

The Role of the Internal Audits to the Quality of Financial Reporting

(Survey of the Banks are Listed on the Indonesia Stock Exchange)

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Abstract

The research objectives are to examine the influence of the role of the internal audits to the quality of financial reporting.

This research uses descriptive and verification methods, with data collection using census approach by distributing questionnaires to 43 banks that listed on the Indonesia Stock Exchange. The unit of analysis is the bank that listed on the Indonesia Stock Exchange with the audit committee, the internal audit manager, the finance and accounting managers as respondents. The types of data that used as primary data is the result of questionnaire respondents' feedback and secondary data is obtained from the listed bank's annual reports. Validity and reliability tests are conducted on the questionnaire's feedback that were collected for further testing hypotheses. Data analysis hypothesis testing is using regression. The research outcome showed that there are significant role of internal audit to the quality of financial reporting. The quality of financial reporting is higher if the internal audit role have a role in completion and understanding the objectives, management, scope of work, the application of the principles and implementation of the internal audit function.

Keywords: the role of the internal audit, the quality of financial reporting

1. Introduction

1.1. Background Research

The financial statements serve as the primary tool for management to deliver

financial and operational information as management accountability and to meet the needs of internal and external parties who lack the authority to obtain the required information from the direct sources of the company (Schipper and Vincent, 2003). As stated in the basic framework for the preparation and presentation of financial statements (IAI, 2008) that the purpose of financial statements is to provide information relating to the financial position, performance, and changes in the financial position of an entity that is beneficial to a large number of users in economic decision making.

The financial statements prepared under the Financial Accounting Standards consist of statements of financial position, consolidated income statement, cash flow statement, statement of changes in equity and notes to the financial statements. Users of financial statements include current investors and potential investors, employees, lenders, suppliers and other business creditors, customers, governments and institutions, and the public. (IAI: 2008)

Bank as a trust institution, preparing and presenting financial statements as a form of management accountability to stakeholders for the trust that has been received (PBI, 2008)

Indonesia can reflect on the experience of developed countries how a large company but not well managed, weak internal control and the absence of a counterweight of the control mechanisms of independent and objective parties, so that if there is no corrective action managerial then this condition will end With bankruptcy that will ultimately hurt shareholders and shake up its capital markets (Halim Alamsyah, 2011). Case Enron Corporation, Global Crossing, World Com and Tyco in the United States, Maxwell Communication Corporation and Mirror Group Newspaper in the UK, Parmalat in Italy, insurance giant HIH Insurance Ltd and third-largest Telkom company One-Tell Ltd. In Australia, Swissair in Switzerland, Baring Futures in Singapore and Peregrine Investment Ltd in Hong Kong, is an empirical example of how weak GCG principles of transparency, accountability, responsibility, independency and fairness (Siswanto and Aldridge, 2005) are applied. Another case of Police Criminal Investigation Police arrested two people bank burglary suspects worth Rp 836 billion. Suspect initials HS applying credit to 7 private or state-owned banks using a fake Purchase Order (PO) document. Similarly, PT BTN reported the alleged counterfeiting of times deposit worth Rp 258 billion, which cost five customers to the police. President Director of BTN Maryono expressed readiness to compensate if found guilty.

Based on the above and in an effort to implement governance for commercial banks in delivering financial information through quality financial reporting, in accordance with Bank Indonesia Regulation No. 8/14 / PBI / 2006, Banks have obliged the Commercial Bank to improve the implementation of internal audit role effective, then in this research there are some interesting phenomenon to be examined that is as follows; The occurrence of a financial scandal is a failure of supervisory institutions, namely internal audit in performing its role to produce financial statements that have high integrity and reliable to meet the needs of information users of the report (Nashwa George, 2003).

As a public company whose shares are owned by the public through the stock exchange, the presentation of financial statements must meet the requirements stipu-

lated by the competent authority, in Indonesia this institution is Financial Service Authority, and this report should be published through mass media which can be used as a source of information. Importantly required by the shareholders in particular and the parties concerned with the company (stakeholders) in general. One of the regulations issued is that issuers are required to disclose important information through annual reports including financial reports to shareholders and other reports. The Financial Services Authority, the Stock Exchange, and to the public in a timely, accurate, understandable and objective manner. (OJK, 2012).

Based on the situation, condition and phenomena that have been mentioned above, and supported by some survey results that have been done before, it can be formulated the theme of this research as follows: "That with the role of internal audit will affect the quality of financial reporting". Based on the theme of the study the authors are interested to conduct research with the title "The Influence of the role of Internal Audit on the Quality of Financial Reporting". This research will be conducted on Banking companies listed on Indonesia Stock Exchange (IDX).

1.2. Problem Formulation

Based on the background of the above research, the formulation of the problem in this study are: How much internal audit affects the quality of corporate financial reporting, the company Bank listed on the Stock Exchange.

