

# Determinants for Quality Financial Reporting in Public Sector

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## ABSTRACT

This research aims to find out the empirical evidence of determinants for financial reporting quality with some variables such as an internal accountant competence, information technology utilization, internal accounting control, role of internal auditor, and case study in public sector particularly the government of Hulu Sungai Selatan regency, South Kalimantan, Indonesia. The principles of organizing the regional finance are accountability and reliability. Accountability means that it is accountable towards public as the user of financial report so that the local government requires a decent quality of financial report. The research applied associative causality approach. The methods of the research used a survey and questioner for the data collection. The government of Hulu Sungai Selatan regency, that are responsible in making financial report that include accounting entity and financial reporting entity of the local government, are the object of unit analysis. The analysis of the data applies Likert scale in multiple regression. The result of the research attests that variable such as the competence of internal accountant, utilization of information and technology, control of internal accounting, and role of internal auditor significantly have positive correlation to the quality of financial report. It indicates that the government of Hulu Sungai Selatan regency should observe and develop those four variables in order to improve the quality of financial report.

**Keywords:** financial reporting quality, internal accountant competence, information technology utilization, internal accounting control, role of internal auditor

## Introduction

The management of regional finance of public sector in Indonesia is expected to be able to meet the accountability principle and therefore reporting mechanisms which include planning until final implementation are required. One of the reporting forms that is related to the financial management is the financial report, particularly, of the local government. Government regulation (known as *Peraturan Pemerintah* or PP) No. 24 Year 2005 concerning Government Accounting Standard (GAS) obliges local government to make a financial statement which includes statement of budget realization, balance sheet, statement of cash flow, and notes to the financial statements. Government Regulation No. 24 Year 2005 is replaced by Government Regulation No. 71 Year 2010 concerning GAS that obliges an accrual basis implementation, and additional report in addition to the obligation statements from the government regulation No.24 Year 2005, those are Operational Reporting, Balance Change Report, Excess Budget Change Report, and Statement of Changes in Equity.

Head district requires organizing regional finance report, then it is examined by Audit Board of Indonesia (known as *Badan Pemeriksa Keuangan* or BPK) since it has become the key element of the local government's accountability. The accountability is the responsibility towards public or stakeholder as the users of financial report. The regulation concerning this issue is Regulation of the Minister of Home Affairs No. 13 Year 2006 as it has been revised into Regulation of the Minister of Home Affairs No. 21 Year 2011 concerning Guideline on Regional Financial Management.

Based on the examination, Audit Board of Indonesia gives their opinions which are Unqualified Opinion, Qualified Opinion, Adverse Opinion, and Disclaimer of Opinion. The result of the annual examination by Audit

Board towards the local government is stated into 3 reports, which are: Result of the Report of the Audit on Financial Statement in General, Result of the Report of the Audit on the Internal Control System, and Result of the Report on the Audit of the Compliance with Laws and Regulations. Unqualified opinion is the highest assessment to the central and regional government agencies regarding financial report. Moreover, the Result of the Report related to the Internal Control System as well as Compliance with Laws and Regulations should be taken into account as well. Those two reports will help the Audit Board in gaining significant findings that will affect financial reporting quality.

In the last two years, which is from the fiscal year 2013 up to 2014, Government of Hulu Sungai Selatan (HSS) regency in South Kalimantan is one of the regencies that has claimed unqualified opinion. Nonetheless, it does not mean that the financial report is flawless. It can be seen from the Result of the Report by Audit Board that still found problems in the financial report, especially the issues concerning internal control system and disobedience towards laws and regulations, for instance Land and Building Tax receivable that has not been verified, management of income grants that is not appropriate with GAS, and management of asset grant to the society that has not been completed with the document according to the laws and regulations. Based on the related issues, Mairi (2014) states that presentation of the Financial Report of Department of Revenue Finance Asset Management in HSS, generally is still inaccurate according to the provision. Moreover, the explanation does not provide detail number that complicates the users in general to understand the financial report.

