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Research Article

How Does the Regional Financial Accounting System Affect the Quality of Financial Statements?

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ABSTRACT

This study analyzes the effect of internal control system, financial manager competence, and information technology use on the quality of local financial reports in Baubau City, Indonesia. Using a quantitative approach, data were analyzed using AMOS 24 to test the relationship between variables. The results showed that these factors play an important role in achieving an effective financial accounting system and quality financial reports. The findings provide valuable insights for local governments in improving financial policies and strengthening local financial accountability. However, there are limitations such as the reliance on self-reported data from respondents and the specific nature of the findings for Baubau City, which may not be fully generalizable to other regions. This research is expected to serve as a reference for efforts to improve local financial systems throughout Indonesia

Keywords: Internal Controls, Financial Reporting, Financial Managers, Information Technology Reporting

INTRODUCTION

Transparent, accountable and focused local financial management is a major challenge in achieving good governance [1], [2]. During public demands for accountability and transparency, local governments are required to produce quality financial reports that provide an accurate picture of budget execution and the use of public funds [3]. The quality of these financial statements is strongly influenced by the effectiveness of internal controls, the competence of financial managers, and the use of information technology [4]. These three elements are interrelated and require the support of a qualified regional financial accounting system, which is not only an accounting system, but also a tool that strengthens the control and quality of regional financial reporting.

Notwithstanding its significance, implementing the internal control system and the proficiency of financial managers in the local government of Baubau City, Indonesia continue to encounter many challenges [5], [6]. Inadequate internal control frequently results in discrepancies in financial reporting [7], while the limited proficiency of financial managers can impede the process of preparing accurate reports. In this context, the regional financial accounting system is expected to function as an intervening variable, thereby strengthening the influence of internal control and financial competence on the quality of financial statements. Nevertheless, its efficacy remains uncertain, necessitating further investigation to ascertain the degree to which this system can mediate the impact of these factors on the quality of financial statements.

A substantial body of prior research has underscored the significance of internal control, the competence of financial managers, and the utilization of information technology in the generation of quality financial reports [8]–[10]. Nevertheless, research examining the function of local financial accounting systems as an intervening variable in this relationship is scarce. Agency theory, for instance, underscores the significance of financial control and reporting to mitigate information asymmetry between the government as agent and the public as principal [11], [12]. Conversely, human resource theory underscores the significance of financial managers' competencies in upholding sound financial governance [13]. While these theories are relevant, further investigation is required to ascertain how they apply in the context of local financial accounting systems as mediators in the influence of internal control, competence, and technology on the quality of financial statements.

This study looks at how the quality of financial statements is affected by the internal control system, financial managers' competence, and information technology use. It also looks at the role of the regional financial accounting system. This approach uses Structural Equation Modeling (SEM) through AMOS version 24 software to identify relationships between variables. This study is important for local governments because it helps them create better financial policies. Suppose

the internal control system or manager competence affects report quality through the regional financial accounting system. The government can create a plan to improve controls and competence based on data in that case. Investing in IT is a good idea if IT plays a big part in enhancing report quality. This study should help local governments build a better accounting system, improve reporting quality, and strengthen local financial accountability.

This study aims to analyze the effect of the internal control system, the competence of financial managers, and the use of information technology on the quality of regional financial reports, with the regional financial accounting system serving as a mediating variable. Furthermore, this study seeks to provide recommendations for the local government of Baubau City, with the aim of improving the quality of its financial statements through the strengthening of relevant systems and competencies. It is anticipated that this research will contribute to the development of public sector accounting science, particularly with regard to the role of regional financial accounting systems in enhancing the quality of financial reporting. Additionally, the findings of this study can serve as a point of reference for local governments in the formulation of more effective and accountable financial management strategies.

OBJECTIVES

Internal Control of Regional Financial Accounting System

The regional financial accounting system is vital in government financial management, guaranteeing precise and systematic documentation of financial transactions and fostering accountability and transparency [14], [15]. The system incorporates checks and balances to prevent errors and detect irregularities, reducing financial mismanagement risk [16]. The system's structured data and reports facilitate more effective monitoring and evaluation of ongoing activities by financial managers [17], strengthening the control environment and resulting in more accurate and reliable financial reporting [18].

