Financial Reporting Quality of Rural Banks in Yogyakarta Province

Dwi Prastowo Darminto[1] and Winwin Yadiati[2]

[1] *Doctoral Candidate, Faculty of Economics and Business, UniversitasPadjadjaran, Bandung, Indonesia*
E-mail: dwiprastowo81@yahoo.co.id
[2] *Faculty of Economics and Business, UniversitasPadjadjaran, Bandung, Indonesia*

Abstract: This study is aimedat examiningand analyzing the influence of the compliance with accounting guidelines and control environment on financial reporting quality at rural banks. The method used in this research is descriptive research and the technique used is multiple regression analysis. This study is aimed at testing the hypothesis about the influence of compliance with accounting standard and internal control on financial reporting quality. The findings of this study indicated that the compliance with accounting guidelines and control environmentinfluence the financial reporting quality. The variableof compliance with accounting guidelineshas no significant influence on the financial reporting quality. The variable of control environment has asignificant influence on financial reporting the quality. The variable of compliance with accounting guidelines has no significant influence on financial reporting the quality. The variable of control environment has no influence on financial reporting quality.

Keywords: Financial Reporting Quality of Rural Banks, Compliance with Accounting Guideline, Control Environment.

I. INTRODUCTION

A critical challenge for every economic life is to allocate saving into investment opportunities. If the allocation can be done well, it will be able to develop ideas for a new business that is able to accelerate the innovation, create jobs and increase prosperity. Conversely, failure to make a good savingallocation will cause the loss of well-being and failure in supporting business opportunities.

The presence of intermediariesmay prevent the cessation of capital market activity.The intermediaries are like car mechanics who provide independent certification of the used carquality to help buyers and sellers in reaching a deal price. According to Palepu (2004: I-3), intermediaries consist of two types, namely financial intermediaries and informationintermediaries. The examples of financial intermediaries are venture capital firms, banks, mutual funds and insurance companies. They focus on collecting funds from individual

investors and analyzing a variety of investment alternatives in the framework of investment decision. While the examples of informationintermediaries are auditors, financial analysts, bond rating agencies, and financial press. They focus on delivering information to investors about the quality of the business investment opportunities. Both intermediaries provide added value by helping investors to distinguish "good" investment opportunities from "bad" opportunities.

Rural Bank (BPR) is one of the supporters of the Indonesian economy, especially to the micro, small and medium enterprises and informal sectors. The role of BPR in the provision of credit to the micro, small and medium enterprises can help to create employment, make equal income distribution, and provide equal opportunity of doing business in Indonesia (PA BPR, 2010: v).

In line with Bank Indonesia's policy inencouraging the establishment of BPR incorporated as PT (limited liability company), the number of BPR incorporated as PT continues to increase. PT is a legal form of entity that is ideal for the banking industry, better than other legal entitiessuch as PD (regionalcompany) and cooperatives. The legal form reflects the composition of ownership of BPR.

The manipulation scandal of firm financial statements often occurred in Indonesia. This practice has been prevalent since 1990. The mode is used vary, such as marking up the profit by enlarging supplies and performing double counting on the sale, hiding losses by not entering derivative transactions or deflating AYDA (foreclosed asset) valuation (Stabilitas Magazine no 78, December 2012 Th.VII, p 67).

As quoted by I NyomanTjager (2002: 54-55), some time ago there was an allegation ofmarkupcase in the financial statement of Kimia Farma. This firm inflateditsnet income. Another case was the practice of trading by using access of inside people (inside information), and this is a violation of the fairness principle.

Financial crimes in the capital markets are still always overshadowed by the scandal of Enron, World Com the recent case of Olympus. The cases certainly are not able to be separated from the role of accountants and accounting as the information that must be reflected in the financial statements (DwiSetiawan, 2011: 35).

In connection with the accounting standards, the research conducted by GN Ogbonna and AppahEbimoboweiconcluded that ethical accounting standard is significantly related to the quality of financial reports of banks in Nigeria.

