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Effectiveness of Accounting Information System (AIS) on Public Financial Reporting Quality (PFRQ); An Empirical Study in Sri Lanka

Mayadunnege Senaka Anuruddha

Senior Consultant, Sri Lanka Institute of Development Administration

senakamayadunne@gmail.com

Prof. Prathiba Mahanamahewa

Dean, Faculty of Law, University of Technology, Jamaica.

mahanamahewa@yahoo.com

Abstract: *The research investigated whether the effectiveness of the Accounting Information System (AIS) is associated with Public Financial Reporting Quality (PFRQ). Public financial reporting is accountable to maintain public trust by protecting the accountability, openness, and transparency of public money which leads to the good governance of the country. There were many criticisms over financial reporting quality by various stakeholders of entities across the countries. The research collected primary data from the government ministries and departments in central government, Sri Lanka. The questionnaire survey method was used for the primary data collection from the sample selected by an accountant in the field. Multiple linear regression model applied with the assistance of SPSS version 20.0 software for the data analysis. The study was evident that the effectiveness of AIS has a direct association with PFRQ. Furthermore, it was admitted that the scope, timeliness, and aggregation of AIS have a direct significant influence on PFRQ. Finally, it can be recommended that the government of Sri Lanka should ensure the effectiveness of AIS of the ministries and departments to improve the public financial reporting quality of the country.*

Keywords: *Public Financial Reporting Quality, Quality Characteristics, Accounting Information System.*

Introduction

There were many criticisms over financial reporting quality by various stakeholders of entities across the countries (Akeju and Babatunde, 2017) because of the insufficiency of the quality of financial information disclosure (Fung, 2014; Mahboub, 2017). There is pressure by the interested parties to maintain sufficient quality measures in the organizational governance structure to upgrade financial reporting quality (Klai and Omri, 2011).

The same conspiracy applied in public financial management in today's scenario. It is a challenging job to maintain transparency, accountability, and efficiency in the public finance spectrum (Babatunde & Fofie, 2016). Public financial reporting is accountable to maintain public trust by protecting the accountability, openness, and transparency of public money and facilitating effective and efficient decision making (Oghoghomeh & Ijeoma, 2014; OAG-Wellington, 2016). According to Olomiyete, and Ayobami, (2014), the concept expressing that the key objective of financial reporting in the public sector is achieving the objective of maximizing the efficiency of their decisions. Stakeholders and mainly the public can use financial reports to evaluate the performance or results of the decisions taken by the officials. Government policy directives are depending on the public trust (Hetherington, 2006), which is depending on the sufficiency of the financial information available for their concerns (Welch, et al. 2005; Waymire et al. 2014). The Canadian Institute of Chartered Accountants (2013) pointed out that, public sector required a multidirectional complex nature financial reporting structure because of the complexity of financial information expectations. Such a set of financial reporting includes; additional information regarding the entity's financial condition on a long run basis; additional financial performance information; and non-financial performance information. Further, the financial information required includes the operational information which is explaining as today's performance of the entity, and the financial position of the entity which describes the financial condition of the entity at the end of the financial year.

Furthermore, institutions such as the Committee on Public Accounts and Transparency International have pointed out several major lapses in the Public Financial Management System of Sri Lanka. Some of those serious limitations on public accountability identified were non-existence of Fixed Asset Registers and Losses & Damages Registers (CPA, 2013), unable to provide their Revenue Accounts for years (CPA, 2013), lack of full disclosure of government liabilities (CPA, 2013), the terms and conditions of borrowing and the proxy borrowing of state banks to finance government expenditure (TISL, 2014).

Considering the facts, the research has focused on studying the influence of the effectiveness of AIS on PFRQ as its research statement. As mentioned, though there were studies under the different environments, this study directly engaged with the public sector environment aiming to fill the gap in the literature. This is an empirical analysis of the phenomenon which covers the public sector in Sri Lanka.

