

The Effect of Internal Auditor Competency on Internal Audit Quality and Its Implication on the Accountability of Local Government

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The Effect of Internal Auditor Competency on Internal Audit Quality and Its Implication on the Accountability of Local Government

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Abstract:

Accountability is one of the fundamental elements of good governance manifestation that currently is strived in Indonesia. Transparency and accountability of regional financial management requires a supervisory agency of local government, an internal Auditor (inspectorate) to improve the accounting quality.

¹⁴ The aim of this study is to provide empirical evidence on how the internal auditor's competency can affect internal audit quality in local government, and how its implication toward accountability of local government will be beneficial. The study is done with the population of all inspectorates in regency/city of Lampung Province, by using path analysis of Partial Least Square (PLS).

The result of this study gives empirical evidence that internal auditor (inspectorate) competency positively and significantly affects internal audit quality. Likewise, internal audit quality positively and significantly affects financial accountability of regency/city of Lampung. The higher the internal auditor competency, the better audit quality that is proxied by the number of findings by internal audit.

Based on descriptive and verificative approach in all Province/City/Regency Inspectorates in Lampung, it shows that internal auditors (inspectorate) have been adequately competent, but there are some regions that have not been competent (have not had adequate education level and skill). Accountability of local government of regency/city of Lampung is quite accountable, but not all regions of regency/city produce maximal opinion (WTP).

Keywords: Internal auditor competency, audit quality, accountability of local government.

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1. Introduction

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Good internal auditing is a requirement to the implementation of good governance in government. Public sector is often judged as the source of inefficiency, waste of leakage source, and an institution that always has financial losses. Based on data from the Supreme Audit Board (BPK) in local government in Indonesia, that is one of the results from the process of internal audit by inspectorate, the number of findings that tend to increase from 2013-2015. Audit opinion on Financial Report of Local Government in Indonesia also shows that most of local governments have not achieved fair opinion without adjustment. Audit opinion of local government financial report reflects the level of financial accountability of local government.

Therefore, the phenomenon is that the financial report of local government is still inadequately accountable. Transparency and accountability of regional financial management requires supervisory agency of local government that in this matter is internal auditor (inspectorate) to increase its quality. Internal audit quality helps in achieving accountability in governmental system. It is strengthening by the results of Baltaci and Yilmaz (2006), Bayramov (2009), Tilema and Henk (2008) and Havens (1990) that audit quality can increase financial transparency and accountability. The function of audit as one of balancer in the implementation of APBD (Local Government Budget) gives contribution in developing toward Local Government Work Unit (SKPD) in the scope of local government.

According to Boynton (2005), the function of internal auditor is to conduct the function of internal investigation to examine and evaluate organization activity. As Libby and Frederick (1990), Bonner (1990) and Soh and Bennie (2010) stated that auditor's competency obtained from experience and knowledge plays an important role in increasing audit quality. Based on the explanation of this phenomenon, theory and previous study, the authors want to investigate how big is the effect of internal auditor's (inspectorate) competency on internal audit quality in all regencies/cities in Lampung Province, and how is its implication toward accountability of local government.

2. Literature Review and Hypothesis Development

2.1 Internal Auditor Competency

Internal auditor must have professional competency to conduct his/her duty and responsibility (Pickett, 2010; Mc Intosh, 1999; Government Auditing Standards/GAS, 2007; Yazid and Suryanto, 2016; Setyawati *et al.*, 2017). Furthermore, Cheng, *et al.* (2002) stated that auditor's competency consists of two factors, which are knowledge and behaviour. It is strengthened by Institute of Internal Auditors (IIA) in 2010, stating that there are 3 dimensions for auditor's competency, which are knowledge, behavioural skill and technical skill ability. Behn *et al.* (1997)

developed the attribute of audit quality that among other is high ethical standard, while other attributes are related to auditor's competency.

