

The Effect of Audit Competence on Regional Financial Performance Moderated by the Internal Control System

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Abstract

The low quality of financial performance is often found in local governments with limited budgets and income. This contrasts with those who have sufficient income and budgets for services, where public interests are more accommodated than individual and political interests. The purpose of this research is to examine the effect of competence and internal control systems on financial performance. The sample taken in this research includes all Regional Work Units (SKPD) in Indonesia, with an analysis tool in the form of the Structural Equation Model (SEM) program through Smart PLS software. The results show that competence does not have a significant impact on financial performance but has a significant effect on the internal control system. The internal control system has a positive and significant effect on financial reporting performance and can also mediate the influence of competence on financial performance.

Keywords: Audit competence, Internal control system, Financial performance.

1. Introduction

The policy of regional autonomy in Indonesia has given local governments the authority to manage their own finances related to administrative activities. This authority aims to optimize public services and make it easier to control funds derived from the regional revenue and expenditure budget. Furthermore, the principles of state financial management based on Law No. 17 of 2003 and local government performance No. 23 of 2014, namely effective, efficient, transparent, and accountable (Akase et al., 2021). The financial planning composed by local organizations is not separate from policy formulation. The stages start from formulation, implementation, and evaluation of public policy, however, this policy has limitations (Francisco, 2016). Substantially, it includes fiscal constraints (Gelfand, 1979), debt constraints (Galiński, 2015), and human resource constraints (Gonçales Veiga and Veiga, 2016). Policies related to financial planning should ensure sustainable development and improve the quality of life of the community. Furthermore, financial planning is necessary because of the unlimited and evolving desires of the community, while the resources available are very limited (Akase et al., 2021). The low quality of financial performance is often found in local governments with limited budgets and income. This contrasts with those who have sufficient income and budgets for services, where public interests are more accommodated than individual and political interests. Also, the low performance of regional financial planning and management poses challenges for local governments (Akase et al., 2021). Furthermore, financial planning and management of the region that is in accordance with the principle of public service leads to: public dissatisfaction and social gaps

(Ryan et al., 2000; Yusuf et al., 2013), low human development index (Amyulianthy et al., 2016; Siregar and Pratiwi, 2017), and economic growth slowdown (Galiński, 2015). This condition requires serious attention from local governments in terms of pro-poor budgeting policies, jobs, growth, and environment. According to Dzomira (2014), most fraud perpetrators take advantage of weaknesses in internal financial management control.

Policies to realize good governance in the public sector include establishing ethical standards and behavior of government apparatus, establishing an organizational structure and organizational processes that clearly regulate roles and responsibilities as well as organizational accountability to the public, setting up an adequate organizational control system, and external reporting prepared based on an accounting system that complies with government accounting standards (Febriansyah et al., 2013 and Sri Yaumi, 2021). Management is responsible for providing stakeholders with information about various entity activities, which can be achieved through financial reporting (Baker and Al-Thuneibat, 2011). However, the flexibility inherent in many accounting standards allows managers to take advantage of it and provide incorrect information. As a result, a key element of the financial reporting process is to ensure independent verification of financial reports prepared by company management (Chan et al., 1993). It is widely known that audit committees and Internal auditors play a central role in ensuring the integrity of the financial reporting process (Cohen et al., 2004; Johl et al., 2007; Vafeas, 2005). Another opinion expressed by Indriasih (2014) is that the competency factor of apparatus influences the quality of local government management and financial reporting. If internal audit staff are not competent, independent, and do not comply with professional standards, then they cannot fulfill their roles and thus do not function (Twaha Kigongo Kaawaase et al., 2020).