The rest of this study is structured as follows: the second section provides a brief review of the literature on the financial reporting quality determinants; it also sets out the hypotheses to be tested. The third section presents the research methodology of the study. The fourth section discusses the interpretation and analysis of the results. At last, the fifth section provides the conclusion of the study.

Research question

The study has designed to achieve the study objectives by answering the research questions below:

“Is there any relationship between the quality of Accounting Information System over the quality of Public Financial Reporting?”

“What variables of Accounting Information System that mostly influence the quality of public Financial Reporting?”

Scope of the Study

The AIS of central government ministries and departments in Sri Lanka has been selected for the study. The public sector in Sri Lanka is large and diverse. It consists of ministries, departments, revenue earning, and non-revenue base statutory bodies in the central government and provincial councils (ADB, 2002). There were several concerns raised by the Committee on Public Accounts in the Parliament as the topmost legislative body, over the accuracy, timeliness, and effectiveness of the accounting information and financial reporting of the country (CPA, 2015). The study is based on the survey data collected through the accountants in the central government ministries and departments in Sri Lanka.

Significance of the study

The ability to enhance the governance of public Finance by improving public financial reporting quality is the primary concern of the study. The study applies a diagnostic approach to find out the effect of the factors of AIS on public financial reporting quality; by enhancing the capacity of focusing in the right direction for the improvements of public financial reporting quality. The contribution of the study to strengthen the subject.

Furthermore, the findings will be useful to future researchers and academies for further studies in the subject quality of financial reporting and its determinates. The real gain of the study devoted to the public servants in Sri Lanka is to find ways and means to improve public financial reporting quality to meet the good governance objectives in public financial management.

Review of literature

Public Financial Reporting

Public financial reporting protects the accountability, openness, and transparency of public money that facilitates the trust of the public sector while facilitating effective and efficient decision making (OAG- Wellington, 2016). According to Allen (2002); Olomiyete, and Ayobami (2014), the concept expressing that the key objective of financial reporting in the public sector is achieving the objective of maximizing the efficiency of their decisions. Stakeholders and mainly the public is able to use financial reports to evaluate the performance or results of the decisions taken by the officials. Government policy directives are depending on the public trust (Hetherington 2006), which is depending on the sufficiency of the financial information available for their concerns (Welch et al. 2005; Waymire et al. 2014).

Internal and external users of the financial reporting engaged with the financial reports prepared by the relevant internal parties, and their main objective is to enhance the decisions taken based on the financial reporting provided (Tasios and Bekiaris 2012). Public sector financial reporting has to fulfill a dual requirement of satisfying internal and external user requirements (Premchand 1999; Onyinyechi et al. 2016). Waymire et al. (2014) emphasized that the public financial reports should be included the important information and basic information in detail on financial performance and position of the public entities to enable the decision-making process. Potential users of financial reports of public sector organizations are further varied, including creditors, suppliers, financial analysts, government authorities, researchers, and in general, all other related parties but still not limited (Tasios and Bekiaris 2012; Eivani et al. 2012; Mande 2015).

Public Financial Reporting Quality

The quality of financial reporting has been extracted from the common phenomenon of quality, which has different meanings depending on the approach. In the context of public financial reporting quality, there are complex considerations, including financial information, disclosures, and non-financial information that are useful in decision making (Cheung et al. 2010). Quality, according to Afiah and Rahmatika (2014), is the level of performance that achieves the requirements of inborn individualities. The said achievements of a phenomenon; product, person, process, service, and system which is expected to be met expectations or satisfies stated needs, requirements, or specification at the level of fulfilling the totality of features and inherent or assigned characteristics of the phenomenon. Therefore, Information quality is considered the highest priority in the management process, and producing high-quality reporting is again a pivotal function of the management (Renkas et al. 2016).

There are several definitions of financial reporting quality. As the financial reporting quality denominating vast subjects, several definitions can be investigated, based on different user perspectives. The first such definition investigated was Verdi's (2006) definition that defines the subject as “the precision with which financial reports convey information about the firm’s operations, in particular, its cash flows; to inform equity investors ". Tang et al. (2008) argue that the level of fulfilling the true and fair view of the financial statements is expressing the financial performance and the position of the organization as financial reporting quality. The main financial reporting quality objective is to equip the financial reporting users with useful, adequate, and correct data for decision making (IASB, 2008). Zheng (2010) argues that the define financial reporting quality is a difficult task because of the complex environment which inculcates with the vast subject disciplines such as environments, regulations, procedures, and understandings.