2.2 Audit Quality

Watkins *et al.* (2004) identified some definitions of audit quality into four groups. First, the definition given by DeAngelo (1981) is that audit quality as a probability of market value, which is financial report containing material error, and an auditor will find a material error. Second, the definition proposed by Lee *et al.* (1999), is that audit quality is the probability that audit will not report audit report with fair opinion without exception for any financial report that contains material error. The third definition is that audit quality is measured from information accuracy reported by an auditor. The fourth definition is that audit quality is determined from the ability of audit to reduce noise and bias and to increase purity on accountancy data (Watkins *et al.*, 2004). Internal audit quality includes: the level of compliance with IIA standards, the ability to audit plan, execute audit findings and communicate audit findings (Moeller, 2005; Cohen and Sayag, 2010; Mihret and Yismaw, 2007; Spraakman, 1997). In line with the previous statement on audit quality, Chen *et al.* (2004) stated that the number of findings showed audit quality. Audit quality is increasing more because the presence of auditor's competency improvement that is obtained along with the longer assignment period of auditor.

2.3 Accountability

Accountability is a form of obligation to be responsible for the success or failure of organization mission implementation in achieving goal and target that have been determined previously, through a media of responsibility that is done periodically (Stanbury, 2003). Local government conducts the mandate from public in the form of local financial management, financial of local is required to be transparent and accountable in its responsibility. Information transparency especially financial and fiscal information must be done in relevant and easily understandable form (Schiavo-Campo and Tamosi, 1999). An important accountability related to local financial management is financial accountability. This accountability requires public agencies to make financial report to describe financial performance of organization to external party. Financial accountability is related to the avoidance of public fund misuse. In other words, accountability contains the obligation to present and report local financial management into local financial report. Financial report is an instrument to facilitate the creation of public transparency and accountability.

2.4 The Effect of internal auditor competency on internal audit quality

Competency is related to adequate education and experience owned by public accountant in the field of auditing and accounting. Furthermore, Libby and Frederick (1990) stated that auditor competency obtained from experience and knowledge plays an important role in increasing audit quality. It is in line with Pickett and

Spencer (2010), stating that competency is related to adequate education and experience owned by public accountant in the field of auditing and accounting. Bonner (1990) obtained a study result showing that knowledge on specific duty that can increase the performance of experienced auditor, even though only in the determination of analytical risk. In the Regulation of Head of BPKP No.PER-211/K/JF/2010 about functional competency of auditor states that in order to conduct duty and responsibility of auditor professionally, auditor competency qualification is needed to conduct supervisory duty in accordance with his/her level of position. Based on the above explanation, the proposed hypothesis is as follows:

H1: Internal auditor competency positively affects internal audit quality.

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2.5 The Effect of Internal Audit Quality on Accountability

Audit quality will increase the weight of responsibility or accountability because it produces independent report about whether financial information arranged by government is presented fairly and fulfills the requirement of obedience toward applied legislation (Henk, 2008). Corporate governance is a procedure and structure used to control and manage business activities of the company towards increasing business success and corporate accountability (Suryanto *et al.*, 2016), as well as in government. Audit quality is one factor of good governance. Auditing is necessary to secure accountability (Flint, 1988). Meanwhile, qualified auditing will have effect to increase presented financial information quality for users. Furthermore, Tilema and Henk (2008) found that audit quality in local government is an instrument in increasing government accountability. Audit quality can increase financial transparency and accountability (Baltaci and Yilmaz, 2006; Bayramov, 2009; Tilema and Henk, 2008, Soh and Bennie, 2010). It is strengthened by Havens (1990) finding that audit quality can increase fiscal transparency and government accountability. Based on the above explanation, the proposed hypothesis is:

H2: Internal Audit Quality positively affect accountability of local government.

3. Research methods

Population in this study is all inspectorates of Regency/City/Province of Lampung. The sample is taken from all populations consisting of 15 Regencies/Cities in Lampung Province for a period of 5 years (2011-2015). The primary data is the number of annual findings of each inspectorate of Regency/City, and the data of the number of auditors at the level of junior auditor with undergraduate education obtained from the data updating forum of inspectorates in regencies/cities in Lampung Province. The secondary data is the data audit opinion of local government financial report obtained from Ikhtisar Hasil Pemeriksaan Badan Pemeriksa Keuangan Republik Indonesia (IHPS BPK RI) – Result Overview of Indonesian Supreme Audit Institution in 2016.