1.3. Research Objectives

Related to the formulation of the problem mentioned above, the purpose of this study is to measure the variables studied, while the purpose of this study is to test: The magnitude of the effect of internal audit on the quality of corporate financial reporting at the company Bank registered On IDX.

1.4. Usefulness of Research Results

1.4.1. Practical Usefulness or Effectiveness

The results of this study are expected to contribute thoughts and solutions to problem solving to: Public Bank, the results of this study provide input on the implementation of the bank's internal audit function by conducting audit process in accordance with internal audit standards of banks in improving the implementation of internal control Which is effective as well as to improve financial information.

2. Literature review

2.1. Internal Audit affects the quality of financial reporting

Cohen et.al, (2004) states that there are two factors that affect the quality of the company's financial statements. The first factor is the external factor of the firm, which consists of the judicial system, shareholders, capital market managers, financial statement analysts companies and other regulators. The second factor consists of; Board of directors, audit committee, internal audit and management.

Both factors according to Cohen et.al, (2004) affect the quality of financial statements of the company (financial reporting quality).

A good internal and external audit process will improve the accuracy of the financial statements and then increase the confidence in the financial statements. Arnold Schneider, (1999), conducts audit testing on the prevention of irregular financial reporting by stating that; "The results of the findings of internal and external auditing are as follows: material dollar amounts, irregularities involving asset overstatements, unambiguous GAAP violations, and less incentive for misstating income. However, the deterrent effects can not be attributed to any one of the conditions. Also, the internal auditing effects are similar to those of external auditing.

Martin Bariff, Chair Research Committee (2003), conducted a study of the effects of internal audit with financial reporting and stated that an independent internal audit is ready and always ready to be active in rebuilding the challenges of confidence in the quality of financial and market reporting. Further in his research explains;

"The result is stated that the internal audit wants to have compliance with the Sarbanas Oxlay Act. Further research is needed to gather input on similar issues from the audit committee, ceo, and certified public accountant stake holders. At this point, however the result demonstrate that internal audit independence is ready and already active in the challenge to rebuild trust in financial reporting quality and market.

Barbara Arel, Cathy Beaudoin and Anna M Cianci, (2011), in her research related to the impact of leadership ethics and internal audit function on financial reporting decisions, states that "Two elements of corporate governance, the strength of ethical executive leadership and the internal audit function Provide guidance to accounting managers making decisions involving uncertainty. We examine the join effects of these two factors, manipulated at two levels (strong, weak) in an experiment in which accounting professional decide weather to book a questionable entry. We find that ethical leadership and the internal audit function interact to determine the likelihood that accountant book the entry. These results suggest that the internal audit function has certain unintended consequences of combined with strong leadership.

2.2. The framework of research thinking can be shown in a framework of the following concepts Framework

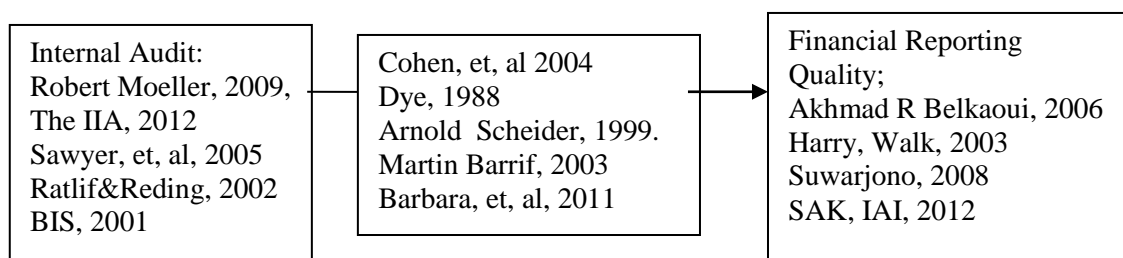


Figure 2.1

2.3. Hypothesis

In accordance with the framework that has been described previously, it can be formulated research hypotheses. The hypothesis formulation is; Internal audit role affects the quality of financial reporting.

3. Research Methods

3.1. Object of research

The object of this research is the role of internal audit, and the quality of financial reporting. The focus of research is directed to the role of internal audit both the weakness and the superiority in performing its role and function to improve the quality of financial reporting.

3.2. Research methods

The research method used in this research is explanatory research, pursued through census research.

3.2.1 Variable Operation

1) Internal Audit; Internal audit, according to The Institute of Internal Audit (1999), is; "Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It is expected that the concept of Internal Audit will be operation in the form of a variable (X).

2) Quality of financial reporting; The main purpose of the financial reporting process is to provide high quality financial reporting that provides information on economic entities, the main financial conditions for use in economic decision making (IAI, 2012). Subsequently financial reporting quality is operation in the form of variables (Y).

