

## THE INFLUENCE OF MANAGER COMPETENCY AND INTERNAL CONTROL EFFECTIVENESS TOWARD ACCOUNTING INFORMATION QUALITY

Sri Mulyani<sup>1</sup> and Enggar Diah Puspa Arum<sup>2</sup>

**Abstract:** *The purpose of this study is to examine the influence of manager competency and internal control effectiveness toward accounting information quality. Research was conducted on 87 companies listed in the Indonesia Stock Exchange and analyzed using SEM-PLS method. The empirical results indicate that manager competency and internal control effectiveness have a positive and significant effect on accounting information quality.*

**Keywords:** *manager competency, internal control effectiveness, accounting information quality*

### INTRODUCTION

**Background research:** Information plays an important role for a company, because managers need information to determine the development of the company's operations and avoid risks which may cause the company suffered losses (Romney & Steinbart, 2009). Information is the data presented in a particular form according to user requirements to be used in the decision-making process, it also has value information for decision makers to reduce uncertainty and increase knowledge about specific areas of concern (Gelinas *et al.*, 2005). According to Azmi Fitriati and Sri Mulyani (2015), information can be useful when it satisfies several characteristics such as: relevance, reliability, completeness, timeliness, understandability and verifiability.

Accounting information is the output of accounting information system that is used by users to make the right decisions related to the company's activities (Sri Mulyani, 2008). Stakeholders uses accounting information to assess the risks and future prospects in determining the value of the company more accurately (Healy

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<sup>1</sup> Department of Accounting, Faculty of Economics and Business, Universitas Padjadjaran, 40132 Bandung, Jawa Barat, Indonesia, *E-mail: srins@fe.unpad.ac.id; srinak67@yahoo.co.id*

<sup>2</sup> Student of Accounting Doctoral Program, Faculty of Economics and Business, Universitas Padjadjaran, 40132 Bandung, Jawa Barat, Indonesia

<sup>2</sup> Department of Accounting, Faculty of Economics and Business, Universitas Jambi, Jambi, Indonesia

& Palepu, 2001). Therefore accounting information needed to achieve the business objectives of the company (Sacer *et al.*, 2006).

Several factors that can affect the quality of accounting information are: manager competency (Cohen *et al.*, 2004; Harrer, 2008; Higson, 2003; Sutton, 2004) and internal control effectiveness (Harrer 2008; Brink, 2011; Zinkin, 2014).

Management has the primary responsibility to ensure that the accounting information produced by the company has a good quality (Cohen *et al.*, 2004). Harrer (2008) adds that the managers must be qualified, have experience and competence to ensure that accounting activities generate a high information quality.

Besides manager competency, internal control effectiveness also contribute to affect accounting information quality (Harrer, 2008; Brink, 2011; Zinkin, 2014). The purpose of internal control is to provide reasonable assurance regarding the company's ability to ensure effective and efficient operations, reliable financial reporting, and compliance with all relevant laws and regulations (Zinkin, 2014). Furthermore Brink (2011) states that the overall objective of internal control over financial reporting is to prepare the accounting information that is accurate and reliable. Therefore, according to Harrer (2008), the company can increase accounting information quality by strengthening internal control.

The purpose of this study is to examine the effect of manager competency and internal control effectiveness toward accounting information quality.

## LITERATURE REVIEW

**Manager competency:** Manager competency is a characteristic, behavior, and attitude of the managers that contribute to their ability to carry out their duties related to management functions (planning, organizing, directing and controlling company's activities) to help the company achieve its goals and superior performance (Spencer & Spencer, 1993; Dubois & Rothwell, 2004; Jones, *et al.*, 2005; McShane & Glinow, 2010; Wagner & Hollenbeck, 2010; Levin & Ward, 2011). Manager competency can be measured through knowledge and skills (Dubois & Rothwell, 2004; McShane & Glinow, 2010; Hsieh *et al.*, 2012).