Several facts that have been stated above indicates that financial reporting quality of Government HSS regency is the variable that still needs improvement and refinement. If it is not refined, then the findings have the potential to be the cause of inaccurate and less reliable financial report. The phenomenon is interesting to be investigated through examining the variables that determine the quality of financial report. Several related regulations that have been stated by Indonesian government as mentioned above are part of the reforms in public sector especially government, which are the reforms of the five areas. One of them is accounting reform in an attempt to increase the efficiency of public sector management especially for central and regional government (Mardiasmo, 2002:27). In general, the reformation phenomenon occurred in several countries in an attempt to increase the efficiency (Ryan, 1998) including in Indonesia. As a consequence, government needs refinement of the accounting system quality and its report in order to provide an accurate information and reflect some risks, in other words a good quality of financial report is required (Heiling, 2011 and Pina et al. 2009).

Conceptually, a good quality of financial report is essential as an accountability of the principle to the agent as explained in the Agency Theory (Jensen and Meckling, in Chhotray and Stoker, 2009:148) and Legitimacy Theory (Chhotray and Stoker, 2009:84). As part of the reform in the context of refinement of financial reporting quality, Government Regulation No. 71 Year 2010 concerning Government Accounting Standard (GAS) is enacted since fiscal year 2015 and in the implementation, it requires the readiness of the local government, whether in term of the human resource or the supporting device. Therefore, the focus of the research is the aspects of human resource that are the competence of internal accountant and role of internal auditor, as well as the supporting aspect relates to the utilization of information technology, and control of internal accounting.

Several empirical studies show the inconsistency of the previous result study so that it invigorates the idea to reconduct the study regarding some variables. Setiyawati (2013) and Yensi et al. (2014) attest that the variables of internal accountant competence along with the capacity of human resource take effect to the financial reporting quality. It contradicts to the study conducted by Sukmaningrum and Harto (2012), and Inriasari and Nahartyo (2008) that show variable of human resource capacity does not significantly affect the quality of financial report. In line with this, Yensi et al. (2014) do not prove the effect of internal audit towards financial reporting quality. On the contrary, the study conducted by Yuliani et al. (2010) successfully attest that the role of internal audit gives significant impact to financial reporting quality and it is supported by Kewo and Afiah (2017).

In addition, Setiyawati (2013) also fail to prove the effect of internal control system to the financial report quality. The result of the study contradicts to the study conducted by Nahartyo (2008) and Sukmaningrum and Harto (2012). The result of the study done by Kewo and Afiah (2017) also prove the effect of the variable to the financial report quality. Specifically, variable of information technology utilization, based on the previous studies, tends to have a consistent result which affects to the financial report quality. However, the previous studies have limited aspect that it cannot be generalized to other studies.

The result of the study done by Yensi et al. (2014) find that the role of regional financial accounting system as part of information technology utilization partially affects the financial reporting quality. In line with the study conducted by Darwanis and Mahyani (2009) and Sukmaningrum and Harto (2012), they find variable of external factor such as development of information technology, development of web and internet technology cannot be made as a factor influencing quality of human resource and internal control system, but it is used as independent variable along with internal control system towards the information quality of financial report of local government.

Yulianti et al. (2010) investigates the influence of understanding of accounting, utilization of regional financial accounting information system and role of internal auditor towards the financial reporting quality. The result of the study shows that the three independent variables that are studied both simultaneously and partially have

positive correlation to the quality of financial report significantly. The study done by Indriasari and Nahartyo (2008) state that utilization of information and technology and partial internal control accounting significantly have positive correlation to the financial report quality. This research is conducted through model research regarding determinants affecting financial reporting quality in public sector particularly in the local government of HSS regency in West Java Province.

## **Literature Review**

### **Agency Theory and Legitimacy Theory**

The importance of financial report quality in public accountability can be explained through agency theory and legitimacy theory. Jensen and Meckling in Chhotray and Stoker (2009:148) reveal that agent contracting principle to manage human resource in organization and oblige to give reward to agent while the agent obliges to manage human resource that is owned by the organization and be responsible to the assigned tasks. Thus, it requires accountability such as financial report. Financial report should have a decent quality so that it will not misleading the users of the financial report. The report of the local government's financial statement is one of the practices based on the agency theory. Government whose role as the agent should present the useful information to the user of information (society) whose role as the house of representative in evaluating the accountability.