Beest et al. (2009), highlighted measurement tools to assess the quality of financial reporting used in prior research with their advantages and disadvantages and they revealed that the advantages outweigh the disadvantages. Nwaobia, et al. (2016) examine the detailed features of a quality financial report in their studies while Schipper and Vincent (2003); Van der Meulen et al. (2007); Barth et al. (2001); Nwaobia et al. (2016), examines the quality characteristics of a quality financial report giving special attention to the usefulness of the financial reporting in the decision process.

According to Tasios, (2012); Palea, (2013); Kythreotis, (2014); Renkas, at el. (2016), quality characteristics can be divided into two basic categories as; fundamental and enhancing. The basic information on financial reporting identifies as usefulness and relevancy considering the effect of including non-useful or misleading information for a faithful presentation of information. When the information provided by the financial reports facilitating an alternative option for the decision-makers to take decisions, it is the relevance of the information. Enhancing characteristics are aggravating the effect of fundamental characteristics in the sense of determining the financial reporting quality. Therefore, enhancing characteristics by themselves cannot increase the decision usefulness of the financial reporting and only the fundamental characteristics can do it. Namely enhancing characteristics are comparability, timeliness, understandability, and verifiability. According to Hong, (2016), relevance and reliability are considered as fundamentals while consistency and comparability as secondary. Cheung, et al. (2010) poised qualitative characteristics for financial reporting as relevance, reliability, comparability, and understandability, while Hall (2011); Afiah and Rahmatika (2014) saying the quality of financial information as relevant, timely, accurate, complete, and concise. Hall (2011) stated dimensions of information quality as relevant, timeliness, accuracy, completeness, and summarizing. McLeod and Schell (2007); pointed out only the accurate, timely, relative, and completeness representing as financial reporting quality characteristics while Zheng (2010), pointing relevance, understandability, reliability, completeness, objectivity, comparability, and timeliness as financial reporting quality characteristics. Eivani et al. (2012) figure out relevance, timeliness, reliability, completeness, and usefulness as the same.

Accounting Information System (AIS) as a determinant of Financial Reporting Quality

The quality of financial reporting has become a famous subject area in recent years and the determinants of the same are highly influential in the current accounting literature, though there is a different value over the definition of financial reporting quality which is different in many other subjects (Zheng 2010). Many scholars admitted, such as Dechow and Dichev (2002); Schipper and Vincent, (2003); Botosan (2004); Daske and Gebhardt (2006); Beest et al. (2009), that the assessment of quality in financial reporting become complex because of the different arguments over the subject depending on researcher oriented factors. Salehi et al. (2010); Ramdany (2015); Susanto (2015); argued that the AIS is a major influential factor that determines the quality of financial reporting in an organization.

AIS is an important and highly required information processing mechanism in any type of entity (Borthick and Clark 1990; Rahman et al. 1988; Wilkinson 1993; Wilkinson et al. 1999). According to Romney and Steinbart (2012), the purpose of the AIS is a process of providing information to the decision-making process by process, store, and presenting raw data in an entity. The benefits of AIS are broadening. It impacts the decision-making process, quality of financial reporting, performance measurements, and facilitating transactions in an entry (Samuel, 2013).

Chenhall, (2003); Gerdin and Greve, (2004): Soudani, (2012); defining the AIS as; an organized process of collecting, entering, and processing data and storing, managing, controlling and reporting information to achieve the organizational goals through accurate decision making while Wilkinson (1993); Watts (1999); Samuel (2013) admitting that it is there to convert the raw data into financial data. The AIS is establishing the mechanism to capture data and converting, processing and presenting as financial information that is vital for the decision making of the entity (Salehi et al. 2010; Soudani 2012) and it is improving the quality of financial reporting and information within (Salehi et al. 2010). Mc Leod and Schell (2007); Aren (2012); Bentley and Whitten (2007); Susanto (2013), admitted that the AIS should be defined and well construct by the entity on its own.