The system consolidates and reports data from disparate departments, facilitating centralized oversight and reducing discrepancies. The standardization of accounting procedures ensures the implementation of consistent practices, thereby reducing the variance in the quality of financial reporting [19]. Automating financial processes minimizes the potential for human error and streamlines verification procedures, thereby fostering a stronger foundation for preparing reliable financial statements [20].

Furthermore, the system facilitates regulatory compliance, ensuring all financial activities align with established laws and guidelines [21]. It provides a framework for evaluating internal controls through continuous monitoring and assessment [22], reinforcing an organization-wide accountability culture. Its capabilities extend to real-time control and oversight, allowing managers to monitor spending patterns and identify potential risks. By integrating advanced technology, the system has transformed internal control functions, making them more responsive, precise, and integral to high-quality financial reporting.

Following previous research, the hypotheses of this study have been developed:

H.1. Internal control systems have a positive and significant effect on the regional financial accounting system.

H.4. Internal control system has a positive and significant effect on the quality of financial statements.

H.7. The regional financial accounting system has a positive and significant effect on the quality of financial statements.

H.8. The regional financial accounting system mediates the influence between the internal control system on the quality of financial statements.

Financial Manager Competencies on Financial Statement Quality

The competence of financial managers is of paramount importance to produce high-quality financial statements [23]. They can effectively leverage the regional financial accounting system, enhancing the accuracy of financial data and the reliability of financial reports [17]. They comprehensively understand the prevailing accounting standards and regulations, ensuring compliance and upholding the requisite quality standards [24]. Their proficiency in financial data interpretation guarantees the accuracy and fairness of financial reporting. Additionally, competent managers demonstrate robust analytical capabilities, enabling them to discern patterns, evaluate risks, and make well-informed decisions based on financial data [25]. Such analytical insight minimizes the potential for oversight and data misinterpretation, thereby ensuring financial statement reliability. Additionally, they optimize the accounting system's functionality, enabling them to customize reports, streamline data processing, and maximize system efficiency.

Training and development initiatives are crucial for maintaining high levels of competence among financial managers. Continuous professional development ensures they remain apprised of evolving accounting standards, regulatory changes, and system upgrades [26]. Investments in the competence of financial managers contribute to a more robust financial reporting process, ensuring the accuracy and reflection of financial statements. Financial managers' competence positively impacts organizational performance, contributing to efficient budget allocation, effective resource management, and strategic decision-making [27]. Their ability to produce accurate financial statements supports governmental planning and fosters stakeholder confidence in public financial management.

Following previous research, the hypotheses of this study have been developed:

H.2. Financial manager competence has a positive and significant effect on the regional financial accounting system.

H.5. Financial manager's competence has a positive and significant effect on the quality of financial statements.

H.9. The Regional Financial Accounting System mediates the influence between the Competence of Financial Managers on the Quality of Financial Statements.

Use of Information Technology in Improving the Quality of Financial Statements

Information technology (IT) is a vital tool for improving financial reporting processes' efficiency, accuracy, and transparency [28]. It mitigates the potential for human error, accelerates the preparation of financial statements, and provides real-time access to financial data, thereby ensuring the accuracy and relevance of financial statements. Integrating IT with the regional financial accounting system facilitates the optimization of workflows, enhancing the management of data and the generation of reports [29]. Implementing automated reconciliation tools and data validation checks ensures the accuracy of financial records before their compilation into statements. This process reduces discrepancies and fosters consistency.

Furthermore, IT systems facilitate data safeguarding, thereby guaranteeing financial information's integrity [30]. Access controls and encryption safeguard financial data from unauthorized access and potential breaches. This ensures the integrity and reliability of financial statements. It facilitates data analytics, enabling financial managers to derive insights and make data-driven decisions [31]. The application of analytics tools enables the identification of spending patterns, highlighting areas for potential efficiency improvement, and forecasting future financial trends. These capabilities contribute to the accuracy of financial statements.

Implementing IT in government entities can facilitate improvements in financial reporting processes, ultimately producing comprehensive financial statements [32]. Furthermore, the integration and standardization of data across departments, enabled by IT, can enhance the quality of financial statements [33]. By consolidating financial information from diverse sources, IT systems can ensure the inclusion of all pertinent data in financial statements, reducing the risk of incomplete or inaccurate information and ensuring consistency across reports.