In relation to legitimacy theory, Chhotray and Stoker (2009:84) state that in order that every government system to be able to stand in a long-term period, the system should build a legitimacy from society. Government is expected to convince that every activity is aligned to what society expects. A financial reporting quality becomes one of the attempts performed by government as the accountability to society. Furthermore, Suchman (1995:2) emphasizes that legitimacy is considered important by an organization since the legitimacy of society towards organization becomes a strategic factor to the development of organization in the future. Therefore, a decent quality of financial report is required as one of the reporting media to the public.

### **Financial Report Quality**

In relation to the qualitative characteristic of financial report, based on Conceptual Framework of Government Accounting Standards (PP No. 71 Year 2010), it is defined as normative standards that needs to be realized in the accounting information so that it can fulfill its purpose. Those four characteristics are the normative conditions that is required in order that financial report can meet the requirement: (a) relevant, (b) reliable, (c) comparable, and (d) understandable.

Financial report is considered relevant if the information can facilitate the user in evaluating the previous or recent event and predict the future as well as confirm or correct the result of the evaluation. It is considered reliable if it is not misleading and not containing error material. It is considered comparable if it can be compared to the previous financial report (internal) or financial report of other entities in general (external) and If it applies a consistent accounting policy continuously. It is considered understandable if it is stated in the form and term that is adjusted to the user understanding and the willingness of the user to understand the financial report.

Moreover, International Public Sector Accounting Standards (IPSAS (2010) explains that financial report quality should refer to: relevance, faithful representation, understandability, comparability, and timeless. Furthermore, it is conceptually explained that faithful representation, neutrality, and completeness are part of the components of reliability.

### **Internal Accountant Competence**

Setiyawati (2013) argue that internal accountant competence is knowledge, skill, attitude, and experience owned by accountants in the organization where they work. Knowledge refers to the educational background. Skill refers to the technical skill. Attitude refers to the performance in fulfilling the responsibility of the duty. Experience is gained through the period of time as long as the person is carrying the duty.

Hevesi (2005) states that competence can be seen from the educational background, trainings, and skill that is gained while carrying the duty. Competence is a characteristic of someone who has skill, knowledge, and ability to carry the duty. It is a characteristic that underlies a person to achieve high performance on the work. The employee who does not have sufficient knowledge will face many obstacles that causes waste of material, time, and energy.

Internal accountant competence affects determinants for financial reporting quality. It is supported by the result of the research conducted by Setiyawati (2013). She argues that the better internal accountant competence, the higher financial reporting quality will increase. The argument is strengthened by the research done by Yensi et al. (2014) and Afiah and Rahmatika (2014). On the contrary, the research done by Indriasari and Nahartyo (2008) do not support the argument.

### **Information and Technology Utilization**

Widyaningtias (2014) mentions that information technology is an integrated mean that can be used to gain, process, and send or provide electronic data into information in various forms that is beneficial for the user. Andriani (2010) states that in the management of regional finance, local government is expected to provide

information of Regional Revenue and Expenditure Budget and accounting information that will be used by public manager to perform appropriate, relevant, accurate, and complete planning and controlling functions of an organization, so that information technology (hardware and software) is required in order to provide the information.

Jurnali and Supomo (2002) define technology information utilization as level of integration information technology on the implementation of accounting duties. Computerization functions in improving system capability. Computer and components related to information technology are integrated to the accounting information system. Accounting information system is able to collect, process, and store the data. The system also stores controls of the accuracy of the data. It also generates reports and other information. Computerization make data processing can be regulated in a way so that the information can be presented on time and the budget that is below the benefit. Data processing can be adjusted to the requirement, so the economic benefit of the information can be gained maximally.

Therefore, information technology utilization affects determinant for financial reporting quality as stated in the result of the study conducted by Indriasari and Nahartyo (2008), Darwanis and Mahyani (2009), Yuliani et al. (2010), Sukmaningrum and Harto (2012), and Yensi et al. (2014).