According to the National Governing Council of the Indonesian Accountant Association, preparing a financial statement with IFRS becomes more complex and there is much use of fair value and professional judgment (PA RB, 2010). Such conditions are quite difficult for most companies in Indonesia, especially for micro, small, and medium enterprises. Therefore,there has been a solution launched namely the Financial Accounting Standards for Entities without Public Accountability (SAK ETAP).

The governor of Bank Indonesia stated that with the limited and simple activities, it is considered inadequate in terms of costs and benefits for the BPR to use common financial accounting standards as used by commercial banks (PA BPR, 2010: iii). Therefore, for the BPR is set the simple financial accounting standard (SAK ETAP) which has been used since January 1, 2010.

Based on the phenomenon presented, the author is interestedin conducting research related to the influence of compliance with accounting guideline and control environment on the financial reporting quality in rural banks (BPR).

II. LITERATURE REVIEW

The Treadway Commission, as quoted by Davia (200: 16), defined fraudulent financial reporting as the intentional or reckless conduct from, whether act or omission that results in materially misleading financial statements. Schilit (1993: 1) explained that financial shenanigans are actions or omission intended to hide or distort the real financial performance or financial condition of an entity.Furthermore, Palepu (2004: 3-4) mentioned that there are three potential sources causing noise and bias in the accounting data, namely: rigidity in accounting rules, random forecast errors reporting and systematic choices made by corporate managers to achieve specific objectives.

GN OgbonnaandAppahEbimobowei (2012: 69-78), examining the influence of ethical accounting standard on the quality of financial reports of banks in Nigeria, concluded that the ethical accounting standard is fundamentally necessary for accountants to be able to generate high-quality financial statements which are free from misstatement material.

The research on accounting standardcompliance performed by AbubakarSadiqKasum (2010: 57) recommended that "standardsshould be reviewed on a continuous basis with the aim of ensuring that better business practices are enforced using the instrument of standardization and the standards should be better complied with by companies".

Gunter Gebhardt (2010: 2) examined the implications of mandatory IFRS adoption on the quality of the financial reporting of banks in Europe. Specifically, this study analyzes how the changes in the recognition and measurement of banks' main operating accrual itemssuch as the loan provision affect income smoothing behavior and timely lossrecognition. The study found that "the restriction to incurred losses under IFRS significantly reduces the ability of banks to engage in income smoothing. This effect is less pronounces in countries with widely dispersed ownership structures and strict bank supervision, providing further evidence that institutions matter in shaping financial reporting outcomes. However, the application of the incurred loss approach results in less timely loanloss recognition implying delayed communication of future expected losses".

Accounting guidelines for BPR are set more specifically,different from Bank Accounting Guidelinesprevalent earlier (PAPI), particularly in terms of recognition and measurement of loan interest income, credit presentation on the balance sheet, PPAP formation, as well the accrual and recognition of interest expense.

Fraudulent financial reporting may have significant consequences to the organization and public confidence in the capital market. The cases of high profile financial fraudulent have brought attention to the credibility of the financial reporting process and doubts about the role of auditors, regulators and analysts of financial statements (Mark S. Beasley, 1999: 4). There has been a research project providing an extensively updated analysis of financial statement fraud occurrences, sponsored by COSO. This research is expected to provide information to the COSO and other parties that can be used as a guide to address the problem of financial statement fraud and provide a better understanding of the cases of financial statement fraud. By using 200 samples, this research found the environmental characteristics ofinternal control (control environment), particularly related to top management and the board.

The main purpose of internal control is to provide reasonable assurance to the reliability of financial reporting. Although the internal control environment is a component of important internal control, there

is only a few empirical research investigating the relationship between the control environment and financial reporting. Jill M. D'Aquila (1998: 472) conducted a study to determine whether there is a relationship between the control environment and financial reporting decisions. The component of internal control environment focused on this research is the management's integrityas supported by COSO, believing that "theeffectiveness of internal controls cannot rise above the integrity and ethical values of the people who create, administer, and monitor them. Integrity and ethical values are essential elements of the internal control environment, affecting the design, administration, and monitoring of other internal control components".