The quality of accounting information system is influenced by many factors (Stair and Reynolds, 2010). As defined by Susanto (2013), the collection of the subsystems/components both physical and nonphysical are interconnected and cooperate in harmony to process transaction data. According to Sacer (2006), the quality of integrating the AIS components; hardware, software, brain ware, telecommunication network, and database, is decided by the quality of AIS. There were several scholars argued that the poor design of an AIS in an entity does not assure quality financial information. According to Susanto (2015), non-integrated systems of AIS does not support quality financial reporting. Laudon and Laudon (2012) further argued that the timeliness of financial reporting has prioritized in the process of protecting quality.

There are different arguments on AIS quality demonstrators. It can be demonstrated by the characteristics of information provided by the system (Gul, 1991). The AIS quality attributes identified, described, and tested by Soudani (2012); Samuel (2013), was; scope, timeliness, level of aggregation, and integration.

The AIS measurement "Scope" represents the monetary or non-monetary terms of information which are focusing on future vs. historical events or external vs. internal events which in broad to evaluate the time and space of the information process (Samuel, 2013). As Sacer and Oluic (2013) emphasized, timeliness has a significant influence on the AIS system quality, which defines by Soudani (2012); as short to long-run information requirements, referring to the frequency, speed of reporting, and the orientation. Aggregation has defined as the way, data is aggregated in periods, functions, or following decision models (Gordon and Miller, 1976; Soudani, 2012; Samuel, 2013). Integration is a set of components and formal procedures that is related to each other (Susanto, 2013). It combines hardware, software, brain ware, telecommunication network, and database quality, and the quality of work and satisfaction of users (Sacer, 2006). According to Morley and Parker (2009), it is the togetherness of system operation. The way it was fabricated basic parts and functions of the system for better functionality of the system is representing the integrating (Norman, 2007). Finally, different types of functionalities applying different techniques required smooth coordination which represents the integration functionality of AIS (Gordon and Miller, 1976; Soudani, 2012; Samuel, 2013).

Research Design

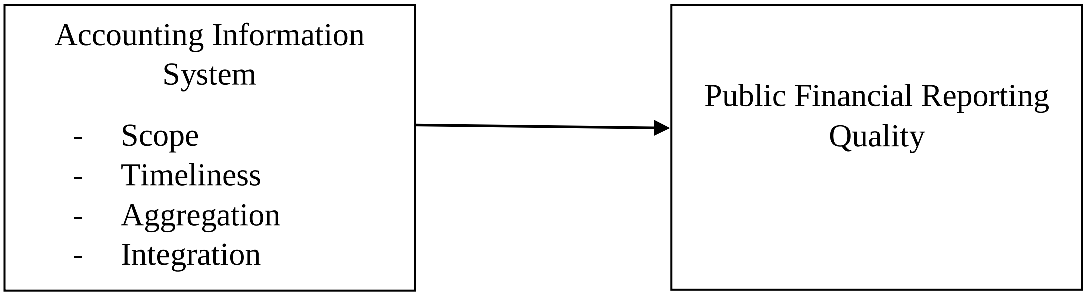
Research Approach

The research applied the practical field knowledge in the field of Public Financial Reporting to develop the theory with the assistance of existing theoretical findings. The primary theoretical findings as studied under the literature review has identified that there is a reasonable literature gap in this field. Therefore, the research has coming under the applied research type. Since the Financial Reporting is used in an organizational setting it is difficult to do a laboratory experiment with controlled variables, the research follows field based empirical research approach.

Conceptual Framework

The first level conceptual framework developed to demonstrate the basic relationship of internal control variable for the public financial reporting quality is shown in Figure 1.