### **Internal Accounting Control**

Wilkinson et al. (2000:15) state that an organization should develop its control activities— policies, practices, and procedures. The control activities aim to ensure that the employees have performed their jobs according to the directions of management. It means that the reason of internal accounting control is making sure that the information from the accounting system has a decent quality. An accounting system closely related to the internal control that is applied in the organization, in the other words a decent accounting system is the one that has an effective control system.

Internal control according to Regulation of the Minister of Home Affairs No.13 Year 2006 concerning Financial Management Guidelines of the region is a process which is designed to ensure that the objective achievement of the local government is reflected in the financial reporting quality, efficiency and effectivity of the program implementation and activity as well as the compliance with the regulations. There are three functions of the regulation above: (a) financial reporting quality, (b) efficiency and effectivity operation, (c) compliance with the regulations. Bastian (2006:51) defines internal accounting control as a control which includes organization planning, procedure, and note that is designed to maintain the quality of accounting data. Thus, internal accounting control can be defined as a control that is done in the accounting system which aims to ensure the quality of accounting data, so it will determine financial reporting quality.

Internal accounting control determines financial reporting quality as supported by the previous studies conducted by Indriasari and Nahartyo (2008), Sukmaningrum and Harto (2012), Setiyawati (2013), Afiah and Rahmatika (2014), and Kewo and Afiah (2017). On the contrary, the research conducted by Yensi et al. (2014) oppose the argument.

### **Role of Internal Auditor**

Internal Federation of Accountant (2014) explains that internal auditing is an independent activity, objective and consultation activity that is designed to give additional evaluation and improve organization operation. Internal auditing can facilitate organization to achieve the goal through applying systematical and disciplined approach to evaluate and improve effectiveness of risk management process, adequacy of supervision and organizational management.

Role of internal auditor, generally, is divided into two main categories: assurance and consultation. Assurance is a service in giving an objective assessment of the audit evidence to provide opinion or independent conclusion regarding the process, system or subject of another matter. Type and scope of assurance is determined by the internal auditor. While, consultation is a service in giving suggestion, and generally it is done based on the special demand from the client. Internal auditor should maintain the objectivity and not carry management responsibility while doing the consultation.

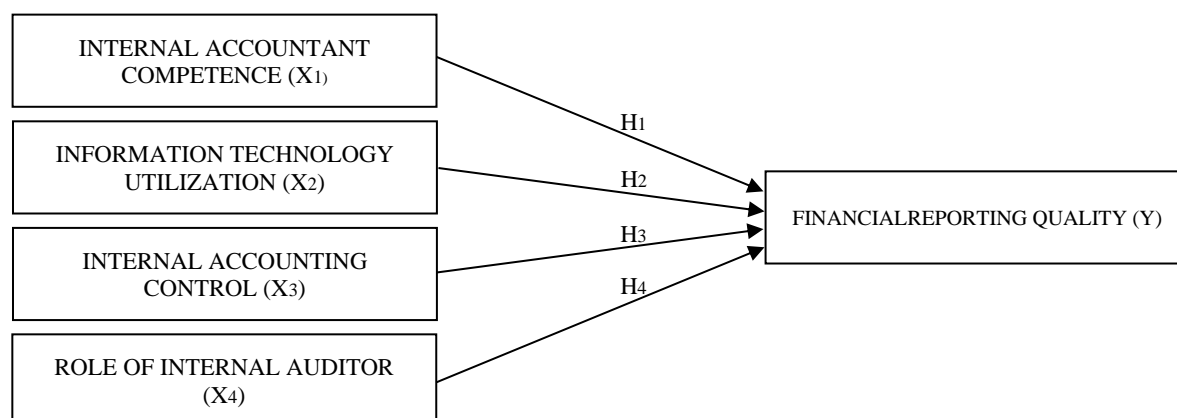
Role of internal auditor determines the quality of financial report as Yuliani et al. (2010) state in her research that the more effective the role of internal auditor, the better impact it gives to the financial reporting quality. The argument is supported by the research done by Kewo and Afiah (2017).

