company's ISO 9000 certified manufacturing in New Zealand, which found that the results of the application of TQM has changed the roles and responsibilities of the internal audit function which in addition to focusing on the previous function, that is only on audit and assessing compliance of internal control but also more focused on the review of the quality management system. In general, it was concluded that although the application of TQM does not conflict with the role of internal auditors, but with the implementation of TQM the internal auditor must adjust its role in the implementation of TQM. This was done through a review of the quality assurance and process improvement work is directed through the implementation of TQM.

While the results of this study which show the effect of the Internal Audit Function of the Financial Reporting Quality is achieved by 34.95% (another factor of 65.05%), proving that the research carried out by Al-Shetwi et. Al (2011) and Gras Gil et al (2012) on the topic of the effect of the Internal Audit Function on the Financial Reporting Quality; Al-Shetwi found that there is a weak relationship between the Internal Audit Function on Quality Financial Reporting, the implications of the research findings is that the Internal Audit Function only as a symbol of compliance with capital market regulations, which is why the company/organization in Saudia should increase the role of the Internal Auditor Function performance internal control and global recognition. Gras Gil also found in his research that the organization has a good quality of financial reporting should involve internal audit in reviewing the financial statements in order to improve the quality of their financial reporting.

Furthermore, in order to meet public expectations of quality improvement, there should always be the goal and focus on the wishes and expectations of the customer to be embraced into employee activity in an entity. All employees in these entities must work together to meet the desires and expectations of internal and external customers. (Deming in Hawkes and Adams; 1994). Wishes and expectations of the public one is the reliability of information entities.

5. CONCLUSIONS AND LIMITATIONS OF STUDY

5.1 Conclusion

Based on the results of research conducted to determine the effect of the application of Total Quality Management (TQM), which consists of Customer Focused, Continuous Improvement and Employee Empowerment, as well as the Internal Audit Function on Financial Reporting Quality at SKPD certified ISO 9001:2008 in Bandung Municipal Government, as well as discussion that has been described previously, the following Conclusions can be drawn:

1. Total Quality Management, which consists of Customer Focused, Continuous Improvement and Employee

- Empowerment simultaneously affect the Internal Audit Function. It can be concluded that the effect of each variable is significant between: (a) Customer Focused on Internal Audit Function; (b) Continuous Improvement of the Internal Audit Function, and (c) Employee Empowerment on Internal Audit Function.
2. Total Quality Management, which consists of Customer Focused, Continuous Improvement and Employee Empowerment, as well as the Internal Audit function directly and indirectly affect the Financial Reporting Quality. It can be concluded that the effect of each variable is significant between: (a) Customer Focused through Internal Audit Function has a significant effect on Quality Financial Reporting, (b) Continuous Improvement through the Internal Audit Function has significant effect on Financial Reporting Quality, (c) Employee Empowerment through Internal Audit Function has significant effect on Financial Reporting Quality, and (d) Internal Audit function directly affects the Quality Financial Reporting.

5.2 Limitations of Study

This study has several limitations or drawbacks. Limitations in this study are expected to be addressed by subsequent researchers.

1. The first limitation is the sample being used. Although this study employs the entire population, but its scope is the SKPD that have obtained ISO 9001:2008 in Bandung Municipal Government, so the results of this study cannot be generalized to the possibility of SKPDs or other unit/government reporting entity as a whole. Therefore, subsequent research should be able to take a broader research object.
2. This study is limited to research on Total Quality Management (TQM), which consists of Customer Focused, Continuous Improvement and Employee Empowerment, as well as the Internal Audit Function on Quality Financial Reporting at SKPD that have obtained ISO 9001:2008 on Quality Management System. Further research can be conducted on SKPD with and without ISO certified.

Variables that can determine the Financial Reporting Quality is not just limited to the variable Total Quality Management (TQM), but also the Internal Audit Function. Further research can be conducted by adding another variable affecting the identified Financial Reporting Quality.

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