Table 1: Variable Operational Measurement

No	Variable	Measurement Indicator
1	Internal Auditor Competency (the Regulation of Head of BPKP No.PER-211/K/JF/2010 on the functional competency of auditor)	The qualification of required competency 1. Education = Minimal 3 year Associate's Degree 2. Training and Experience = has attended JFA Workshop and occupied a position at least Junior Auditor. The formulation of Auditor Competency Percentage: $\frac{\text{the number of auditors fulfilled the qualification}}{\text{the number of existing Auditors}} \times 100\%$
2	Internal Audit Quality	The number of Annual Findings of Inspectorate of Regency/City
3	Accountability	Opinion of Financial Report of Local Government Fair without adjustment (WTP) : notation 5 Fair without adjustment with explanatory paragraph (WTP DPP) : notation 4 Fair with adjustment (WDP) : notation 3 <i>Adverse</i> : notation 2 <i>Disclaimer</i> : notation 1

4. Research results

As shown in Table 2 the average value of internal auditor competency in local governments in all regencies in Lampung for the study period is 76.30%, meaning that most of internal auditors in the inspectorates, as much as 76.30%, have been competent with the position of at least junior auditor and have undergone education minimum to undergraduate studies. The lowest competency is 33.33% and the highest is 100% from the total of auditors in each inspectorate of regency/city. The accountability has the mean value of 3.82, meaning that on average, regencies/cities in Lampung have had adequately good opinion (3.82%) which is opinion of WDF to WDP DPP, but have not achieved maximum opinion (WTP).

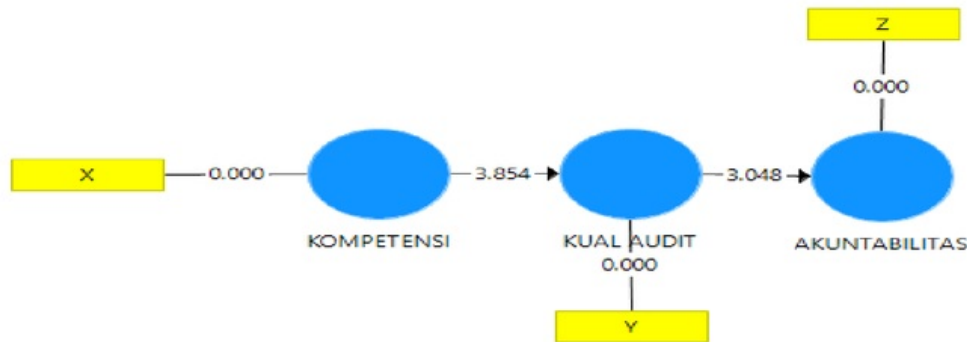
Table 2: Variable Descriptive

Variable	Mean	Minimum	Maximum
Internal auditor Competency	76.30 %	33.33 %	100.00%
Internal audit Quality	2,760,000,0 00 cases	13,645,522 cases	42,900,000,000 cases
Accountability	3.82	1	5

The study uses Partial Least Square as the analysis method. Based on the result of validity test, all variables have been valid, proven by the value of AVE is higher than 0.5. It means that information in all dimensions and indicators has been represented in the laten variable. Laten variable has the reliability value more than

0.6 (recommended score) meaning that all dimensions and indicators have consistency. By using the method of PLS analysis, the path diagram model is in Figure 1:

Figure 1. Coefficient Standard of Structural Model (Output Bootstrapping PLS)



The estimated models show that R square of the regression model 1 is 0.158, meaning that the variable of internal auditor competency can explain the variable of internal audit quality as much as 15.8%. R squared for regression model 2 is 0.106, meaning that the variable of internal audit quality explains the variable of accountability as much as 10.6%. This value shows that the model is still weak. It means that there are still other variables that can affect internal audit quality and accountability of local government. The testing result of the first hypothesis shows that there is a positive and significant effect from internal auditor competency toward internal audit quality at significance level of 0.5% with path coefficient of 0.398. The testing result of the second hypothesis shows that there is a positive and significant effect from audit quality on accountability at significance level of 5% with path coefficient of 0.326 (Table 3).