### **Method**

The research applied associative causality approach. The research conducted a survey and used questioner for the data collection thus the data used in the study is the primary data gained from the respondent itself. The research took place in the government of Cimahi district in the West Java Province in Indonesia.

Unit analysis of the research is the officer that is responsible in making financial report in the accounting entity and financial reporting entity of the local government that includes Regional Finance Administration Unit, Structural and Functional Officer in accounting and regional assets. The research involves 98 respondents using a random sampling of 79 persons. The number of samples is determined by Yamane approach (Ferdinand, 2006:227).

The research examines determinants for the financial reporting quality that includes some variables such as the competence of internal accountant, utilization of information technology, control of internal accounting, role of internal auditor. The analysis of the data applies Likert scale 1-5 in multiple regression. The research model is presented in the picture bellow.



**Figure 1. Research Model**

Based on the research model above, therefore the hypotheses that will be tested are:

H<sub>1</sub>: Internal accountant competence has a positive correlation with financial reporting quality.

H<sub>2</sub>: Information technology utilization has a positive correlation with financial reporting quality.

H<sub>3</sub>: Internal accounting control has a positive correlation with financial reporting quality.

H<sub>4</sub>: Role of Internal auditor has a positive correlation with financial reporting quality.

## Findings

The result of the multiple regression is presented in the following table.

**Table 1. Result of Multiple Regression**

Variable	Coefficient	Significance	Comment
INTERNAL ACCOUNTANT COMPETENCE (X <sub>1</sub> )	0,180	0,035	Significance
INFORMATION TECHNOLOGY UTILIZATION (X <sub>2</sub> )	0,206	0,018	Significance
INTERNAL ACCOUNTING CONTROL (X <sub>3</sub> )	0,322	0,008	Significance
ROLE OF INTERNAL AUDITOR (X <sub>4</sub> )	0,242	0,025	Significance

**Table 2. Result of Coefficient of Determination**

Model Estimate	R	R Square	Adjusted R Square	Std. Error of the
1.	0,813	0,661	0,643	0,21424

Based on the Table 4.1. above, it indicates that internal accountant competence (X<sub>1</sub>) is one of determinant factor that has positive correlation to the financial reporting quality (Y) (p-value 0,035 is lower than significance level 0,05). Information technology utilization (X<sub>2</sub>) is one of determinant factor that has positive correlation to the financial reporting quality (Y) (p-value 0,018 is lower than significance level 0,05). Internal accounting control (X<sub>3</sub>) is one of determinant factor that has positive correlation to the financial reporting quality (Y) (p-value 0,008 is lower than significance level 0,05). Role of internal auditor (X<sub>4</sub>) is one of determinant factor that has positive correlation to the financial reporting quality (Y) (p-value 0,025 is lower than significance level 0,05).

Correlation coefficient (R) on the Table 4.2. above is 0,813 that indicates the correlation between independent variable and dependent variable is 81,3%. While, R Square is 0,661 which means financial reporting quality variable (Y) can be explained by four independent variables which is 66,1%, and the rest are explained by other variable other than this research model. Next, Adjusted R Square (0,643) is the value that has been adjusted and more moderate to explain the financial reporting quality (Y) by the four independent variables with 64,3%, while 35,7% is explained by other variables. Standard Error of the Estimates (SEE) is 0,21424 indicates a relatively small value. Thus, it can be concluded that the regression model is better in predicting the four variables in this research model.



## Discussion

### **The Effect of Internal Accounting Competence on Financial Reporting Quality**

The research attests that internal accounting competence has positive correlation with the financial reporting quality of the local government. It is due to the competence of human resources is one of determinant factor that reflects employees' ability such as knowledge, skill, and attitude which should be responsible of the financial report. It is supported by the research conducted by Yensi et al. (2014), and Afiah and Rahmatika (2014). Difference findings are shown from the research done by Indriasari and Nahartyo (2008).