**Internal control effectiveness:** Internal control effectiveness is the ability of management to achieve the company's objectives by performing control (related to their responsibility) and understand the company's business, as part of a process designed to provide reasonable assurance that operations are effective and efficient, the financial statements are reliable, and compliance with laws and regulation can be achieved (Sudit, 1998; Murdock and Scutt, 2002; Chorafas, 2004; Graham, 2008; Hightower, 2009; Collier *et al.*, 2007; Woods *et al.*, 2008; Ramos, 2008; Messier *et al.*, 2008). Internal control effectiveness can be measured through five COSO's internal

control components, namely: control environment, risk assessment, control activities, information and communication, and monitoring activities (Collier *et al.*, 2007; Graham, 2008; Ramos, 2008; Hightower, 2009; Arens *et al.*, 2012).

**Accounting information quality:** Accounting information quality is conformity of information which produced by accounting system to meet the needs of interested parties in making economic decisions (Meigs & Meigs., 2006; Britton & Wate., 2006; Gibson, 2011). Accounting information quality can be measured through the qualitative characteristics of accounting, namely: relevant, reliable, complete, timeliness, understandable, and verifiable (Romney, 2006; McLeod, 2007; Azmi Fitriati and Sri Mulyani, 2015).

**Research framework:** Management is central to any discussion of financial reporting, whether at the statutory or regulatory level, or at the level of official pronouncements of accounting bodies (Higson, 2003). Furthermore, Cohen *et al.* (2004) suggested that the company's management has primary responsibility for ensuring that the company's financial reporting system, including the control environment as a whole, produce high-quality accounting information to be presented to stakeholders. More specifically Harrer (2008) stated that financial reporting personnel (manager) should be qualified and possess the experience and competencies needed to ensure the quality of financial statements. Specific skills and experience needed to prepare reliable financial statements should be identified and regularly evaluated, and accounting, tax, and IT personnel should have training to keep their skills current.

Financial manager oversees the implementation of accounting principles and procedures and preparation of financial reporting. Educational background and accounting expertise of financial manager determine accounting information quality because they are responsible for the financial functions of company as a whole (Aier, 2005).

Studies on the effect of manager competency toward accounting information quality had conducted by Barton and Simko (2002), Aier *et al.* (2005), Brochet and Welch (2011), and Demerjian *et al.* (2013). The results of previous research indicates that manager competency has an effect on accounting information quality. Based on the description above, the first hypothesis proposed in this study:

*H<sub>1</sub>: manager competency has an effect on accounting information quality*

The overall objective of internal control over financial reporting is to provide accounting information such as financial reports that accurate and reliable (Harrer 2008). Furthermore Zinkin (2014) stated that the purpose of internal control is to provide reasonable assurance that company has ability to ensure that effective and efficient operations, reliable financial reporting, and compliance with all relevant laws and regulations can be achieved.

COSO framework identifies five components of effective internal control, namely: control environment, risk assessment, control activities, information and communication, and monitoring of activities (Graham, 2008). According to Moeller (2008), control environment is the foundation of all components of internal control and effect the internal control objectives (effective and efficient operations, reliable financial reporting, and compliance with all relevant laws and regulations) and all activities of the company. This is due to control environment is a reflection of the attitudes and actions of management that will affect the actions of all employees. In achieving its objectives, the company faced with risks that may occur, therefore management should take action to assess the risks that could affect the company as a whole as well as the risks in the various activities of the company and take appropriate action to mitigate the risks. Control activities include policies and procedures about what should be done to keep the company on track in achieving its objectives. The exact information that is supported by information technology systems must be communicated at every level within the organization so that everyone can be responsible in performing their duties, and the company's goals can be achieved. Monitoring is an important element in internal control, because there should be a monitoring process to assess the effectiveness of internal control components and take corrective action if necessary.

Previous study regarding the effect of internal control effectiveness toward accounting information quality had conducted by Bedard (2006), Doyle *et al.* (2007), Ashbaugh-Skaife *et al.* (2008), and Lu *et al.* (2010). The results indicate that internal control effectiveness has an effect on accounting information quality. Based on the previous description, the second hypothesis proposed in this study:

