

Internal Control System on the Quality of Financial Statement Information and Financial Accountability in Primary Schools in Bandung, Indonesia

Aristanti Widyaningsih

Doctoral Student in Accounting Sciences, University of Padjadjaran, Indonesia
Lecturer of Accounting Study Program in Indonesia University of Education

Abstract

Purpose – The purpose of the present study is to get an overview of the implementation of internal control systems associated with financial statement information quality and financial accountability in primary schools in Bandung, Indonesia. **Design/methodology/approach** – This study used the path analysis technique to process data from 168 samples with units of analysis of the study are primary schools in Bandung, Indonesia. **Findings** – Control environment and control activities have significant influence on the quality of financial statement information. The quality of financial statement information has significant influence on the quality of financial accountability in primary schools in Bandung. **Originality/value** – The implementation of internal control system in public sector institutions, primary schools.

Keywords: Internal Control System, Financial statement Information Quality, Financial Accountability

Background

The realization of governance and institutional governance based on the principle of Good School Governance as one of the development goals of Education Unit is a necessity to be able to design and develop a model of Schools Internal Control System (Sistem Pengendalian Intern Sekolah or SPIS). One strategy to achieve this goal is by strengthening accountability and improved image of the school, as well as improving the quality of governance and institutional governance.

In Indonesia, the Internal Control System (as stipulated in Law No. 1 of 2004 on State Treasury) is designed to improve performance, transparency, and accountability in financial management of an organization. Direction of the Internal Control System (Sistem Pengendalian Intern or SPI) is to improve the practice of bureaucratic organizational performance and financial performance, in the form of performance reports and financial statements. Implementation of SPI will support an increase in the reliability of performance report and reliability of financial reporting.

Starting in July 2005, the government passed the School Operational Assistance (Bantuan Operasional Sekolah or BOS) as a program run by the government for the provision of funding for basic education unit as the executor of compulsory education in Indonesia. The purpose of the provision of BOS funds are as assistance to schools in order to free students from tuition, but the school still be able to maintain the quality of education services given to the community. The consequences of this aid, in an accounting perspective, every school principal must submit a report on the financial sector, especially regarding the revenues and expenditures of the school to the School Committee and the government. Thus, the accounting standards applied as reporting criteria are presented to the school management. This will ensure public accountability, especially for users of educational services (Indra Bastian, 2007).

Meanwhile, from the perspective of public administration, financial management goal of education is to help the management of financial resources of educational organizations and creating the appropriate control mechanisms, for financial decision making in achieving the educational organization that is transparent, accountable and effective (Indra Bastian, 2007). Good control of the financial management educational administration will provide a good social responsibility to the various interested parties (stakeholders) (Sutedjo, 2010: 20).

Punctuality is crucial in financial reporting, because the relevant and reliable reports can be irrelevant if there is a delay in the presentation (Kateeba, 2010: 28). According to Gale (2003) in Kateba (2010: 27), the low quality of financial reporting greatly reduces the quality of the institution itself. The quality of information includes readable, reliable, comparable, consistent, complete, timely, decision-useful, accessible and cost effective. The best integrity served by the nonprofit sector is accountability (Gale, 2003) in Kateba (2010: 29).

The main purpose of accountability is to encourage the creation of school performance accountability as a condition for the creation of a good and reliable school. School administrators should be able to account for all components of the management of the school to the community. Not only does accountability involve a learning process, but also about the financial management, and output quality (Mardiasmo, 2004).

Financial accountability can be measured from the small number of irregularities in the financial management of the school. Sources of income, the size of the reception, as well as the distribution, all can be

accounted for by the manager (Haryanto, 2007). Accountable financial managers will earn the trust from the school community and society.

Many researches related to the internal control system have been conducted in the business sector and the public sector, but are still rare when it comes specifically for the public sector, especially in educational institutions. Schneider & Becker (2010) conducted a study using the COSO model in internal control as the ethical initiative framework in business schools. Mawanda (2008) conducted a study on the effect of the internal control system on financial performance in higher education institutions in Uganda. Based on the findings of these studies, it is found that institutions have an effective system of internal control because it is supported by a clear separation of roles, supervision, training, and management commitment.

