



## **Audit Opinion on Government Financial Report: Evidence from Local Governments in Indonesia**

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### **ABSTRACT**

We investigate the effect of local government characteristics namely APBD (Regional Budget for Revenue and Expenditure) ratification timeliness, local government complexity, financial supervision, LKPD (local government financial statement) submission timeliness, and local government size on the audit opinion of 1,034 local governments' financial statement in Indonesia for 2014 and 2015 fiscal periods. This research uses secondary data and purposive sampling method. Data analysis is conducted with unbalanced panel data regression using random effect model. The results show that the local government complexity, financial supervision, and size have a positive effect on the audit opinion of LKPD; the timeliness of APBD ratification and LKPD submission affect audit opinion on LKPD; local government type have significant effect while geographical location and surplus/deficit of budget realization do not affect the audit opinion on LKPD. The result implies that the timeliness of local government financial management and supervision are substantial factors in determining the audit opinion on LKPD in Indonesia. Therefore, it is important for local governments to meet the timeliness of financial processes and improve the quality of financial supervision in order to build on the accountability of local government financial management through the audit opinion on LKPD

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## INTRODUCTION

The implementation of regional autonomy has been conducted in Indonesia for eighteen years. However, financial management at the regional level has not reached the optimum level. The Book I of State Mid-Term Development Plan (RPJMN) 2015-2019 explains that the issue can be viewed from a relatively low budget allocation for capital expenditure, high budget allocation for personnel expenditure, delay in local government budget (APBD) ratification, inaccessible APBD information by the public, low or late implementation of APBD, and the low number of local governments that earn 'unqualified' audit opinion. In line with the argument, Suwanda (2015) states that there are several problems in the implementation of local autonomy namely high collusion, corruption, and nepotism; not optimum performance; low budget absorption; and accountability issues. Law Number 23 of 2014 concerning local government regulates that the head of local government is responsible for carrying out and taking the responsibility for regional financial management. The responsibility is finally manifested in the form of a financial report that will be audited by the BPK (Supreme Audit Board of the Republic of Indonesia). BPK, will then publish an audit report and provide an audit opinion stating the fairness of financial information disclosed in the local government financial report (LKPD).

The development of the data from BPK<sup>1</sup> shows that the number of LKPDs that obtain the 'unqualified' audit opinion for each year is increasing. In 2009, there is only 3 percent of LKPDs that obtained the 'unqualified' audit opinion, while for the four subsequent years there are 7%, 13%, 23%, and 43% of LKPD that obtain the 'unqualified' opinion. This is an achievement that should be appreciated and at the same time, it is interesting to study the factors that affect the success of a local government in achieving the 'unqualified' audit opinion to improve the accountability of the management of state finances. 'Unqualified' audit opinion is important as the central government has included as a target in the RPJMN 2015-2019. Thus, the target for 'unqualified' opinion in 2019 is regulated in Presidential Regulation Number 2 of 2015 for each local government level; 85% for the provincial government, 60% for district government, and 65% for city government. These targets are expected to improve the state financial management process from the budgeting to the reporting process.

Audit opinion on financial statement is related to certain issues regarding the content of the financial statement itself, specifically whether it meets intended criteria such as conformity with the standards, disclosure adequacy, and compliance to the regulation (Law Number 15 of 2004). Indeed, improving financial reporting practice has been highlighted as an important matter (Edmonds et al., 2017). However, the issue of audit opinion is not limited only to financial report content. Scholars are aware that the characteristics of the local government itself also matter (Nuraeni, 2017; Nurdiono et al., 2016; Pratiwi and Aryani, 2017; Rosadi, Siyamto, and Aisyiah, 2017; Sutopo, Sutaryo, and Christian, 2017; Wulandari and Bandi, 2015). Local government characteristics determine how financial processes are implemented and thus also affect how financial report is prepared. This will further affect financial report (LKPD) quality. Therefore, it is necessary to conduct more investigation from the local government perspective.