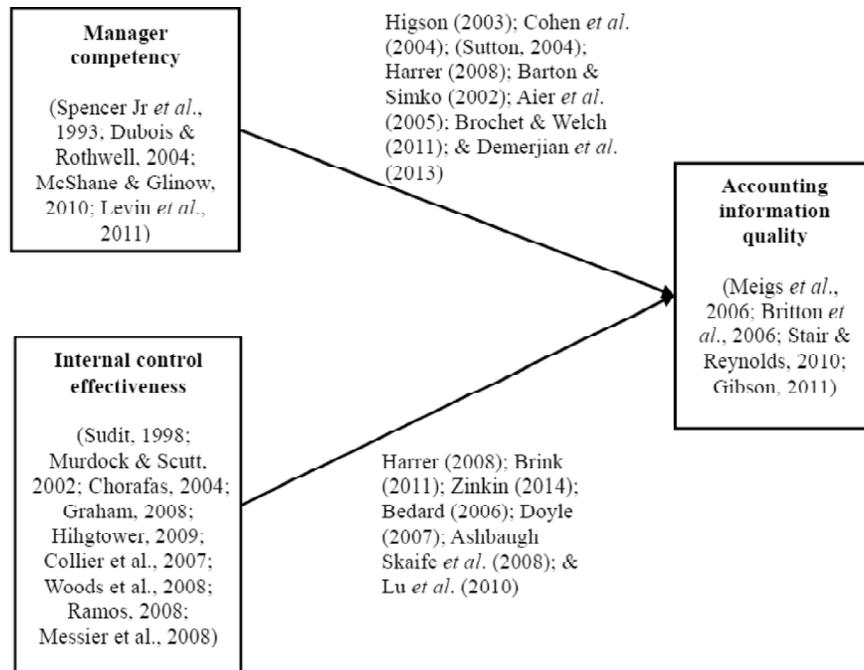
*H<sub>2</sub>: internal control effectiveness has an effect on accounting information quality*

The research framework can be shown as Figure 1:

## MATERIALS AND METHODS

**Research object:** The object of study is variable, or what is the focal point of a study (Suharsimi Arikunto, 2013). A variable is anything that can differentiate or bring variation in values (Sekaran and Bougie, 2013). Thus the object of this study is manager competency, effectiveness internal control, and accounting information quality. The method of this study is explanatory survey method because it aims to study the situation or problem to explain the influence between variables (Saunders *et al.*, 2009).

**Variables operationalization:** Variables operationalization is the process of operationalizing the concept into a variable that can be measured, which is categorized based on the elements that can be measured (Sekaran & Bougie, 2013).



**Figure 1: The research framework**

Variables operationalization in this study can be seen in Table 1.

**Table 1**  
**Variables operationalization**

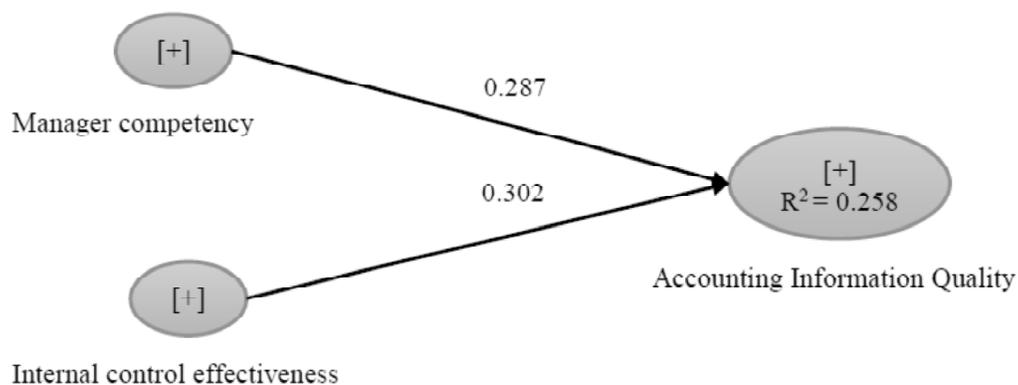
<i>Variables</i>	<i>Indicator</i>	<i>Scale</i>
Manager competency (Spencer & Spencer, 1993; Dubois & Rothwell, 2004; Aier, <i>et al.</i> , 2005; McShane & Glinow, 2010; Hsieh, <i>et al.</i> , 2012)	Knowledge	5-point Likert (ordinal)
	Skill	5-point Likert (ordinal)
Internal control effectiveness (Collier <i>et al.</i> , 2007; Graham, 2008; Ramos, 2008; Hightower, 2009; Arens <i>et al.</i> , 2012; COSO: 2013)	Control environment	5-point Likert (ordinal)
	Risk assesment	5-point Likert (ordinal)
	Control activities	5-point Likert (ordinal)
	Information and communication	5-point Likert (ordinal)
	Monitoring	5-point Likert (ordinal)
Accounting information quality (Romney, 2006; McLeod, 2007; Epstein & Jermakowicz, 2010)	Relevant	5-point Likert (ordinal)
	Reliable	5-point Likert (ordinal)
	Complete	5-point Likert (ordinal)
	Timeliness	5-point Likert (ordinal)
	Understandability	5-point Likert (ordinal)
	Verifiability	5-point Likert (ordinal)