Aims and Objectives of the Study

The aim of this study is to get an overview of the implementation of internal control systems associated with quality of financial report information and financial accountability in primary schools in Bandung, Indonesia.

The objective to be achieved in this research is to quantify the size of the implementation of the internal control system (which consists of the control environment, risk assessment, control activities, information and communication, and monitoring) partially and simultaneously on the quality of financial report information, and to determine whether the quality of the financial report information can improve the quality of financial accountability.

Rationale

Accountability appears as a logical consequence of the relationship between an agent and a principal. Agency relationship is a contract in the form of a delegation of authority in decision-making provided by the owner (principal) to the company or organization (agent).

Agency Theory is a framework for accountability. Accountability is an obligation to provide information (including the financial information) or calculation (reckoning) required of an action that is the responsibility of the organization (Gray et al., 1996). Accountability as a fiduciary obligation (government) to provide accountability, presenting, reporting and disclose all activities and activities that are under their responsibility to those giving the mandate (people) who have the rights to ask for the accountability (Mardiasmo, 2002).

Financial accountability is an accountability regarding financial integrity, disclosure and compliance with legislation. Presentation honesty reflects the financial integrity. In order to make a reliable financial statement, the information contained therein should describe honest transactions and other events should be presented or that may reasonably be expected to be presented. The disclosure concept requires that the financial statement is designed and presented as a collection of picture or the reality of the economic events that affect an institution for a period and contain enough information. In accounting, a financial report must demonstrate adherence to laws and regulations relating to the implementation of governmental accounting rule (BPKP, 2001).

Concrete efforts in realizing accountability and transparency within the government requires each state financial managers to submit a report on financial management accountability with wider coverage and timely. Law Number 17 Year 2003 on State Finance confirms that the financial accountability report shall be declared in the form of Financial Statements which at least cover the Budget Realization Statement, Balance Sheet, Cash Flow Statement, and Notes to Financial Statements, and ordered by the Government Accounting Standards. The impact of accountability and transparency in financial reporting on the governance of an organization is usually reflected in the level of quality of financial reporting (Sanni, 2011).

A financial statement of public sector organizations certainly has a purpose and function of retrospective accountability and reporting. The financial statement is used as a form of accountability to the public. The financial statement is used to monitor and evaluate the management performance, providing a basis to observe trends of inter-period, the attainment of set objectives, and compare them with the performance of other similar organization, if applicable. The financial statement also allows outsiders to obtain cost information on goods and services received, as well as allowing them to assess the efficiency and effectiveness of the use of organizational resources (Mardiasmo, 2004). But it must be based on the assumption that the financial statement is an accountability media prepared on the basis of certain assumptions, namely independence, entities, the continuity of the entity and report measurable in terms of money and that information must be qualified to have the characteristics of relevant, reliable, comparable and understandable by using the accounting and financial reporting principles (Urip Santoso, 2011).

Wolk (2001) said that in order to make information generated from a financial statement be useful then it must meet the following requirements: relevant, reliable, consistent and comparable, materials. Fulfillment of objectives and financial statements will be beneficial and be able to meet its objectives if it meets four qualitative characteristics of financial statements (Nurlan Darise, 2008: 53-55), namely: understandability, relevance, reliability, and comparability.

Meanwhile, according to Government Regulation No. 24 Year 2005 concerning the Government Accounting Standards, the qualitative characteristics of financial statements is normative measures that need to be realized in the accounting information so that it can fulfill its purpose: (a) Relevant; (B) Reliable; (C) Comparable; and (d) understandable.

Altamura & Beatty (2009) stated that an effective system of internal control is a mechanism to build the quality of financial reporting. The responsibility for providing adequate internal control structure and effective management lies in the organization. The leader of each organization should ensure that appropriate internal control structure has been instituted, reviewed, and updated in order to remain effective. Support and positive attitude of all the leaders in all parts is very important. Leaders must be a person with professional and integrity in nature. They are maintaining the level of competence that allows them to understand the importance of developing, implementing, and maintaining effective internal control (INTOSAI, 2001).