Local government has specific characteristics that are significant in its financial management. Previous researches that examine the factors affecting LKPD audit opinion consider several factors such as public budget proportion (Nurdiono et al., 2016), planning and budgeting process (Boex and Muga, 2009), LKPD submission timeliness (Rosadi et al., 2017; Sutopo et al., 2017), previous audit opinion (Fatimah, Sari, and Rasuli, 2014; Nurdiono et al., 2016), follow-up of the findings (Nurdiono et al., 2016; Pratiwi and Aryani, 2017; Wulandari and Bandi, 2015), compliance with legislation (Pamungkas, Ibtida, and Avrian, 2018; Rosadi et al., 2017). Local government internal characteristics have also been highlighted namely internal control (Kewo and Afifah, 2017; Nurdiono et al., 2016; Silviana and Zahara, 2015), government complexity (Maulana and Bestari, 2015; Nuraeni, 2017), human resource competency (Kewo and Afifah, 2017; Nurdiono et al., 2016), and Government Internal Supervisory Apparatus (APIP) competency (Silviana and Zahara, 2015; Wulandari and Bandi, 2015), and local government size (Nuraeni, 2017; Pratiwi and Aryani, 2017; Rosadi et al., 2017).

This research aims to identify the determinants of audit opinion on the Indonesian Local Government Financial Report (LKPD) in terms of local government characteristics. This research develops the results of previous studies as mentioned above by using more research samples and longer observation periods of research to obtain a more comprehensive result that can be generalized. This research expands the previous studies by

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<sup>1</sup> BPK Summary of Semester Audit Results (Semester 1, 2014)

examining various factors that matter for financial processes implementation as independent variables namely APBD ratification timeliness (Boex and Muga, 2009), local government financial supervision/APIP capability (Silviana and Zahara, 2015; Wulandari and Bandi, 2015), LKPD submission timeliness (Sutopo et al., 2017), and local government size (Nuraeni, 2017). We also add two control variables namely local government type (Husnatarina and Halim, 2014) and the geographical location of the local government (Arifin et al. 2015).

The reason for the selection of independent variable and control variable is as follows: the timeliness of APBD ratification and LKPD submission is two of the indicators for a good local government financial management, local government complexity, and local government size might complicate the financial management at the state level starting from the planning stage to its accountability stage. Local government financial supervision is a necessity in monitoring financial management, while local government location and type affect how social control is imposed by the public for the accountability of local government financial management. All of the variables are predicted to affect audit opinion on LKPD to a certain degree. Based on the explanation above, research questions are developed as follows:

RQ1: How does APBD ratification timeliness affect LKPD audit opinion?

RQ2: How does local government complexity affect LKPD audit opinion?

RQ3: How does local government financial supervision affect LKPD audit opinion?

RQ4: How does LKPD submission timeliness affect LKPD audit opinion?

RQ5: How does local government size affect LKPD audit opinion?

The scope of this research covers all local governments in Indonesia, both at the provincial and city/district level. The contribution of this research goes further by extending the more comprehensive literature on governmental audit specifically related to the determinants of audit opinion on Indonesian local government financial report. In addition, this research also contributes to the practice of local government audit as important information for decision-making to improve the audit opinion on financial statements and the accountability of local government financial management. The findings of this research will enrich the government auditor with the information in the process of audit itself. For the society, this study can encourage the society to monitor the accountability and transparency of financial management of local government.

## LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

### Agency Theory

The agency relationship is a contract to perform a certain job that involves delegation of authority from the principal to agent (Jensen and Meckling, 1976). However, because the agent has their self-interest, thus they do not always act according to the interest of the principal. Hay and Cordery (2018) state that the application of agency theory also suits the context of government sector for its ability to explain various issues, including financial reporting and auditing issues. In the context of Indonesian local government, Law Number 23 of 2014 concerning Local Government explains that the local government head is directly elected by people, which is a form of authority delegation. People expect the elected officials to perform public service with good financial management that is in people's interest (Araujo and Tejedo-Romero, 2016).