Figure 1: Conceptual framework



Based on the conceptual framework, the multiple regression model developed for the research is y = β0 + β1X1 + β2X2 +........+βPXn + ε (1), where y = Quality of Public Financial Reporting (PFRQ), X1 = Scope, X2 = Timeliness, X3 = Aggregation and X4 = Integration in the AIS while β0 = constant of the regression, β1 to β4 = Regression Coefficients and ε: is the error term.

Hypothesis Development

Considering the findings in the literature review, the following hypothesizes were developed for the study;

H_{01}: There is no positive influence by Scope of the AIS over the Public Financial Reporting Quality

H_{02}: There is no positive influence by Timeliness of the AIS over the Public Financial Reporting Quality

H_{03}: There is no positive influence by Aggregation of the AIS over the Public Financial Reporting Quality

H_{04}: There is no positive influence by Integration of the AIS over the Public Financial Reporting Quality

Field Data Collection

A questionnaire survey was administered to select a randomly selected sample of Government Accountants who are employed in the Central Government Ministries and Departments in Sri Lanka. The study selected the Self-Administered Questionnaire type which applies 5-point Likert scale questions rated from ‘Very High’ to ‘Very Poor’ scale. A pilot test was carried out with 20 accountants from the same source. The internal consistency of the measurements included in the questionnaire was tested by the Cronbach Alpha model. The value of Cronbach’s Alpha for the measurements was 0.807 which shows a strong high level of consistent reliability in response. The population of the study was 1,265 Accountants employing in Central Government Ministries and Departments. The sample size was decided based on Yaro Yamane’s sampling size calculation formula. There were 217 completed questionnaires returned out of 304 samples of accountants, managing 71% of response rate (See Table 01).

Table 01: Questionnaire Survey – Response Rate

Population	Survey Sample	No of Responses	Response Rate %
1,265	304	217	71

Source: Develop by the Researcher

Data analysis

The analysis section has presented the results of survey data processed by the IBM SPSS version 20.0 software and given interpretations for the results. The multiple regression results have been summarised and interpreted with the key objectives of answering research questions. The hypotheses of the study were tested based on the statistical results generated by the research.

Analysis and Interpretations of Regression Model Significance

Whether the multiple regression model developed for the research is statistically significant as a whole, is measured by the ANOVA F statistic tests. The research investigated the influence of the independent variable over the dependent variable.

F-Test established the relationship of independent variables (X) with the dependent variable (Y) which demonstrated the model fit 11.994 > F table (α = 0.05) 2.37 at significant at P=0.000 (Table 02). The results have shown that there is a strong relationship between the predictors and the outcomes of the regression variable. In the interpretation, the research accepted the independent AIS has a statistically significant positive influence over the dependent PFRQ. The researchers admitted that the factors of AIS: Scope, Timeliness, Aggregation, and Integration, influence the PFRQ simultaneously.

Table 02: ANOVA

Model	*Sum of Squares*	*Df*	*Mean Square*	*F*	*Sig.*
Regression	3.691	4	0.923	11.944	.000
Residual	16.146	209	0.077		
Total	19.836	213			

Source: Develop by the Researcher

Interpreting the R-square Statistic

The influence of each independent variable over the dependent variable has been measured by the R-square statistic. Table 03: Result of Coefficient Correlation of Multiple Determination Test, shows the results of SPSS analysis in this research, in which, the variables: scope, timeliness, aggregation, and integration, of AIS, has expressed R-square value 0.186 convincing of the 18.6% variation from independent variables to PFRQ. The researchers admitted that the simultaneous effect of factors of AIS: Scope, Timeliness, Aggregation, and Integration, is statistically significant and moderately influences the PFRQ.

Table 03: Result of Coefficient Correlation of Multiple Determination Test

Model	**R**	**R Square**	**Adjusted R Square**	**Std. Error of the Estimate**
1	.431	.186	.170	.27794

Source: Develop by the Researcher

Interpreting Linear Regression Coefficients and Testing Hypothesis

The important step in the study is to identify the influence of each independent variable over the dependent variable. The analysis is based on the statistical data produced in Table 04. The multiple regression model applied the calculated beta values can be demonstrated as:

PFRQ = 1.469 + 0.128 IAS_01 + 0.087 IAS_02 + 0.079 IAS_03 + 0.0.021 IAS_04 + ε.