Furthermore, financial report performance is also influenced by internal control. Efforts to improve the quality of LKPD are also in line with Inpres No. 4 Year 2011, about Accelerating the Improvement of the Quality of State Financial Accountability. One of its instructions is for BPKP to assist ministries / institutions / regional governments in increasing understanding for central / regional government officials in state financial management, increasing compliance with laws and regulations, and improving the quality of financial reports and governance. Financial examinations are conducted in order to provide an opinion on the fairness of the financial information presented in the financial statements. Performance audits aim to assess economic aspects, efficiency, and effectiveness. The Financial Audit Board (BPK) audit report contains audit findings. Each finding can consist of one or more problems, in the form of weaknesses in the internal control system (SPI) and/or non-compliance with statutory regulations. This non-compliance can result in state losses, potential state losses, revenue shortages, administrative deviations, inefficiency, or ineffectiveness. Non-compliance that results in state losses, potential state losses and shortage of revenues are problems that have a financial impact, while administrative deviations, inefficiency, and ineffectiveness are problems that do not have a financial impact. In more detail, the BPK disclosed 10,198 findings containing 15,568 problems, including 7,661 (49%) SPI weaknesses and 7,907 (51%) non-compliance issues with statutory regulations worth IDR 44.68 trillion (Vivi Eriani et al., 2017). From the problems above, the researcher is interested in studying the influence of the internal control system and audit competency on local financial reports.

2. Literature Review & Hypothesis

Audit Competence

Audit competence is an auditor who can carry out an audit objectively, accurately and carefully with explicit knowledge. An auditor with higher education will have a lot of knowledge about his/her field, so he/she can understand various problems more deeply. Besides, with sufficient broad knowledge, auditors will find it easier to follow increasingly complex work. Therefore, auditors can produce high-quality audits (Naomi, 2018). The first general standard (SA section 210 in SPAP,

2001) states that an audit must be carried out by a person or those with sufficient technical training as auditors. Meanwhile, the third general standard (SA section 230 in SPAP, 2001) states that in conducting an audit and compiling its report, the auditor must use his professional skills accurately and carefully. Therefore, every auditor must have professional skills and expertise in carrying out his duties as an auditor (Naomi, 2018).

Internal System Control

According to the goal-setting theory, the internal control system carried out by management and other personnel in the organization is designed to gain adequate assurance that there will be improvements in achieving goals: effectiveness and efficiency of operations, reliability of financial reports, and compliance with regulations. The Internal Control System can also improve the improvement of the quality of government financial reports used as a decision-making tool by users of financial reports (Udiyanti et al, 2014). According to Udiyanti et al. (2014), the elements of the internal control system consist of: Control Environment, Risk Assessment, Control Activities, Information and communication.

Financial Performance

The success of the local government can be measured from its ability to manage the budget both in terms of income and programs to realize the organization's vision, mission, and objectives. The measurement of the regional financial management index is determined based on the dimensions and indicators of financial performance quality that are effective, efficient, transparent, and accountable. According to Asrori (2019), regional autonomy has no effect on budget effectiveness, but it affects the financial performance of local governments. One of the main problems in evaluating financial performance is because it does not consider the influence of social and economic environmental factors (Zafra-Gómez et al., 2009).

Hypothesis

- H1: Audit Competence Influences Regional Financial Report Performance
- H2: Audit Competence Influences the Internal Financial Control System
- H3: The Internal Financial Control System Influences Regional Financial Report Performance
- H4: Audit Competence Influences Regional Financial Report Performance mediated by the Internal Financial Control System

3. Methodology

This research uses a quantitative approach with a non-experimental method (there is no treatment or manipulation of research variables), which is a study where the variables to be measured are already inherent in the respondents. Data collection techniques can be done by interview, questionnaire, and observation. It uses a Structural Equation Model (SEM) analysis tool through the Smart PLS software. The sample taken is based on 5 times the number of 41 items, which is 205 samples that include all Regional Work Units (SKPD) in Indonesia.