Thus, the basic concept is that local government acts as agent while the principal is the public (Lane, 2005) in which local government are run by elected politicians and officers (Hay and Cordery, 2018). Going further, according to Halim and Abdullah (2006), there are three agency relationships in the implementation of agency theory in government organization: the relationship between executive and legislative, the relationship between legislative and public, and agency relationship between executive or head of local government with the head of government organization in budgeting. In the context of agency relationship between legislative and executive, legislative as the principal demands the accountability of regional financial management. One of the mechanism is through financial statement presentation for one fiscal year (Pamungkas et al., 2018).

Local government financial statement must be audited by independent institution so that the fairness of institution can be obtained by the legislature. Thus, the opinion of local government financial statement is very important for the legislature as the user of local government financial statement information. Siwy, Saerang, and Karamoy (2016) state that in the agency relationship the agent acts on behalf of and for the interest of the

principal, thus for such role the agent will earn certain compensation. After the resource management process and the embodiment of policy are entrusted to the agent, the accountability is a form of agent's responsibility to be accounted for the process, one of them through the submission of government financial report. In other words, financial reporting becomes the media for local government accountability to the public in managing its financial resources. This argument is in line with Law Number 17 of 2003, which mentions that the preparation of LKPD is the responsibility of the Head of Local Government.

### **Audit Opinion of Local Government Financial Report (LKPD)**

People have called for more information related to how government manage public resources in order to reduce the information asymmetry between the government and the public (Garrido et al. 2019). It is important to ensure government accountability. This now can be accommodated by providing audit opinion on government financial report. Indeed, for the past decades, there has been a growing demand for auditing for government institutions, as the public realizes the value of government auditing (Hay and Cordery, 2018). The audit opinion is an auditor's professional statement that states the fairness of a financial statement based on the criteria of financial information fairness.

A financial statement is assessed based on specific intended criteria namely (i) conformity with the Government Accounting Principle (Standar Akuntansi Pemerintahan – SAP), (ii) adequate disclosure, (iii) comply to the law and regulation, and (iv) internal control system (SPI) effectiveness to determine the audit opinion (Law Number 15 of 2004). According to Law Number 17 of 2003, the audit process on government institution financial report is conducted by the BPK, which will then issue an audit opinion on LKPD. Concerning the issuance of audit opinion, BPK refers to the Regulation of BPK Number 1 of 2017 concerning the State Audit Standard (SPKN). SPKN mentions four different opinions that can be issued by auditors to the auditee: (i) 'unqualified' audit opinion, (ii) qualified audit opinion, (iii) adverse audit opinion, and (iv) disclaimer audit opinion.

Currently, there is a trend in which local governments in Indonesia are competing to earn the 'unqualified' audit opinion from BPK, this result will be exposed as the success of the head of the local government. At least there are three reasons why local government wants the 'unqualified' audit opinion: (i) prestige, (ii) clear and clean, and (iii) image (Special Coverage of BPK, 2017). Besides that, there is another motivation for local government to pursue the 'unqualified' audit opinion from BPK; to get a reward from the central government. Meanwhile, there is no punishment set for the local governments that fail to earn 'unqualified' audit opinion. The reward from the central government is regulated in the Minister of Finance Regulation Number 158/PMK.02/2014. It can be in the form of additional budget for the next year budgeting, priority to get funding for new initiatives, and priority for additional expenditure budget if the condition of state finance allows.