Managementintegrity is indicated by setting the"tone at the top" that encourages ethical decisions, implementation of the code of conduct and actions that do not create pressure to achieve short-term performance targets or setthe compensation based on the achievement of those performance targets. According to Jill M. D'Aquila (1998: 473), thesethree variablesare identified based on the factor analysis ofthe answers to the questions of control environment during a pilot study, in which the questions were developed based on the COSO tools (1992).

According to Mulyadi (2002: 184), the effectiveness of internal control comes from the people who design and implement it. An adequate internal control design but run by the people who do not uphold the integrity and ethics will not realize the internal control objectives. Therefore, management responsibility is to uphold the values of integrity. This isthe ability to realize what is said or has been the commitment. In addition, in carrying out the business activities, managers are required tostick to the ethics. The values integrity and business ethics are communicated by managers through personal behavior and operational behavior. Through personal behavior, the managers communicate the value of integrity and ethics through their individual actions, so that the values can be observed by employees.Through operational behavior, the managersdesign the system used to form the desired behavior which is based on the value of integrity and ethics.

Zainal Fanani (2009: 20-45),examining the determinants of financial reporting quality,concluded that the sales volatility, firm performance, and industry classifications are positively related to the quality of factorial financial reporting. The proxiesof financial reporting quality used in this study are thevalue relevance, timeliness, conservatism, and the attributes of the new financial reporting quality which are the analysis result of the previous attributes (quality of reporting factorial).Variable of value relevance uses an operational definitionof earning capacity to explain the variation in the return, where the greater explanatory power is more desirable, with the size of the value relevance $= -R2Jt$ where adjusted R2 is obtained from the equation $RETJt = \beta0$ Earningsjt $+ \beta1\Delta$ Earningsjt $+$ [jt.The RET is return while earnings are the earnings before the extraordinary items.

Barua (2006) developedthe measurement of earning quality by using the qualitative characteristics of financial information in accordance with SFAC No. 2 with two dimensions: the relevance and reliability. To be relevant, any information must have a predictive value or feedback value,or both. Predictive value is measured by its ability to predict future earnings and futurecashflows.To measure the predictive ability of earning, Barua (2006: 20-21) used four models, namely: future earning on current earning (ROAt+1), future earning on components of current earnings (Et+1), and future cashflows on current earnings (OCFt+1).

Krismiaji (2013: 121) measured the quality of information that is the relevance by usingthe variables as used by Barua, reasoning thatthese variables have been developed through a validation process. The variables are grouped according to relevance element, i.e. the predictive value and the feedback value. The predictive value is measured by using the size of the ROA (Return on Assets). ROA is the earning before extraordinary element and discounted operation divided by average assets. The independent variable used to measure the predictive value is ROA in the current year, while the dependent variable is ROA in the years to come. The measurement of the feedback value is done by measuring the ability of current year profit to alter the prediction about next year's profits. The feedback value is measured as the difference between the absolute prediction errors in the coming years before considering the current year profit (PEB) and absolute prediction errors in the coming year after considering the current year profit (PEA).

Based on the foundation of the overall research framework related to the compliance with accounting guidelines, internal control environment, and the financial reporting quality, the following hypotheses can be formulated:

H_1: Compliance with accounting guidelines influences the financial reporting quality of BPR.

H_2: Control environment influences the financial reporting quality of BPR.

H_3: Compliance with accounting guidelines and control environment influence the financial reporting quality of BPR.

III. METHODOLOGY

The method used in this research is descriptive research method. This study is aimed at testing the hypothesis about the influence of compliance with accounting standard and internal control on financial reporting quality.

In this study, the dependent variable is the financial reporting quality, explained by the independent variables consisting of the compliance with accounting standard and internal control environment.