5. Discussion of the results

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5.1 The Effect of Internal Audit Competency on Internal Audit Quality

1 There is a positive and significant effect of internal auditor (inspectorate) competency on internal audit quality at significance level 5%. The higher the competency of internal auditor (inspectorate), the more increased internal audit quality (the number of audit findings), it means that internal auditor will be able to disclose audit findings more. It supports the study by Libby and Frederick (1990) stating that auditor's competency obtained from experience and knowledge plays an important role in increasing audit quality. The experience owned by auditor will affect his/her audit quality. Having more experiences, auditor will be able to produce kinds of notions in explaining audit findings. The result of this study is in line with the results of Christiawan (2002) and Tubbs (1992) in Libby and Frederick (1990)

that competency will increase audit quality. An experienced internal auditor has superiority in detecting error, understanding error accurately, and searching the cause of error. Therefore, more competent internal auditor will be more sensitive to error.

Table 3: The Effect of Internal Auditor Competency on Audit Quality (the number of findings) and its Implication toward Accountability

Influence	Path Coefficient	t value	P Value	Ha
Competency → Internal Audit Quality	0.398	3.854	0.000	Supported
Internal Audit Quality → Accountability	0.326	3.048	0.002	Supported

5.2 The Effect of Internal Audit Quality on Accountability of Local Government

There is a positive and significant effect of inspectorate internal audit quality (the number of inspectorate internal audit finding) on accountability of local government at significance level 5%. The higher the quality of internal audit (the number of internal audit findings), the accountability is increasing. It is in line with the agency theory that to minimize conflict between owner (community) and agent (management) which is local government, local government must report local government financial accountably which can be achieved by increasing the audit quality through inspectorate internal auditor role as supervisor in all local governments of Regency/City.

The result of this study also supports the statement of Henk (2008) that audit quality will increase the weight of responsibility or accountability because it produces independent report about whether financial information is arranged by government fairly and has fulfilled the requirement of obedience toward applied legislation. Qualified audit process will increase financial information quality presented for users (proxied by the opinion of BPK). Financial report audited by independent auditor can disclose financial information and relevant material fact to audit service users. Furthermore, Tilema and Henk (2008) found that audit quality in local government is one of the instruments in increasing the accountability of government.

Government Accounting Standards Board (GASB, 1999) in its concept for the objective of financial reporting, is that audit in the scope of government is a very important matter that must be noticed and evaluated its implementation because it is related to public accountability especially financial accountability. Audit quality can increase financial transparency and accountability (Baltaci and Yilmaz, 2006; Bayramov, 2009). The result by Havens (1990) is that audit quality can increase fiscal transparency and government accountability. It is strengthened by Baltaci and Yilmaz (2006) as well as by Bayramov (2009), stated that audit quality in government can increase financial accountability of local government.

6. Conclusion

Competency of internal auditor (inspectorate) positively and significantly affects internal audit quality (the number of internal audit findings). The more competent internal auditor, the greater number of internal audit findings, it means that internal audit quality increases more. Internal audit quality positively and significantly affects accountability of local government. The more qualified internal audit (more internal audit findings), the more increased financial accountability of local government (audit opinion). This study supports the theory.

In order to increase the quality of inspectorate internal audit, a local government must increase the competency of internal auditor and also increase the quality of the audit process itself. To increase the financial accountability of local government, a local government must increase the audit quality. Accountable financial report is reflected from audit opinion given.

A future study can add other variables that affect internal audit quality and financial accountability of local government because internal audit quality is not only determined by internal auditor's competency but also depends on implemented audit process.

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