3) Operational Variables.

a. The Internal audit consists of seven dimensions including; (a) The general objectives and authority of the audit committee; (b), the responsibilities of the audit committee; (c), the structure of the audit committee; (d), the terms of the members of the audit committee; (e), Audit Committee meeting; (f) Reporting of the audit committee; (g), Performance audit committee.

b. The quality of financial reporting consists of (a), the basic framework of the financial statements, (b), qualitative characteristics of financial statements, (c), Recognition of elements of financial statements and (d) Measurement of elements of financial statements.

3.2.2. Types of data, Research instruments and Measuring Instruments

Data in this research are primary and secondary data, with research instrument in the form of questionnaires to obtain data for internal audit role variable, and quality of financial reporting. Internal audit member research respondents, and accounting officers at the Banks listed on the Indonesia Stock Exchange. The research tool used to convert qualitative data from the questionnaire

into a quantitative data size is Summated Rating Method: Likert Schale (Likert Scale).

3.2.3. Population Research and Census

The target population in this study were all bank companies listed on the Indonesia Stock Exchange in the 2014-2016 research year, namely: (i) a banking service provider company during the period of observation (ii) a company with an audit committee (iii) a company that issued an annual report For the year ended December 31, 2014, 2015 and 2016.

List of companies that are censored based on the above mentioned criteria are all Bank companies listed on the Indonesia Stock Exchange in 2015.

3.2.4. Testing Data

Testing validity (test of validity), testing the validity of the questionnaire is done by calculating the correlation coefficient between the score of each item with the total item variable score and testing Reliability (test of reliability). Testing reliability, test questionnaire for each variable used split half technique, the total score of both groups of items is then calculated correlation coefficient.

3.2.5. Data Analysis Tool

3.2.5.1. Analysis data

Analysis data here the main purpose is to test the research hypothesis. Data analysis tool used is regression analysis.

Research Structure

Sub structure 1 is: identify the variable X to Y

Information:

X = Internal Audit

Y = Quality of Financial Reporting

PYX = The coefficient of the independent variable path to the dependent variable,

PY ϵ = Influence of other variables beyond the model assigned to the variable

3.2.5.2. Hypothesis Testing Research

Testing the hypothesis that, Internal Audit affect the Quality of Financial Reporting.

1) Calculating the Structure equation

$$Y = PYX + \epsilon$$

Tests conducted to test the hypothesis formulation as follows:

H0: $\rho_{YX} = 0$; Internal Audit has no significant effect on the Quality of Financial Reporting

H1: $\rho_{YX} \neq 0$; Internal Audit has a significant influence on the Quality of Financial Reporting

4. Research Result and Discussion

4.1 Research Results

Discussion

After the hypothesis test results are statistically, then in this section will be a descriptive discussion that explains the results of empirical tests compared with the theory put forward in the literature review (CHAPTER II) and the results of previous research.

Effect of Internal Audit on Quality of Financial Reporting

The result of the hypothesis test shows that there is an effect of internal audit on the quality of financial reporting at public banks in Indonesia by 31.82%. According to Guilford category 31.82% of the effect of internal audit on the quality of financial reporting included in the weak category. Strong weak influence refers to Guilford's opinion (1956), which specifies that the interval between 0.20 - 0.40 is in the weak / low classification. The results of the calculation of grand mean score of respondents regarding the internal audit is at the interval 6-7 (ie by 6.33) which means being in the category plays a very good role.

The role of internal audit of public banks in Indonesia has been performed very well in terms of internal audit management (6.27), internal audit task scope (6.22), internal audit principles (6.13), and internal audit functioning (6, 54). The role of internal audit on the internal audit objectives dimension with the score of respondents (5.97) good. Although in general the role of internal audit in improving the quality of financial reporting has been running very well but still requires improvement to the dimension of achieving audit objectives related to the periodic review of the implementation of accounting and operating policies, findings of various irregularities, suggestions for update of various operating standards. Similarly, for internal audit dimensions with very good categories in the scope there are still things that need to be improved, namely in terms of audit management, the competence of internal audit staff about the internal audit staff operating experience, the competence in the field of electronic data processing known with the system Current banking accounting information is supported by fully technology information system for both accounting data processing and for various banking services.

The responsibilities of internal audit as disclosed by the Institute of Internal Audit / The IIA (1992) include "review the reliability and integrity of financial and operating information and the means used of identify, measure, classify and report such information. Similarly, the Bank for International Settlements (2001), the scope of internal audit tasks include "the review of management and financial information systems, including the electronic information system and electronic banking services. The internal audit process will improve the accuracy of the financial statements and then increase confidence in the financial statements (Martin Bariff: 2003).