The value of  $\beta_1$  coefficient for internal accountant competence variable is 0,180. It indicates that if internal accountant competence is developed, it will increase the financial reporting quality at 18%. Another aspect that should be pointed out in this variable is a sufficiency of human resources. This indicator, based on the research, has less response since it does not have a particular accounting staff that helps in making accounting record and financial report of the local government agency. It indicates that human resources that are responsible of making the financial report are still insufficient.

### **The Effect of Information Technology Utilization on Financial Reporting Quality**

The result of the research shows that information technology utilization has positive correlation with the financial reporting quality of the local government. It indicates that information technology as a mean of determinant factor in processing and presenting the financial report since it can provide information in various forms that benefits its users. It is supported by the previous research done by Indriasari and Nahartyo (2008), Darwanis and Mahyani (2009), Yuliani et al. (2010), Sukmaningrum and Harto (2012), and Yensi et al. (2014). The value of  $\beta_2$  coefficient for information technology utilization variable is 0,206. It indicates that through increasing the utilization of information technology, financial reporting quality will increase up to 20,6%. Government of HSS regency since 2007 has cooperated with Financial Control Board of South Kalimantan Representative in making use of the information technology in making financial report of the local government. Another concern regarding this variable is that financial report of the local government gets more complex. Thus, the utilization of information technology increases speed of transaction processing and other data and accuracy of the calculation. It facilitates in making a decent quality of financial report of the local government.

### **The Effect of Internal Accounting Control on Financial Reporting Quality**

The result of the research attests that internal accounting control has positive correlation with the financial reporting quality of the local government. It indicates that every policy, procedure, and practice in implementing the program and development activity is highly required as an internal control mechanism particularly in the process of accounting data until it becomes financial report. The finding is supported by some previous research conducted by Indriasari and Nahartyo (2008), Sukmaningrum and Harto (2012), Setiyawati (2013), Afiah and Rahmatika (2014), and Kewo and Afiah (2017). On the contrary, the research done by Yensi et al. (2014) shows a difference result.

Internal accounting control variable is closely related to the capacity of internal control system that influences public trust towards financial report of the local government. The better internal accounting control, the more reliable the financial report will be. The better internal accounting control that will increase the accountability of the financial report, the better quality of the financial report will be.

The value of  $\beta_3$  coefficient of internal accounting control variable is 0,322. It signifies that through increasing the internal accounting control, the quality of financial report will increase at 32,2%. It should concern government of Hulu Sungai Selatan regency in improving internal accounting control which includes maintaining the financial report to be up-to-date. It is due to the implementation tends to postpone the accounting records. This phenomenon should be anticipated through improving the existing internal accounting control. For example, the obligation of monthly financial report should be applied thus it will have an up-to-date accounting record.

### **The Effect of Internal Auditor's Role**

The result of the research shows that role of internal auditor has positive correlation with the financial reporting quality of the local government. It indicates that the stronger the role of the internal auditor, the better quality of financial report of the local government will be. Therefore, it becomes one of the determinant factors for financial reporting quality since it gives beneficial aspect in evaluating and improving the effectivity of organization, managing risk and internal control system. The argument is supported by Yuliani et al. (2010) and Kewo and Afiah (2017) on their research.

The value of  $\beta_4$  coefficient of internal auditor's role is 0,242. It indicates that the increase of internal auditor's role will improve the financial reporting quality at 24,2%. The role of internal auditor is still not maximal as the information gained from the inspectorate of HSS regency. It relates to the limited number of personnel of the supervisory apparatus.

The result of the research attests the effect of four independent variables as determinant factors of the financial reporting quality. Therefore, those variables should get special attention from the government of Hulu Sungai

Selatan regency, particularly in maintaining and improving quality of financial report. If government focuses on improving those four variables, thus the quality of financial report of the local government will improve optimally.

### Conclusion

Internal accountant competence, information technology utilization, internal accounting control, and role of internal auditor are determinant factors that significantly affect the financial reporting quality of the local government. The improvement in the implementation of internal accountant competence, information technology utilization, internal accounting control, and role of internal auditor will increase the quality of local government financial report.

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