Following previous research, the hypotheses of this study have been developed:

H.3. Information Technology Utilization has a positive and significant effect on the Regional Financial Accounting System.

H.6. The use of information technology has a positive and significant effect on the quality of financial statements.

H.10. The Regional Financial Accounting System mediates the influence between Information Technology Utilization on the Quality of Financial Statements.

METHODS

This study employs quantitative research methodology [34], with the objective of gathering and analyzing numerical data pertaining to the impact of the Regional Financial Accounting System on the quality of financial statements. The primary data were obtained through the administration of a questionnaire to a predetermined sample of respondents. The number of samples was deemed sufficient to answer the questionnaire, as it aligns with the minimum sample criteria for research employing path analysis statistical tools with the Maximum Likelihood Estimation (MLE) procedure, which stipulates a minimum of 100 and a maximum of 200 respondents for each estimated parameter.

Table 1. Respondent demographic information

Respondents		**Number**	**Percent**
Age	Male	96	48%
	Female	104	52%
Total		**200**	**100%**
Working Group	Category II	44	22%
	Category III	127	63,5%
	Category IV	29	14,5%
Total		**200**	**100%**

Source: Primary data processed, 2024

In this study, data were collected via the distribution of questionnaires to a sample of 200 selected respondents. The respondents were selected based on specific criteria to ensure the data collected is both relevant and reliable. The questionnaire was constructed with the objective of measuring a range of variables pertaining to the Regional Financial Accounting System and the Quality of Financial Statements. The data obtained from the respondents' answers were then processed using the AMOS 24 software.

In the data analysis stage, AMOS 24 is employed to conduct path analysis with the Maximum Likelihood Estimation (MLE) procedure [35]. This technique permits researchers to examine the interrelationships between multiple variables and ascertain their combined impact. The application of path analysis using AMOS 24 ensures the generation of accurate and reliable results [36], thereby enabling this research to present valid and comprehensive conclusions regarding the impact of the Regional Financial Accounting System on the Quality of Financial Statements. Accordingly, the number of

samples utilized in this study is sufficient to meet the requirements for the statistical analysis employed, thereby ensuring the validity and reliability of the research findings.

To respond to the research hypothesis and quantify the relationship between variables (direct and indirect) [35], [37], this research is transformed into a regression diagram, which is used to describe the causal relationship between exogenous variables and endogenous variables. The latter will be combined with indicators to form exogenous and endogenous variables, which will then be incorporated into a structural equation model known as SEM (Structural Equation Modeling), as illustrated in Figure 1 below.

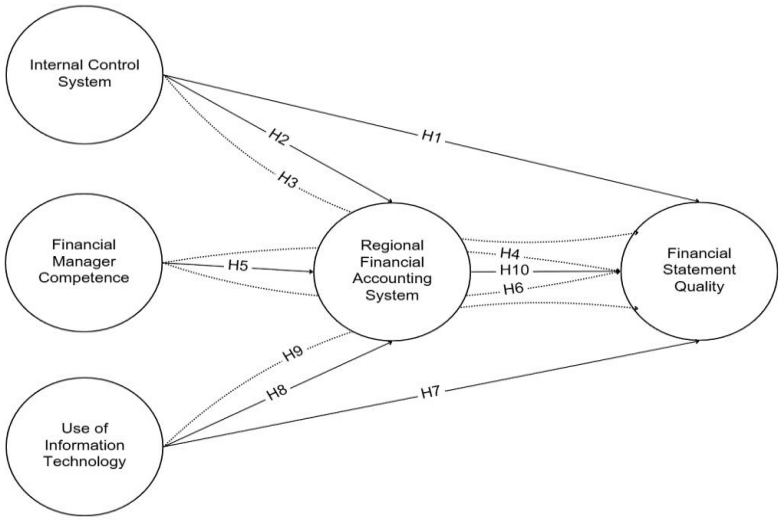

Figure 1: Research Model.
Source: Primary data processed, 2024

RESULTS

Construct Reliability

The construct reliability value is the square of the total (sum) standard loading value divided by the square of the total standard loading value plus the sum error value, using the following formula:

$$Construct\ Reliability\ \frac{(\sum Std.\ Loading)^2}{(\sum Std.\ Loading)^2+\sum\theta}$$

Where the standard loading value comes from the standardized loading value for each indicator (AMOS output results). While the error (e) comes from the measurement error of each indicator: (1-Loading2). The cut-off value for the construct reliability test is accepted if the value is > 0.70, but if the research is still explanatory, the value below 0.7 is still acceptable.