4. Result and Discussion

Measurement Model Testing (Outer Model) Convergent validity is related to the principle that the manifest variables of a construct should correlate highly. Convergent validity with PLS software can be seen from the loading factor for each construct indicator. To assess convergent validity, the

loading factor value should be greater than 0.7, and the average variance extracted (AVE) and communality values should be greater than 0.5. The results obtained are as follows:

Table 1. Factor Loadings

Variables	Manifest Variables	Factor Loading
Audit Competence	Skills	0.858
	Knowledge	0.819
	Attitude and Behavior	0.888
Internal System Control	Control Activity	0.738
	Information and Communication	0.781
	Control Environment	0.817
	Monitoring	0.739
	Risk Assessment	0.837
Financial Performance	Reliable	0.875
	Can be compared	0.866
	Understandable	0.858
	Relevant	0.781

The table above provides information regarding the loading factor value for each manifest variable. The loading factor value from all indicators to the latent variables shows >0.7, so all indicators are declared valid and are capable of measuring the variables accurately.

Table 2. Average Variance Extracted (AVE)

Variables	Average Variance Extracted (AVE)
Financial Performance	0.679
Audit Competence	0.732
Internal System Control	0.614

In the table above, it can be seen that all four latent variables have an AVE (average variance extracted) value greater than the specified value of 0.5. Hence, all variables are deemed valid in explaining their respective latent variables, indicating that the use of these manifest variables meets the AVE requirements. Therefore, all manifest variables are declared to have met the requirements of convergent validity. Convergent validity itself is established if scores obtained by instruments that measure concepts or measure concepts using different methods have a high correlation.

Discriminant Validity

Discriminant validity can be observed from the comparison of cross-loading factors with constructs and the comparison of AVE with correlation of latent variables. If the correlation of a construct with the main measurement (each indicator) is higher than that of other constructs, it is said to have high discriminant validity. The cross-loading values are presented as follows:

Table 3. Cross-Loading

Constructs	Audit Competence	Internal System Control	Financial Performance
Knowledge	0.819	0.654	0.439

Skills	0.858	0.668	0.388
Attitude and Behavior	0.888	0.744	0.576
Control Environment	0.890	0.817	0.527
Risk Assessment	0.867	0.837	0.531
Control Activity	0.402	0.738	0.567
Information and Communication	0.430	0.781	0.632
Monitoring	0.397	0.739	0.628
Relevant	0.326	0.545	0.681
Reliable	0.499	0.616	0.875
Can be compared	0.478	0.619	0.866
Understandable	0.509	0.596	0.858

Based on the PLS software output table above, it is clear that the cross-loading factor correlation of each latent construct for corresponding indicators is higher than other constructs. Thus, it can be concluded that the indicators used to measure latent variables have met the requirements.

Reliability Test

Reliability testing in Partial Least Square (PLS) can use two methods, namely Composite Reliability (CR) and Cronbach’s Alpha, which are presented as follows:

Table 4. Results of Composite Reliability (CR) and Cronbach’s Alpha Test

Variables	Cronbach's Alpha	Composite Reliability
Financial Performance	0.838	0.893
Audit Competence	0.817	0.891
Internal System Control	0.846	0.888

From the test results above, it can be seen that the Composite Reliability (CR) value is greater than 0.7 and the Cronbach's Alpha value is greater than 0.6. Therefore, it can be concluded that the data is reliable, indicating that all indicators are consistent in measuring each variable.

Testing the Structural Model (Inner Model)

This structural model examination is to test the influence of one latent variable on another latent variable. The test is carried out by looking at the path value to see whether the effect is significant or not, based on the t-value of the path (the t-value can be obtained by bootstrapping). Here is a picture of the results of the bootstrapping done in this study:

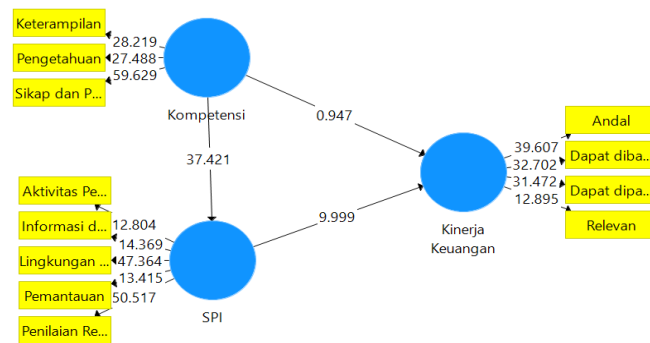


Figure 1. Bootstrapping

Predictive Relevance (Q2)

The Q-square measures how well the observed values produced by the model and its parameter estimates match. A Q-square value greater than 0 shows that the model has predictive relevance, while a Q-square value less than 0 indicates that the model does not have predictive relevance.