COSO Report (Saia, 1992: 19) defined internal control system as follows:

Internal control is the process by which an entity's board of directors, management and/or other personnel obtain reasonable assurance as to achievement of specified objectives: it consists of nine interrelated components, with integrity, ethical values and competence, and the control environment serving as the foundation for the other components which are: establishing objectives, risk assessment, information systems, control procedures, communication, managing change, and monitoring.

Government Regulation No. 60 of 2008 also defines the Internal Control System as an integral process in actions and activities carried out continuously by the management and all employees to provide reasonable assurance on the achievement of organizational goals through effective and efficient, reliability of financial reporting, safeguarding of state assets, and compliance with laws and regulations.

Based on Government Regulation No. 60 of 2008, elements of Internal Control System refer to the elements of the Internal Control System that have been practiced in the government in various countries, which include: (a) Control environment; (B) Risk assessment; (C) Control activities; (D) Information and communication; and (e) Monitoring.

Internal control objectives as listed in the definition made by COSO are: (a) Effectiveness and efficiency of operations, (b) Reliability of financial reporting, and (c) compliance with regulations. This is in line with the results of research conducted by Dita Novianti (2003), Aristanti (2009), and Edward (2011, 47), that shows a strong correlation between the quality of internal control and financial reporting.

Based on the presented framework, the following hypotheses are formulated

Hypothesis 1: Implementation of internal control system (which consists of the control environment, risk assessment, control activities, information and communication, and monitoring) partially and simultaneously affect the quality of financial reporting information.

Hypothesis 2: A qualified financial reporting information will improve the quality of financial accountability.

Research Method

This study is an exploratory study that aims to explain the correlation between variables through hypothesis testing (Singarimbun, 1995: 5). The unit of analysis in this study is an education unit at the elementary level with a sampling of the population is all elementary schools in the city of Bandung. Convenience sampling method is used to select a sample of the population elements for which data are easily obtained by researchers. Elements of population selected as the sample is not limited so that researchers have the freedom to select the quickest and inexpensive samples.

There were 937 questionnaires sent to respondents. The sample of questionnaires collected and can be processed in this study amounted to 168. The data collected in this study are primary data obtained through a questionnaire distributed to each respondent. For the sake of generalization and to answer the problems as expressed in the formulation of the problem, the data analysis technique to be used in this study are Path Analysis Technique. With the aim to explain the direct and indirect result of a set of variables, as the exogenous variable to a set of other variables that are endogenous variables. The path analysis can disclose the effect of exogenous variable to endogenous variable. The relative magnitude of the effect of an exogenous variable to a specific endogenous variable is expressed by path coefficient from the exogenous to the endogenous.

Reason for using the path analysis model, except for the purpose of this study which is to see the extent of the correlation between exogenous variables on endogenous variables, it is because a causal relationship between variables to be tested is built on the basis of certain theoretical framework that can explain causal relationships between these variables. The structural models are:

1. First sub-structure:

$$Y = \rho_{Y1X1}X1 + \rho_{Y1X2}X2 + \rho_{Y1X3}X3 + \rho_{Y1X4}X4 + \rho_{Y1X5}X5 + \rho_{Y\epsilon1}\epsilon1$$

2. Second sub-structure:

$$Z = \rho_{ZY}Y + \rho_{Z\epsilon1}\epsilon1$$

Findings and Discussion

The purpose of internal control system, according to Warren, Reeve, & Fees (1999, P183), one of which is to check the accuracy and reliability of accounting data. Internal control itself is a process that is run and designed to provide reasonable assurance of compliance with the control objectives. By specifying and implementing internal control in a good and proper manner in a company, then the company will be easier to accomplish goals and to minimize the risk. Wilkinson et al. (2000: 234) states, "If an internal control has been established then all operations, physical resources, and data to be monitored and are under control, the goal will be achieved, the risk will be smaller, and the resulting information will be more qualified. On the other hand, without the internal controls, conditions that have negatively impacted the company are likely to occur, such as recording errors, errors of decision-making, inefficiency, loss of assets, cessation of business activities, as well as sanctions." As a result, the adoption of internal controls in the accounting system enables the accounting system to produce a higher quality of accounting information (timely, relevant, accurate, and complete), and auditable.