The population in this study is the Rural Banks (BPR) operating in the province of Yogyakarta (DIY). The number of population is 54 rural banks with49 of them are the Limited Liability Company (PT) and 5 of them are the Regional Company (PD). Those 54 rural banks are located in five regencies/cities where the highest number is in Sleman by 27 rural banks, consisted of 26 rural banks incorporated as PT and oneas PD. The second largest number of BPR is in Bantul district with 14 rural banks, where 13 of them are incorporated as PT and one as PD. Of the population of rural bank in the province of Yogyakarta,the sample taken is at least 50% i.e. 27 rural banks. In this study, the sampling was carried out in proportion to each area in the second level region in accordance with the population.

The data collecting technique used in this research is primary data and secondary data. Primary data were obtained by means of (a) questionnaire, a list of questions about the relationship between the compliancewith accounting guidance at rural banks, and the control environment on financial reportingquality, (b) interviews with officials of BPR to check the validity of the answers, and (c) documentation (Riduwan 2004:105), which is the data directly obtained including the relevant financial data, rules and other data relevant to the research. The secondary data were obtained by studying the literature relevant to the issues discussed in this study.

This study uses data analysis techniqueof multiple regression.The procedureof data analysis is done by first checking the completeness of the data and thepresence of anoutlier. In addition, the use of multiple regression requires the test classic assumptions.

IV. RESULT AND DISCUSSION

The sample used in this study is 29 rural banks, drawn from the population of 54 rural banks operating in the Special Region of Yogyakarta specified in accordance with the district/city. Of the total of 29 rural banks, 25 rural banks are incorporated as PT and 4 rural banks are incorporated as PD. The rural banks incorporated as PD are spread in all four regions, and one of them did not return the questionnaire.

Table 1
ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	59.074	2	29.537	4.748	.011[b]
	Residual	522.525	84	6.221		
	Total	581.599	86			

a) Dependent Variable: Y1 (e ROA)

b) Predictors: (Constant), Control environment (X2), Compliance (X1)

The results of the first test using regression analysis showed that the Compliance with Accounting Guideline and Control Environment at BPR influence the Financial Reporting Quality (ROA) in 2010 - 2012. The hypothesis testing done by F test concluded that the Compliance with Accounting Guideline and Control Environmentinfluence the Financial reporting Quality (ROA). The F-count (4.748) is greater than F-table (3.105), thus the null hypothesisin the simultaneous test is rejected (reject H0). The value of significance obtained is less than 0.05, thus the test is significant.

Table 2
Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.319[a]	.102	.080	2.494099579

a) Predictors: (Constant), Control Environment (X2), Compliance (X1)

From the calculation, it is found that the correlation value between the independent variables and Financial Reporting Quality (ROA)is 0.319. This simultaneous relationship is in the category not strong. The contribution (influence) Compliance with Accounting Guideline and Control Environment on the Financial Reporting Quality (ROA) is indicated by the coefficient of determination of 0.102. This means that the contribution of the Compliance with Accounting Guidelines and Control Environment is 10.2% in explaining/affectingthe Financial Reporting Quality (ROA). While 89.8% is explained by other variables not examined in this study.

Table 3
ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	.000	2	.000	.129	.879[b]
	Residual	.160	84	.002		
	Total	.160	86			

a) Dependent Variable: Y2 (e TA)

b) Predictors: (Constant), Control Environment (X2), Compliance (X1)

Regression analysis showed that the Compliance with Accounting Guideline and Control Environment have no effect on the Financial Reporting Quality (TA) in 2010 - 2012. The hypothesis testing done by F-test showed that F-count (0.129) is smaller than F-table (3.105). This means thatin the simultaneous test, thenull hypothesis is rejected (rejecting H0).

Table 4
Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.055[a]	.003	-.021	.043600530

a) Predictors: (Constant), Control Environment (X2), Compliance (X1)

The correlation value between the independent variables and Financial Reporting Quality (TA) is 0.055. Thissimultaneousrelationship is in the category very weak. The contribution (influence) of the independent variables on the Financial Reporting Quality (TA) is indicated by the determination coefficient of 0.003. The result of the analysis showed that the contribution of independent variables on Financial Reporting Quality (TA)is only 0.3% while 99.7% is explained by other variables not examined in this study.