Table 2. Reliability Test

Variables	Indicator	Loading	e Value	Construct Reliability
Internal Control (X1)	Control environment	0.522	0.462	0,87
	Monitoring activities	0.581	0.427	
	Risk understanding	0.73	0.225	
	Information and communication	0.433	0.29	
	Monitoring	0.631	0.241	
Financial Manager Competency (X2)	Skills	0.422	0.092	0.86
	Knowledge	0.359	0.090	
	Attitude	0.470	0.064	
Information Technology Utilization (X3)	Speed	0.47	0.104	0.89
	Consistency	0.509	0.096	
	Precision	0.452	0.111	
	Reliability	0.418	0.077	
	Relevant	0,841	1,198	0.70

Quality of Financial Statements (Y)	Reliable	0,83	1,535	
	Comparable	0,784	1,258	
	Understandable	0,792	1,256	
Regional Financial Accounting System (Z)	Accounting Basis	0.403	0.124	0.87
	Accounting System	0.504	0.114	
	Accounting Procedures	0.627	0.117	

Source: Primary data processed, 2024

Table 2 shows that all indicators of each variable in this study have a construct reliability value greater than 0.7. This means that these indicators are strong enough and consistent in supporting the research variables. Therefore, these indicators can be recommended as standard indicators to support research variables. These variables include internal control (X1), financial manager competence (X2), information technology utilization (X3), financial statement quality (Y), and regional financial accounting system (Z). Each variable has relevant indicators with significant loading values, indicating that the data obtained are reliable enough to be used in research analysis. In this study, data processing using AMOS shows that all variables have construct reliability values that meet the standards (>0.7), indicating that the indicators used are strong enough and consistent in measuring these variables. This gives more confidence in using these indicators to support the research being conducted.

Data Normality Test

Data normality is one of the requirements for the operation of SEM to process the modeling done. In assessing the normality of the data in this study, it was carried out by looking at the z value possessed. This z-value is seen with the critical value determined by the specified significance level of 0.01 and the critical value is ± 2.58. In data processing with IBM AMOS 24, the z value is seen from the critical ratio.

Tabel 3. Assessment of normality

Indicator	**min**	**max**	**skew**	**c.r.**	**kurtosis**	**c.r.**
Understandable	1.000	5.000	-.690	-3.984	.161	.463
Comparable	1.000	5.000	-.642	-3.708	.016	.046
Reliable	1.000	5.000	-.462	-2.666	-.489	-1.412
Relevant	1.000	5.000	-1.152	-6.654	.571	1.649
Accounting Procedures	1.000	5.000	-.847	-4.888	-.011	-.033
Accounting System	1.000	5.000	-.773	-4.465	-.100	-.288
Accounting Basis	1.000	5.000	-1.006	-5.809	.209	.602
Speed	1.000	5.000	-.848	-4.897	.462	1.332
Consistency	1.000	5.000	-.905	-5.224	.128	.369
Precision	1.000	5.000	-1.005	-5.800	.847	2.446
Reliability	1.000	5.000	-.936	-5.406	.329	.950
Skills	1.000	5.000	-.800	-4.618	.514	1.483
Knowledge	1.000	5.000	-.760	-4.390	.286	.825
Attitude	1.000	5.000	-.941	-5.433	.626	1.808
Monitoring	3.000	5.000	-.852	-4.920	-.320	-.923
Information and communication	3.000	5.000	-.965	-5.571	-.079	-.227
Risk understanding	2.000	5.000	-.538	-3.105	.362	1.045
Monitoring activities	1.000	5.000	-.646	-3.730	.441	1.274
Control environment	2.000	5.000	-.656	-3.786	.254	.735
Multivariate					**27.478**	**6.878**

Source: Primary data processed, 2024

Table 3 shows that the Assessment of normality output above shows that there are no critical ratio values above + 2.58 or below -2.58. For Skewness, the highest value is -1.412 and for Kurtosis, the highest value is 2.446. Based on these results, it can be stated that the assumption of normality is fulfilled.