### **APBD Ratification Timeliness and Audit Opinion of Local Government Financial Report**

Budgeting is a crucial process for a government institution (Christofzik and Kessing, 2018; Rakhman, 2019) as the budget will determine the whole government programs during a fiscal year. Local government budgeting process in Indonesia is started from the preparation of work-plans for each local government working unit. All work-plans will be compiled into regional revenue and expenditure budget plan (RAPBD). RAPBD must be discussed and approved by the legislative before it becomes the official regional revenue and expenditure budget (APBD). In other words, APBD is the result of an agreement between executive and legislative (Widyaningrum, Setiawan, and Brahmana, 2019). APBD is a basis for local government financial management for one budget period (annual).

The ratification of Regional Regulation (Perda) on APBD and Regional Head Regulation (Perkada) on the description of APBD should be done by the latest at December 31st of the previous budget period as regulated in the Minister of Internal Affairs Regulation Number 13 of 2006 Article 116 Paragraph 2. The due date for APBD ratification should be a reference for local government in preparing APBD. However, there are still many local governments that ratify their APBD past the due date. Indeed, the budgeting process in local government often takes long and runs ineffectively (Corrigan, 2018), and thus it has been a growing concern that needs to be solved in many countries. In Indonesia, Government Regulation Number 56 of 2005 already mentions the sanctions for local governments that fail to ratify their APBD on time. The sanctions consist of:

(1) their financial rights will be delayed for 6 (six) months (Law Number 23 of 2014), (2) delay on the distribution of balancing funds and the local government will lost their rights to earn Regional Incentive Fund. APBD ratification delay becomes one of the indications of the lack of local government financial management (Book I of RPJMN 2015-2019).

The delay is usually caused by the long preparation process in the Regional Representative Assembly (DPRD). When a budget draft is proposed before it is ratified, it must be discussed and negotiated between the executive and the legislative (Parwati, Budiasih, and Astika, 2015). In addition to the role of executive and legislative as well as the competency, commitment becomes an important aspect in the budgeting process both during the preparation and ratification of the regional budget (APBD). On-time budgeting will lead to better budget implementation and thus enable better financial reporting processes. As a result, the local government can produce a good financial statement that complies with settled government accounting standards and achieve 'unqualified' audit opinion.

The delay in APBD ratification will create a domino effect on the further process. The delayed budget presentation will create distortion or poor budget implementation (Sam-Tsokwa and Ngara, 2016). For example, when there is a delay in APBD ratification, the implementation of the programs and activities planned in the budget will be delayed too, therefore the due time for each program and activities will be shorter, thus the programs become rushed and rough. Indeed, ineffective budget implementation has been a concern in Indonesian local government, leaving several programs not implemented (Rakhman, 2019). In addition to causing financial reporting issues, this also causes a loss to the public as the budgeted programs aim to improve public welfare (Subechan, Hanafi, and Haryono, 2014). Erlina, Saputra, and Muda (2017) and Rakhman (2019) also find that the delay in APBD approval will make the amount of unabsorbed funds become higher for the budgeting period and lead to Excess of Budget Calculation (SiLPA). Further, Verawaty, Jaya, and Megawati (2016) state that the timeliness of APBD ratification is a crucial matter in government financial management.

In line with that, Boex and Muga (2009) state that better planning and budgeting processes (including timeliness of budget ratification) will increase the probability to earn a 'clean' audit report. Lewis and Hendrawan (2019) summarize that poor budget execution causes low audit performance in Indonesian local governments. Sutaryo et al. (2018) state that local governments that are able to conduct budgeting processes on time illustrate better financial management processes thereby speeding up the audit process of the financial statements and giving the possibility to obtain better opinion. Based on the explanation above, the first hypothesis is proposed as follows:

H1: APBD ratification timeliness affects the audit opinion of local government financial report.