**Data analysis:** Data analysis method used in this research is Structural Equation Model (SEM) - Partial Least Square (PLS). SEM-PLS is used to determine the complexity of relationship of a construct with another construct, as well as the relationship of a construct with the indicators (Hair *et al.*, 2010). According to Hair *et al.* (2010), PLS is an alternative method of SEM that can be used to solve problems of complex relationships among variables but have a small data sample size (30 to 100).

## RESULTS AND DISCUSSION

**Research result and descriptive analysis:** Based on the score of respondents in this study, the average score of manager competency is 2.61; the average score of internal control effectiveness is 3.99; and the average score of accounting information quality is 3.61.

The test results using PLS showed that the model meets the convergent validity, discriminant validity and reliability of the instrument. It was followed by testing the goodness of fit of inner models using the R-square dependent latent variable. R-square value that obtained from the test is 0.258 which means that 25.8% change in accounting information quality explained or influenced by manager competency and internal control effectiveness. Q-value for manager competency and internal control effectiveness are equal to 0.171 and 0.105 which showed that each variables have a good level of prediction of accounting information quality. Results of path coefficients in the structural model can be seen in Fig. 2.



**Figure 2: Results of path coefficients in the structural model (research data)**

Based on calculation results using SmartPLS, variable of manager competency has path coefficient value that equal to 0.287 and t value that equal to 3.193 (larger than critical value = 1.96). Therefore the first hypothesis of this research is accepted,

which means manager competency has positive and significant effect on accounting information quality.

Knowledge and skills of managers in finance plays an important role in determining the quality of accounting information (Aier *et al.*, 2005). Results of this study confirm previous research conducted by Demerjian, *et al.* (2013), Brochet and Welch (2011), Aier, *et al.* (2005), and Barton and Simko (2002) which indicates that manager competency affect accounting information quality.

According to the calculation results of this research, Variable of internal control effectiveness has path coefficient value that equal to 0.302 and t value that equal to 2.076 (larger than critical value = 1.96). Therefore the second hypothesis of this research is accepted, which means internal control effectiveness has positive and significant effect on accounting information quality.

Based on the test results in this study indicates that variable of internal control effectiveness has the greatest influence on variable of accounting information quality. Thus, internal control is an important activities in company operation, in particular the financial activities to achieve company's goal.

Internal controls should be implemented at all levels of management in the company and supervised by the manager in charge at each of the levels. Therefore, it should possess uniformity of understanding at all levels of management in order to become more effective in implementation of control.

Results of this study confirm previous research conducted by Lu, *et al.* (2010), Ashbaugh-Skaife, *et al.* (2008), Doyle & McVay (2007) and Bedard (2006).

## **CONCLUSION**

Based on the results of study it can be concluded that manager competency and internal control effectiveness have a positive and significant effect on accounting information quality. Manager competency is needed to produce qualified accounting information. Improving the competence of managers will improve the quality of accounting information. Knowledge and skills in appropriate areas are needed to improve the managers competency. Internal control effectiveness is important to enhance the accounting information quality. Control environment, risk assessment, control activities, information and communication, and monitoring activities are the components that required for an effective system of internal control.

## **SUGGESTIONS**

This study is only examine the influence of manager competency and internal control effectiveness on accounting information quality. Therefore, the further

research are expected to examine other variables that can effect accounting information quality, such as: good governance mechanism and accounting information system. The further research is also expected to use qualitative methods to discover other factors that affect the quality of accounting information.

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