Goodness of Fit Test

The purpose of the goodness-of-fit test is to determine whether the model formed is a good fit, that is, whether or not the manifest variables (indicator variables) can explain the latent variables present.

Table 4. Goodness of Fit

Goodness of Fit	Cut off value	Result	Decision
Probabilities	≥ 0,05	0,538	Good Fit
Chi Square	Expectedly Small	139,716	Good Fit
GFI	≥ 0,90	0,934	Good Fit
AGFI	≥ 0,90	0,912	Good Fit
CFI	≥ 0,90	1,000	Good Fit
TLI	≥ 0,90	1,005	Good Fit
NFI	≥ 0,90	0,812	Bad Fit
RMSEA	≤ 0,08	0,000	Good Fit

Source: Primary data processed, 2024

Table 4 shows that at least 5 indicators are good fit, so it can be concluded that the overall model is fit. The estimation results obtained that the Chi Square value is 139.716 with a p value = 0.538. It appears that p exceeds the significance level value (p>0.05) which states that there is no significant difference between the sample covariance matrix and the population covariance matrix. The GFI value was 0.934 and above the recommended value (≥ 0.90), then the RMSEA value was 0.000 (less than ≥ 0.08). The TLI value of 1.005 (exceeds the value ≥ 0.95) and CFI of 1.000 (exceeds the value ≥ 0.90), so the CFA analysis results have met the expected requirements. This means that the model is marginally acceptable.

Hypothesis Test of Immediate Effect

Once the overall structural model has been deemed fit, the next step is to ascertain whether there is a significant influence between the independent and dependent variables. This is achieved through a hypothesis test of direct influence.

Table 5. Hypothesis Test of Direct Effect

Hypothesis	Path Coefficient	Estimate	S.E	P	Decision
H1	The effect of internal control system on regional financial accounting system	.586	.089	,***	Positive, Significant
H2	The effect of financial manager competence on regional financial accounting system	.304	.069	,001	Positive, Significant
H3	The effect of information technology utilization on the regional financial accounting system.	.699	.095	***	Positive, Significant
H4	The effect of internal control system on the quality of financial statements.	.357	.055	,001	Positive, Significant
H5	The effect of financial manager competence has a positive and significant effect on the quality of financial statements.	.199	.096	***	Positive, Significant
H6	The effect of the use of information technology on the quality of financial statements.	.605	.091	***	Positive, Significant
H7	The effect of regional financial accounting system on the quality of financial statements	.352	.050	***	Positive, Significant

Source: Primary data processed, 2024

Table 5 shows the results of the AMOS output analysis, which indicate that the C.R. value of 0.586 is greater than the critical value of 1.96, and the P value of 0.000 is less than the alpha level of 0.05. This indicates that the Internal Control System variable exerts a positive and significant effect on the Regional Financial Accounting System. Moreover, the C.R. value of 0.304 is greater than 1.96, and the P value of 0.001 is greater than alpha 0.05, indicating that the variable representing financial manager competency also positively and significantly affects the regional financial accounting system.

Furthermore, the AMOS output indicates that the C.R. value of 0.699 is greater than 1.96, and the P value of 0.000 is less than alpha 0.05. Therefore, it can be concluded that Information Technology Utilization positively and significantly affects the Regional Financial Accounting System. In further observation, the C.R. value of 0.357 is greater than 1.96, and

the P value of 0.001 is greater than alpha 0.05, indicating that the internal control system positively and significantly affects the quality of financial statements.

Additionally, the analysis results indicate that the C.R. value of 0.199 is greater than 1.96 and the P value of 0.000 is greater than alpha 0.05, suggesting that the Financial Manager Competency variable exerts a positive but insignificant influence on the quality of financial statements. Moreover, the utilization of information technology is found to have a positive and significant effect on the quality of financial statements, as evidenced by a C.R. value of 0.605 which is greater than 1.96, and a P value of 0.000 which is smaller than alpha 0.05. Ultimately, the results indicate that the Regional Financial Accounting System exerts a positive and significant influence on the quality of financial statements, as evidenced by a C.R. value of 0.352 that exceeds the 1.96 threshold and a P value of 0.000 that falls below the alpha 0.05 cutoff.

Hypothesis Test of Indirect Effect

In AMOS, to obtain the indirect effect, it is necessary to utilize the Significance of Mediation (Sobel Test) Calculator in order to ascertain the P-Value.