Table 5. R-Square

Variables	R Square
Financial Performance	0.526
Internal System Control	0.652

To calculate Q2, the following formula can be used: $Q2 = 1 - (1 - R12) (1 - R22)$ $Q2 = 1 - (1 - 0.525)(1 - 0.652)$ $Q2 = 0.835$ The achieved Q2 value of 0.835 means that the Q2 value above zero provides evidence that the model has Predictive Relevance.

Hypothesis Testing

The hypotheses in this study will be tested using the path coefficient value and t-values to see whether there is a significant effect or not. In addition, the results of the path significance testing also show the coefficient value of its parameters (original sample). The parameter coefficient indicates the significance value of the influence of each research variable.

Table 6. Path Analysis

Path	Original Sample	t-value	P Values
Audit Competence -> Financial Performance	-0.087	0.947	0.344
Audit Competence -> Internal System Control	0.808	37.421	0.000
Internal System Control -> Financial Performance	0.793	9.999	0.000
Audit Competence -> Internal System Control -> Financial Performance	0.641	9.395	0.000

In this study, the researcher used a confidence level of 95% because according to Indrawati (2015:172), business research usually uses a confidence level of 95%. The path coefficient score as

indicated by the T-Statistic value must be above 1.65 for a one-tailed hypothesis. Based on the Path Coefficient and T-Statistics in Table 4.14 above, conclusions can be drawn as follows:

1. Audit competence does not have a positive and significant effect on financial performance.
2. Audit competence has a positive and significant effect on the internal control system.
3. The internal control system has a positive and significant effect on financial performance.
4. Audit competence has a positive and significant effect on financial performance mediated by the internal control system.

Discussion

The calculation results show that audit competence does not have a significant effect on regional financial performance. This is in line with the research conducted by Salju et al. (2014), which shows that audit competence does not have a significant effect on financial performance. The insignificance is because the audit process carried out by the East Luwu district inspectorate can be understood that the auditor's performance does not depend on his competence. Therefore, it can be concluded that auditors often encounter difficulties, resulting in low audit performance. According to Aswar (2019), audit quality does not guarantee improved financial performance because there are still program plans that do not meet the needs of the community, causing inefficiency.

The calculation results show that competence has a positive and significant effect on the internal control system. According to research conducted by Nunuy Nur Afiah et al. (2020), the competence of employees supported by comprehensive control implementation causes the entire system and data processing of transactions to become accounting information can run well. Thus, the quality level of the resulting accounting information can be better.

The research results show that the internal control system provides a positive and significant effect on financial performance. This is in line with the research conducted by Sahabi Ibrahim et al. (2017), showing results that the internal control system has a significant effect on financial performance. According to Crawford (2011), in pursuing the organization's goals regarding reliable, effective financial reporting and efficient operations, managers and the organization's board resort to building an internal control system to be more effective. The findings in this study also show that the internal control system can mediate the effect of competence on financial performance.

5. Conclusion

Based on the results of the analysis and discussion that have been carried out previously, the conclusions in this study are audit competence does not have a positive and significant effect on financial performance. Audit competence has a positive and significant effect on the internal control system. The internal control system has a positive and significant effect on financial performance. Audit competence has a positive and significant effect on financial performance mediated by the internal control system. Related to the fact that there are still employees who are less analytically and conceptually thinking, management should enhance employee capabilities through training and education to support the creation of more quality reporting. Meanwhile, to overcome the documentation system that does not fully support the internal control system, leaders must continue to monitor and inspect a better documentation system, and if necessary, provide the necessary supporting facilities.

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