
THE INFLUENCE OF INTERNAL AUDIT ON THE QUALITY OF FINANCIAL STATEMENTS (Survey on Private Sector Manufacturing Companies in Bandung)

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ABSTRACT

The quality of financial reports is one of the critical aspects for capital owners in assessing the company's success in its business. Previous research has shown a positive relationship between internal audits and the presentation of quality financial statements. Based on the critical role of the presentation of financial statements, the researchers researched the influence of internal audits on the quality of financial statements. The researcher uses a quantitative approach in answering the problem formulation that set. The sample in this study were 59 employees of the audit department in two manufacturing companies in the city of Bandung. Data analysis used simple linear regression with the results showing a positive influence of internal audit on the quality of financial reports by 50.5%. In contrast, the rest was influenced by other factors not examined. The study results indicate that the better the internal audit is carried out, the better the quality of financial reports.

Keywords: internal audit, quality of financial reports, manufacturing.

INTRODUCTION

Internal audit arises as a method or technique to overcome the increased risk due to the rapid pace of development of the business world or the existence of economic turbulence conditions. Dynamic and unpredictable changes occur in connection with the era of globalization so that traditional and informal sources of information are no longer available. again able to meet the needs of managers who are responsible for things not directly observed. (Oussii & Taktak, 2018)

The internal audit results expect to increase the reliability of information about the conditions in the units it supervises. (Boskou, Kirkos & Spathis, 2019) In line with that, it is appropriate that some management responsibilities are delegated to several internal

audits to carry out internal supervisory tasks. Internal audit is a series of processes and techniques in which employees of a company or government agency seek assurance of the accuracy of financial information and the course of operations as determined. (Gaynor, Kelton, Mercer & Yohn, 2016) In addition to improving the reliability of information and ensuring compliance with management policies, the scope of internal audit work also includes protecting assets and assessing whether the use of resources carries out economically and efficiently. (Prawitt, Smith & Wood, 2009)

Thus it is clear that internal audit has become a dominant tool for leaders of government agencies and companies to monitor and oversee the company's operations. (Roussy & Brivot, 2016) Moreover, these internal inspectors (supervisors) are more aware of all company policies, procedures, and various problems in more detail than external audits (public accountants).

Internal audits of the company's operational activities need to be carried out regularly, both before a problem is felt or after a problem has occurred. Internal audits regularly can prevent a problem from occurring; management will immediately identify and address the problem and its causes before it becomes sustainable. Correctly identify the real problem, the source of the cause, and take practical steps to overcome it. (Boskou, Kirkos & Spathis, 2019) Thus, the functional role of internal audit in an organization is expected to improve the organization's performance.

The research results by Al-Shetwi, Ramadili, Chowdury & Sori (2011) examine the impact of internal audits on the quality of financial reports using a sample of companies listed on the Saudi Arabia stock exchange. They show a relationship between internal audits and the quality of financial statements; this indicates that the companies studied have met the requirements set by the government in presenting financial statements. On the other hand, Hutchinson & Zain (2009) show that internal audits can affect the company's performance and prove that several aspects can improve the company's performance, namely by paying attention to the company growth and independence of the company's audit committee.

Based on previous research studies, the researcher formulates the problem that internal audits influence the quality of financial reports. Therefore, this study aimed to determine the magnitude of the influence of internal audits on the quality of financial statements.

RESEARCH METHODS

The population is the entire data source of the research subject. The population in this study are 2 (two) private manufacturing sector companies in the city of Bandung. The research method used is the survey method, namely research that explains the relationship between research variables with statistical analysis based on primary data that can describe the state of the object of research. The sample of this research is 59 respondents.

Based on a review of concepts, theories, and previous research results, operational research is the internal audit variable. This independent variable is X1 notation with

dimensions of organizational status, objectivity, knowledge and skills, and supervision. The variable of financial report quality, as the dependent variable, is then written with Y notation with relevant, understandable, reliable, and comparable dimensions. The instruments arrange into 15 items, each statement of each research variable with a 5-point Likert scale with alternative answers from Strongly Disagree to Strongly Agree.