Table 6. Hypothesis Test of the Relationship Between

Hypothesis	Path Coefficient	Sobel Test		Decision
		T-Stat	P-Value	
H8	The regional financial accounting system mediates the influence between the internal control system on the quality of financial statements	4.67	0.000	Significant
H9	The Regional Financial Accounting System mediates the influence between the Competence of Financial Managers on the Quality of Financial Statements.	3.67	0.000	Significant
H10	The Regional Financial Accounting System mediates the influence between Information Technology Utilization on the Quality of Financial Statements.	4.93	0.000	Significant

Source: Primary data processed, 2024

Table 6 shows the results of the analysis of the AMOS output calculation of the Significance of Mediation (Sobel Test). The T-statistic value of 4.67 is greater than the critical value of 1.96, and the P-value of 0.000 is less than the alpha level of 0.05, indicating a statistically significant mediation effect. These results indicate that the Regional Financial Accounting System variable mediates between the Internal Control System and the Quality of Financial Statements. Moreover, the T-statistic value of 3.67, which is also greater than 1.96, and the P-value = 0.000 is less than alpha = 0.05, indicates that the regional financial accounting system variable mediates the influence between the competence of financial managers on the quality of financial statements.

Furthermore, the analysis demonstrates that the T-statistic value of 3.67 is greater than 1.96, and the P-value = 0.000 is less than alpha 0.05, confirming that the regional financial accounting system variable mediates the effect between information technology utilization and financial statement quality. This analysis underscores the pivotal mediating function of the Local Financial Accounting System in fortifying the interconnections between these pivotal variables and financial reporting quality, underscoring the significance of a robust accounting system in financial governance.

DISCUSSION

The findings of this study underscore the necessity for enhancements in internal control systems, financial manager competencies, and information technology utilization to attain effective financial accounting systems and superior financial reports in Baubau City. These findings align with those of previous research, which indicates that a robust internal control system and effective utilization of information technology can enhance the transparency and accuracy of financial reports [38]–[40]. However, this study also introduces a new dimension by emphasizing the significant role of financial manager competencies, which has not been widely discussed previously. Hypotheses such as H1 and H3, which demonstrate the positive influence of internal control systems and information technology on regional financial accounting systems, confirm the importance of these elements, which is in line with the findings of previous studies.

Moreover, this study demonstrates that the deployment of information technology not only affects the regional financial accounting system, but also directly enhances the quality of financial statements, as evidenced by hypothesis H6. This result corroborates previous findings indicating that information technology plays a pivotal role in enhancing the efficiency [41], and accuracy of financial statements [28]. However, this study diverges from previous research in its focus on the direct impact of financial managers' competencies on financial statement quality [42], [43], offering novel insights into the significance of managerial skill development in enhancing financial statement quality.

Based on Table 6 of the AMOS analysis results, all hypotheses show a positive and significant effect, as seen in hypotheses H8 to H10. For example, the internal control system (H8) and information technology (H10) have a significant mediating effect through the regional financial accounting system on the quality of financial statements. This

finding is consistent with previous research that shows that a strong internal control system and information technology can improve the transparency and accuracy of financial statements [40], [44].

The results of this study also add a new dimension by emphasizing the significant role of financial managers' competencies, which have not been widely discussed previously. Hypothesis H9 shows that financial managers' competence significantly mediates the quality of financial statements through the regional financial accounting system. This provides new insights into the importance of managerial competence development in improving financial statement quality. Previous research has recognized the importance of internal control and information technology [45], but these findings extend the understanding by showing how financial manager competencies also play an important role.

CONCLUSION AND RECOMMENDATION

This research identifies the significant influence of internal control systems, financial manager competence, and information technology utilization on the quality of financial statements in Baubau City, Indonesia. The regional financial accounting system serves as a mediator, thereby enhancing the impact of these elements on financial statement quality. Nevertheless, the direct impact of financial manager competence on financial statement quality is not statistically significant, suggesting the need for further investigation.

For future research, it is recommended that the role of financial managers' competencies and methods of enhancing them to improve financial statement quality directly be investigated further. Additionally, understanding how to optimize the use of technology in financial reporting could provide valuable insights. Lastly, further research should focus on strengthening the regional financial accounting system to enhance its mediating role between the identified elements and financial statement quality.

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