Based on the results of simultaneous hypothesis testing it is found that the implementation of the internal control system (which consists of the control environment, risk assessment, control activities, information and communication, and monitoring) simultaneously affect the quality of financial reporting information. The magnitude of the effect of implementation variable of the internal control system on the quality of financial reporting information is indicated by the coefficient of determination obtained. The coefficient of determination (R^2) showed the number of 0,706, meaning that 70.6% quality of financial information is affected by the implementation of the internal control system that is running well. The remaining 29.4% is influenced by other factors not included in the specification of this study. Results of study indicate that the effect of the implementation on the internal control system on the quality of financial reporting information in basic education in Bandung is quite high.

This is in line with the opinion of Wilkinson (2000) and also the purpose of the internal control system in accordance with COSO (1992) that basically stated that the internal control system creates reliability in financial reporting. Indeed, the report is a decision making tool. Therefore, the report should be designed to meet the needs of the decision makers. As a decision making tool, the report must have relevant and reliable quality. Relevant means being able to make a decision to be different. In order to have a relevant quality of the report, the report should be presented in time, contain information that enables decision makers to make predictions, and provide feedback for monitoring purposes. Meanwhile, reliable means the decision makers may trust the report. To get a reliable quality, the substance of the report should be verified and tested, as well as the fair presentation so it does not direct the decision on a particular decision.

The results of this study are consistent with the results of researches conducted by A. Widyaningsih (2011), Edward (2011), which indicate a strong positive correlation between the quality of the internal control on financial reporting. Altamura & Beatty (2009) in Edward (2011) stated that an effective internal control system has long been recommended as a mechanism for building high quality financial statements and have been used voluntarily by firms for this purpose. In response to several cases related to financial accounting scandal, COSO issued an integrated framework for internal control report in September 1993, as a basis for assessing the effectiveness of internal controls. They also require some regulatory requirements for management and auditors to report on the effectiveness of internal controls because the internal control has a strong relationship with the quality of financial reporting. The sovereign government financial statements have an impact on the international quality and is significant in the current context of global business (PCAOB).

The test results of partial hypothesis indicates that the control environment has a significant effect on the quality of financial reporting information, and control activities significantly influence the quality of financial statement information. As for the influence of risk assessment, the influence of information and communication, and monitoring, the effect on the quality of financial reporting information are not statistically significant, according to test results.

Due to some insignificant research constructs, the trimming process was performed, that is to recalculate the influence of independent variables on dependent variables by excluding the insignificant variables. Based on the results of the study, the influence of the control environment and control activities on the quality of financial reporting information can be observed by the coefficient of determination (R^2) obtained at 0.667. It is concluded that 66.7 quality of financial reporting information at the basic education level of primary schools in the city of Bandung is affected by the control environment and control activities, with total control environmental influences on the quality of financial reporting information is 19.74% and the total effect of control activities on the quality of financial information is 71.27%. From these results it appears that the effect of the construct of quality control activities on the financial statement information is greater than the influence of the control environment on the quality of financial reporting information. Thus it can be said that the quality of financial reporting information in basic education unit in Bandung is more influenced by the control activities.

The dominance of control activities in affecting the quality of information in the financial statements, can be observed from the empirical information obtained from the respondents' responses. From the results of

descriptive statistics for the variable implementation of the internal control system, it appears that in overall are in good criteria. However, in the implementation of the fifth dimension of internal control system that is fully implemented and is directly related to the activity of financial reporting, that is the dimension of the control environment and control activities. As for the dimensions of risk assessment, utilization of information and communication, and monitoring activities in the activity of internal control are still a novelty for education unit in Bandung. This is also supported by the results of respondents' responses to three dimensions that are in quite good criteria.