The results of this study are consistent with the results of research conducted by Cohen et.al, (2004); Arnold Schneider (1999); Martin Bariff (2003); Barbara

Arel et.al, (2011), with the results of research showing empirical evidence that internal audit has an influence on the quality of financial reporting.

The phenomenon of the low role of internal audit of public banks in Indonesia to improve the quality of financial reporting is evidenced by the existence of several indicators of audit management dimensions, namely the intensity of review of financial reporting, the fulfillment of staff competencies with sufficient operational bank experience and an understanding in the field of electronic data processing Still needs to be improved.

5. Conclusions and Suggestions

5.1 Conclusion

Based on the formulation of the problem, the formulation of hypotheses and research results, it can be concluded as follows: Internal audit affects the quality of financial reporting, although in carrying out its function, internal audit not yet functioning properly to improve the quality of financial reporting in terms of: audit implementation mechanism, support staff who have competence understanding of technology information system / electronic data processing and support operational experience bank.

5.2 Suggestions

- a. Improving the competence of internal auditor staff by engaging in in-house training or ex house training, certification and providing opportunities for special education on internal audit.
- b. Complete the staff of internal auditors with the competence of understanding of information technology either through fresh graduate or experienced recruitment, and improvement of operational experience as requirement of internal auditor position.
- c. Accelerate the audit process of financial statements by public accountants by preparing early the process of selecting a public accounting firm that will audit financial statements. It should be included in the audit committee's annual work program.

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Attachment 1.

List of study populations

Banks are listed on the Indonesia Stock Exchange			
No	Code	Bank	Date of listed
1	AGRO	Bank Agroniaga Tbk	8-Aug-03
2	BABP	Bank ICB Bumiputera Tbk Tbk	15-Jul-02
3	BACA	Bank Capital Indonesia Tbk	4-Oct-07
4	BAEK	Bank Ekonomi Raharja Tbk	8-Jan-08
5	BBCA	Bank Central Asia Tbk	31-May-00
6	BBKP	Bank Bukopin Tbk	10-Jul-06
7	BBNI	Bank Negara Indonesia Tbk	25-Nov-96
8	BBNP	Bank Nusantara Parahyangan Tbk	10-Jan-01
9	BBRI	Bank Rakyat Indonesia (Persero) Tbk	10-Nov-03
10	BBTN	Bank Tabungan Negara (Persero) Tbk	17-Dec-09
11	BCIC	Bank Mutiara Tbk	25-Jun-97
12	BDMN	Bank Danamon Indonesia Tbk	6-Dec-89
13	BEKS	Bank Pundi Indonesia Tbk	13-Jul-01

14	BJBR	Bank Pembangunan Daerah Jabar dan Banten Tbk	8-Jul-10
15	BKSW	Bank QNB Kesawan Tbk Tbk	21-Nov-02
16	BMRI	Bank Mandiri (Persero) Tbk	14-Jul-03
17	BNBA	Bank Bumi Arta Tbk	31-Dec-99
18	BNGA	Bank CIMB Niaga Tbk Tbk	29-Nov-89
19	BNII	Bank Internasional Indonesia Tbk	21-Nov-89
20	BNLI	Bank Permata Tbk	15-Jan-90
21	BSIM	Bank Sinarmas Tbk	13-Dec-10
22	BSWD	Bank of India Indonesia Tbk	1-May-02
23	BTPN	Bank Tabungan Pensiunan Nasional Tbk	12-Mar-08
24	BVIC	Bank Victoria International Tbk	30-Jun-99
25	INPC	Bank Artha Graha Internasional Tbk	29-Aug-90
26	MCOR	Bank Windu Kencana International Tbk	3-Jul-07
27	MAYA	Bank Mayapada Internasional Tbk	29-Aug-97
28	MEGA	Bank Mega Tbk	17-Apr-00
29	NISP	Bank OCBC NISP Tbk Tbk	20-Oct-94
30	PNBN	Bank Pan Indonesia Tbk	29-Dec-82
31	SDRA	Bank Himpunan Saudara 1906 Tbk	15-Dec-06

Sources: Indonesia Stock Exchange

Attachment 2.

Statistics Result

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.378 ^a	.143	.113	7.63321

a. Predictors: (Constant), audit internal

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	33.831	9.066		3.732	.001
	audit internal	.164	.075	.378	2.198	.036

a. Dependent Variable: kualitas pelaporan keuangan

ANOVA^b

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	281.540	1	281.540	4.832	.036 ^a
	Residual	1689.712	29	58.266		
	Total	1971.251	30			

a. Predictors: (Constant), audit internal

b. Dependent Variable: kualitas pelaporan keuangan

Variables Entered/Removed^b

Model	Variables Entered	Variables Removed	Method
1	audit internal ^a		. Enter

a. All requested variables entered.

b. Dependent Variable: kualitas pelaporan keuangan