Table 04: Findings of Multiple Regression

Model	***B***	***t***	***Sig.***
(Constant)	1.469	12.128	.000
Scope of AIS	.128	3.269	.001
Timeliness of AIS	.087	2.170	.031
Aggregation of AIS	.079	2.351	.020
Integration of AIS	.021	.441	.659

Source : Develop by the Researcher

The T-test applies to test the hypothesized relationship of the dependent variable and independent variables. According to the T-test findings (Table 04) following relationships have drowned.

1. The value of t count for the Scope of AIS variable is 3.269 > t table ($\alpha = 0.05$) for 1.6449 and the regression coefficient is indicating 0.128 that impressing statistically significant (Sig.=0.001) unique relationship.

2. The value of t count for Timeliness of AIS variable is 2.170 > t table ($\alpha = 0.05$) for 1.6449 and the regression coefficient is indicating 0.087 that impressing statistically significant (Sig.=0.031) unique relationship.

3. The value of t count for Aggregation of AIS variable is 2.351 > t table ($\alpha = 0.05$) for 1.6449 and the regression coefficient is indicating 0.079 that impressing statistically significant (Sig.=0.020) unique relationship.

4. The value of t count for Integration of AIS variable is 0.441 < t table ($\alpha = 0.05$) for 1.6449 and the regression coefficient is indicating 0.021 that impressing the relationship is not statistically significant (Sig.=0.659).

As described based on the T-test statistics the unique relationship of each variable with the predicted variable, the hypothesized conditions are being decided as follows;

	Hypothesis	***Test Results***
H01	There is no positive influence by Scope of the AIS over the Public Financial Reporting Quality	Rejected
H02	There is no positive influence by Timeliness of the AIS over the Public Financial Reporting Quality	Rejected
H03	There is no positive influence by Aggregation of the AIS over the Public Financial Reporting Quality	Rejected
H04	There is no positive influence by Integration of the AIS over the Public Financial Reporting Quality	Accepted

Answers to the research questions

The positive relationship of AIS and the PFRQ has been admitted by the research. ANOVA F statistic tests in the research have proved that the variables developed under the AIS have demonstrated a statistically significant positive influence over the dependent variable. The positive combined influence of the factors of AIS: Scope, Timeliness, Aggregation, and Integration, was tested by T-test to diagnose the individual identity and influence over the dependent PFRQ. The analysis found that the factors Scope, Timeliness, and Aggregation have statistically significant direct positive influence over the PFRQ which has been identifying as mostly influencing factors.

Conclusion and Recommendation

The basic objective of the study was initiated based on the requirement of identifying the influence of factors of AIS affecting public financial reporting quality in Sri Lanka. The study is limited to the central government ministries and departments in Sri Lanka. Four hypotheses were tested in this regard and found; the scope, timeliness, and aggregation of AIS are been significantly correlated with the public financial reporting quality. The results indicate that the scope, timeliness, and aggregation of AIS have a direct influence to determine the level of public financial reporting quality. There were several similar studies by Ramdany (2015); Neogy (2014), which tested the effectiveness of AIS on Financial Reporting Quality. In this study, it was tested in-depth, by analysing the effectiveness of each of the factors of the AIS over the PFRQ.

As it was repeatedly pointed out by the Committee on Public Accounts which is the topmost constitutional body on the public financial management of the country, there were serious quality-related issues in the financial reporting of ministries and departments in Sri Lanka. Considering the facts, Government of Sri Lanka should take actions to improve regulatory measures to strengthen the AIS of the public sector and effectively implement the regulations and guidelines to enhance PFRQ.

The research model of the study indicates that the effectiveness of AIS has a direct influence over the PFRQ while admitting the influence of other factors other than the AIS. Therefore, it is a timely requirement of researching to identify what are those other factors and the influences of each to determine the PFRQ.

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