Results of testing to answer the second question shows that there is a strong correlation ($r = 0,862$) between the quality of financial reporting information and the quality of financial accountability in the education unit in Bandung. And it has significant influence with the influence of the quality of financial reporting information on the quality of financial accountability by 74.2%. Result of this study supports the results of research conducted by Kateeba (2010: 55) that indicates a strong positive relationship between the quality of financial statements with financial accountability. One of the tools to facilitate the creation of transparency and accountability is through a comprehensive presentation of the financial statements. The financial statements are an essential component to create accountability and is one measure of financial performance (Himma Bandary, 2011). The same is expressed in the research by Siti Aliyah (2012: 12) that the preparation of financial statements in full area in accordance with Government Accounting Standards and easily accessed by all interested parties allow the control and supervision of the financial management can work well. This will increase the transparency and public accountability.

If it is associated with empirical conditions based on the respondents' responses, based on the descriptive statistics, quality of financial reporting information variable in the education unit in Bandung is in good criteria. However, there are still some areas for improvement related to the disclosure of the type of accounting information in the financial statements that may influence decision-making, presents a comparison of performance between the accounting period and the previous accounting period, as well as the lack of tables, charts or graphs, showing the results of school performance in the financial statement accountability. This is also supported by findings in the field at some schools as a reference. There are many schools that do not disclose and publish the results of the financial performance of school affixed to the wall either in the teachers room, principal room, or in the school lobby.

As for the variable of quality of financial accountability in education unit in Bandung in general is in good criteria, but there are still many things that need to be upgraded or repaired to improve the schools' financial accountability. Things that need to be improved, based on the respondents' answers, include the school needs to reveal more reasons for the difference between budget and realization, the realization of the difference with the previous year's budget to the current budget, and the failure to uncover the reasons for inability to achieve the targets that have been set.

Conclusion

Berdasarkan hasil penelitian dan pembahasan, dapat ditarik beberapa kesimpulan sebagai berikut:

Based on the results of study and discussion, there are things that can be concluded as follows:

1. Findings of the descriptive analysis study show that in general: (a) the implementation of the internal control system of primary schools in Bandung is in quite high category; (B) the quality of financial reporting information in elementary school in is in quite high category; and (c) the results of simultaneous testing show that the implementation of the internal control system (which consists of the control environment, risk assessment, control activities, information and communication, and monitoring) significantly affect the quality of financial reporting information, and demonstrate a strong correlation. Partial test results show that only the control environment and control activities that have significant effect on the quality of financial reporting information.
2. The quality of financial accountability in elementary schools in Bandung is categorized as good because it is above average. The level of the correlation between the quality of financial reporting information and the quality of financial accountability is strong. The quality of financial information has a significant impact on the quality of financial accountability in elementary schools in Bandung.

The findings of this study inform you that a good internal control system may generate a high quality financial report information and of course it will encourage the increased quality of the schools' financial accountability.

Suggestion

From the result of the present study, discussion and conclusions mentioned above, for the betterment of the internal control system, and to make financial statement information and financial accountability more qualified, the following suggestions are proposed.

1. For the schools, in relation to the implementation of the internal control system, there should be a good working relationship by having a mechanism of mutual inter-school test. It is recommended that the school starts to recognize the risk of external and internal factors on the activity level in a comprehensive manner. The control activities should pay more attention and increase the physical control activity over assets, separation of functions, authorize transactions, and pending events, restricting access to resources and the documentation. In monitoring activities, the school needs to increase the review activity, continuous monitoring, and follow up on audit recommendations.
2. In order to increase the quality of financial reporting information, the school or education unit needs to clearly disclose the accounting information in the financial statements that may affect decision-making. In addition, the education unit is expected to present the financial statements in comparative performance between the existing accounting period with the previous accounting period. And, there should show some tables, charts, or graphs indicating the results of the schools' performance in the financial statements accountability.
3. To improve the quality of financial accountability in the education unit in Bandung, it is necessary to uncover the causes of differences between budget and realization, inability to achieve targets that have been set, also revealing the causes of the difference to the current budget with the realization of the budget in the previous year.
4. For other researchers, it is necessary to conduct further research on the factors that influence the quality of financial reporting information and the quality of financial accountability, such as entering organizational behavior, leadership commitment, and work culture.

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