Table 5
Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	T	Sig.
1	(Constant)	-10.049	3.275		-3.068	.003
	Compliance (X1)	.632	1.837	.037	.344	.732
	Control environment (X2)	10.193	3.641	.305	2.800	.006

a) Dependent Variable: Y1 (e ROA)

The test resultshowed that the regression coefficient between the Compliance with the Accounting Guideline at BPR (X1) and the Financial Reporting Quality (ROA) is 0.632 (positive), indicating thatthe Compliance with Accounting Guideline at rural banks is in line withthe Financial Reporting Quality (ROA).

So if the Compliance with Accounting Guideline at rural banks increases by 100 percent, while the Control Environment is constant, the Financial Reporting Quality (ROA) will rise by 63.2%. The t-test for the Compliance with the Accounting Guideline at rural banks on the Financial Reporting Quality (ROA) shows that H0 is not rejected. The t-count value for X1 is smaller than the positive value of t (0.05;46) = 1.989. (Tcount = 0.344<1.989). Thus H0 is not rejected. The significance value (p-value) for the variable X1 is 0.732which is greater than 0.05.Thus H0 is not rejected. So, the Compliance with Accounting Guideline at rural banks has no significant effect on the Financial Reporting Quality (ROA).

The regression coefficient of Control Environment (X2) on the Financial Reporting Quality (ROA) is positive 10.193. This indicates thatthe changeof Control Environment is in line with Financial Reporting Quality (ROA). So,if the Control Environment increases, while the Compliance with Accounting Guideline is constant, the Financial Reporting Quality (ROA) will increase by 10.193. The result of the t-test for the Control Environment on the Financial Reporting Quality (ROA) indicates that H0is rejected. The t-count value for X2 is greater than the t-table (t = 2.800>1.989). Thus, H0is rejected. The significance value (p-value) for X2 is 0.006 which is less than 0.05, thusaccording to this number, H0 is also rejected. So, we can conclude that Control Environment significantly influences the Financial Reporting Quality (ROA) in 2010 - 2012.

Table 6
Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	.020	.057		.351	.727
	Compliance (X1)	.010	.032	.035	.307	.759
	Control Environment (X2)	-.031	.064	-.055	-.480	.632

a) Dependent Variable: Y2 (e TA)

The regression coefficient of Compliance with Accounting Guideline at rural banks (X1) on Financial Reporting Quality (TA) is positive of 0.010, meaning that the change in Compliance with Accounting Guideline is in line with Financial Reporting Quality (TA). So if the Compliance with Accounting Guideline increases by 100 percent, while the Control Environment is constant, the Financial Reporting Quality (TA) will rise by 0.010. The t-test for the Compliance with Accounting Guideline on the Financial Reporting Quality (TA) indicates that H0 is not rejected. The t-count value for X1 is smaller than the positive value of t (0.05;84) = 1.989. (t-count = 0.307<1.989), thusH0 is not rejected. The significance value (p-value) for the variable X1 is 0.759 which greater than 0.05.Thus, according to this number, H0is not rejected either. So, the Compliance with Accounting Guideline at rural banks has no significant effect on Financial Reporting Quality (TA).

The regression coefficient of the Control Environment (X2) on the Financial Reporting Quality (TA) is negative -0.031, showing that the changein the Control Environment is inversely related toFinancial Reporting Quality (TA). So if the Control Environment increases, while the Compliance with Accounting Guideline is constant, the Financial Reporting Quality (TA) will decline by 0.031. The t-test for the Control

Environment on Financial Reporting Quality (TA) indicates that H0 is not rejected. T-count value for X2 is smaller than the positive value t-table (t=-0.480<1.989), thusH0 is not rejected. The significance value (p-value) for X2 is 0.632 which is greater than 0.05, thus according to this number H0 is not rejected. So,it can be concludedthat Control Environment does not influence the Financial Reporting Quality (TA) in 2010 - 2012.