Before being analyzed, the data validity test and data reliability test carry out, then data analysis was carried out. Analysis of the data used in this study is simple regression analysis.

RESULTS AND DISCUSSION

The test knows that the data is valid and reliable, as shown in Table 1 below.

Table 1. Test results Validity and reliability of research data

Validity Test			
Item Internal Audit	r	Item Financial Report Quality	r
IA.1	.351	FRQ.1	.349
IA.2	.516	FRQ.2	.518
IA.3	.442	FRQ.3	.458
IA.4	.411	FRQ.4	.494
IA.5	.378	FRQ.5	.414
IA.6	.328	FRQ.6	.513
IA.7	.376	FRQ.7	.474
IA.8	.337	FRQ.8	.457
IA.9	.455	FRQ.9	.559
IA.10	.330	FRQ.10	.358
IA.11	.635	FRQ.11	.523
IA.12	.415	FRQ.12	.465
IA.13	.522	FRQ.13	.614
IA.14	.605	FRQ.14	.466
IA.15	.325	FRQ.15	.351
Reliability Test			
	Cronbach's Alpha		
Internal Audit	0,771		
Financial Report Quality	0,817		

Table 1 shows that the correlation value between statement items for both the internal audit variable and the quality of the financial statements has a value > 0.3 , so it can be said to be valid. In comparison, the reliability test shows the value of Cronbach's Alpha > 0.7 so that the internal audit variables and the quality of financial reports can be said to be reliable.

Furthermore, the researchers analyzed the data using simple linear regression analysis. The calculation results show a positive and significant effect with a b value of 0.711 with an R square of 0.505. In addition, the calculation results show an influence of internal audit on the quality of financial reports by 50.5%, where 49.5% is determined by other factors not included in this study. Thus, the implications of the study indicate that the better the internal audit carried out by the company, the higher the quality of the financial statements produced.

Internal audits improve the reliability of data and accounting records presented in the form of financial reports and management reports so that the resulting reports do not mislead the users of the report and can be verified. Internal audits can also improve employee compliance with the rules and standards set by the company. Company management sets standards which are operational control tools carried out by members of the company's organization. These conditions are related to the management's responsibility to provide quality financial reports for shareholders and other related parties.

The organizational status of the internal audit unit must provide flexibility to fulfill or complete the assigned audit responsibilities. Internal audits must have the support of senior management and the board to get the cooperation of the audited parties and complete their work independently of the interference of other parties.

Internal auditors or internal audits must conduct audits objectively. The objective is a free mental attitude that the internal examiner must possess in carrying out the examination. Internal audits may not place an assessment concerning the audit conducted that is lower than the assessment carried out by other parties or judge something based on the results of the assessment of others. The internal audit department must acquire the knowledge, skills, and various disciplines needed to carry out audit responsibilities.

The internal audit department needs to ensure that the implementation of the internal audit properly monitors. Supervision is a continuous process, starting with planning and ending with concluding the inspections carried out. (Gaynor, Kelton, Mercer & Yohn, 2016)

The study results follow research conducted by Abbott, Daugherty, Parker & Peters (2016), which shows the critical role of internal audit having appropriate competence and independence in presenting quality financial reports. They suggest that to improve financial reports is necessary to have an independent audit executor who has adequate competence so that the effectiveness of financial reporting can achieve optimally. In addition, K. Johl, Kaur Johl, Subramaniam & Cooper (2013) prove that the quality of financial statements can influence internal audits and the quality of the board of directors by verifying a sample of companies in Malaysia.

CONCLUSION

The quality of financial reports is one of the critical aspects for policymakers in making decisions for the organization. In addition, quality financial reports can help policymakers in planning work programs for the future. The study results show the influence of internal audit on the presentation of quality financial statements; for this reason, it is necessary to take concrete steps that need to be prepared by management to realize an excellent internal audit.

This study only uses a survey approach. There are still some weaknesses in presenting the conclusions of the research results. It is recommended that future research comprehensively test using an approach that uses secondary data or surveys conducted in a broader sample.

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