V. CONCLUSION

Based on the identification of the problem, hypothesis, and the results and discussion, the conclusions of this study are as follows:

1. The analysis result shows that there is the contribution of 10.2% of the Compliance with Accounting Guidelines and Control Environment to the Financial Reporting Quality (ROA). The 89.8% is explained by other variables not examined in this study

2. The Compliance with Accounting Guidelines and Control Environment influence the Financial Reporting Quality (ROA).

3. The Compliance with Accounting Guidelineshas no significant influence on Financial Reporting Quality (ROA).

4. The Control Environment significantlyinfluences the Financial Reporting Quality (ROA)

5. The Compliance with Accounting Guidelineshas no significant influence on Financial Reporting Quality (TA).

6. Control Environment does not influence the Financial Reporting Quality (TA)

REFERENCES

AbubakarKasumSadig. *The Impact of Compliance with Accounting Standards on Asset and Profitability of Nigerian Quated*Companies.The Journal of Commerce, Vol. 3, No.3 Haiely College of Commerce, University of the Punjab, Pakistan: 57-68.

Barua, Abhijit. (2006), *Using the FASB'Qualitative Characteristics in Earning Quality*Measure.A Dissertation. Louisiana State University and Agricultural and Mechanical College. The Department of Accounting.

Committee of Sponsoring Organizations of the Treadway Commission (COSO). 2011. *Internal Control: Integrated*Framework.

D'Aquila, Jill M. (1998), *Is the Control Environment Related to Financial Reporting Decisions?*, Managerial Auditing Journal, 13/8 (1998). MCB University Press: 472-478.

DwiSetiawan S (IAI National Board Member from 2010 to 2014). (2011), *Challenges Accountants as a Future Leader.* Indonesian Accountant magazine. Anniversary Edition 54, December 23, 2011: 35.

Gebhardt, Gunter and Zoltan Novotny-Farkas. *(2010), The Effect of IFRS Adoption on the Financial Reporting Quality of European Banks.* Marie Curie Research Training Network, the IFRS Revolution: Compliance, Consequences and Policy Lessons: 1-47.

GN Ogbonna and AppahEbimobowei. (2011), *Ethical Compliance by the Accountant on the Quality of Financial Reporting and Performance of Quoted Companies in*Nigeria.Asian Journal of Business Management 3 (3): 152-160, 2011

I NyomanTjager. (2003), *Principles of Good Corporate*Governance.Corporate Governance: Challenges and Opportunities for Business Community of Indonesia. Jakarta: PT Perhalindo: 49-52

Krismiaji. (2013), *Adoption of International Financial Reporting Standards, Corporate Governance and Financial Information*Quality.Dissertation Doctoral Program in Economics, Financial Accounting Interest. Surakarta: Doctoral Program of Economics Faculty of Economics, University of March.

Mulyadi. (2002), *Auditing.*Book 1. Edition 6, Molds to-1. Jakarta: Publisher Salemba Four.

Kothari, CR *Research Methodology: Methods and Techniques (Second Revised*Edition).New Age International Publishers.

Palepu, Krishna G., Paul M. Healy and Victor L. Bernard. 2004. *Business Analysis and Valuation Using Financial Statements. Text and Cases.* Third Edition. USA: Thomson South-Western.

Riduwan. (2004), *Methods and Techniques Develop a*thesis.First Edition. Bandung: Publisher Alfabeta.

Have now, Uma and Roger Bougie. (2010), *Research Methods for Business: A Skill Building*Approach.Fifth Edition. The Atrium, Sothern Gate, Chichester, West Sussex, United Kingdom: John Wiley & Sons Ltd.

Schilit, Howard M. (1993), *Financial Shenanigans: How to Detect Accounting Gimmicks & Fraud in Financial*Reports.USA: McGraw-Hill.

ZainalFanani. (2009), *Quality Financial Reporting: Various Determinants and Consequences of*Economical.Journal of Accounting and Finance Indonesia, Volume 6 - Number 1, June 2009: 20-45.