### **Local Government Complexity and Audit Opinion of Local Government Financial Report**

Local government complexity is related to the governance of local government activities. This condition affects a local government, either directly or indirectly. In general, government complexity variable can be measured using several proxies. Ingram (1984) describe government complexity with the total population in its administrative area. Meanwhile, more recent studies view government complexity from the perspective of governance structure in which considers the functional responsibilities assignment within a government (Leon-Moreta, 2018). Thus, functional differentiation is often used as a proxy for measurement, which is the level of how much a government is divided into different functional units (Ewens and van der Voet, 2019). In the context of Indonesian local government, local government complexity can be measured with the number of local government working unit (SKPD) (Hardiningsih et al., 2019; Setyaningrum and Syafitri, 2012). Setyaningrum and Syafitri (2012) further state that a more complex government will have more SKPD. Local government heads as the ones responsible for government programs and activities will delegate particular authority to certain SKPD.

The level of functional differentiation in a government structure is related to problem-solving in government affairs (Trein, Thomann, and Maggetti, 2019) as it directly involves policy-making for every activity. Government Regulation Number 24 of 2005 regulates that each SKPD is obliged to prepare a financial statement. Therefore, the number of SKPD will affect LKPD preparation. Hardiningsih et al. (2019) find a relationship between local government complexity and LKPD disclosure. Bimo et al. 2019 predict that the more complex organization results in the more issue in accounting process. Cagle et al. (2017) further state that local governments with a higher degree of complexity tend to be late in compiling the financial report because they

involve more reporting entities. Besides that, a higher degree of complexity will also be able to cause more problems in LKPD preparation. Finally, Bimo et al. (2019) find negative association between organizational complexity and financial reporting quality. Thus, it is less likely to get a fair audit opinion on government financial statements. Based on the explanation above, the second hypothesis is formulated as follows:

H2: Local government complexity negatively affects the audit opinion of the local government financial report.

### **Local Government Financial Supervision and Audit Opinion of Local Government Financial Report**

It is generally accepted that supervision is an integral part in governance process (Thomas and Purcell, 2019). In local government context, it is important for the sake of ensuring that local government is able to fulfill the public requirements of performance and accountability. The supervision of local government financial management is conducted by two separate institutions, both internal and external. Internal supervision is performed by the local government inspectorate as Government Internal Oversight Apparatus (APIP). The role of internal supervision is very crucial, especially for local government in implementing effective financial processes (van Rensburg and Coetzee, 2016). Therefore, APIP needs sufficient capability to perform its role effectively (Zain, Subramaniam, and Stewart, 2006). BPKP, through BPKP Regulation Number PER-1633/JF/2011, regulates that the development of APIP capability in Indonesia adopts the Internal Audit Capability Model (IACM) to strengthen internal supervision. In IACM, the capability level is divided into 5 levels: level 1 (Initial), level 2 (Infrastructure), level 3 (Integrated), level 4 (Managed), and level 5 (Optimized) (Institute of Internal Auditors, 2009). Therefore, it is expected that all APIP units in Indonesia will reach at least Level 3 by the end of 2019, in line with the target of RPJMN for 2015-2019 as mentioned in BPKP Regulation Number 6 of 2015.

Effective APIP supervision and guidance in financial management will assure that the local governments implement the applicable regulation and the implementation of the accounting standard as well as financial reporting, to obtain the 'unqualified' audit opinion. The participation of APIP is needed to improve the quality of LKPD. More qualified APIP will reassure that local governments are able to improve accountability by achieving an 'unqualified' audit opinion for their LKPD. Gamayuni (2018) finds that the capacity of APIP supports local government in preparing a high-quality financial statement. Rahmatika (2014) also demonstrates that internal supervision helps improve local government financial reporting process, quality, and timeliness in which will help achieve 'unqualified' opinion. Finally, Thomas and Purcell (2019) also highlight that local government internal audit effectiveness will support the financial reporting process and outcome. This will increase the possibility for local government to obtain 'unqualified' audit opinion. Based on the argument, the third hypothesis is formulated as follows:

H3: Local government financial supervision positively affects the audit opinion of the local government financial report.

### **LKPD Submission and Audit Opinion of Local Government Financial Report**

Timeliness is an important qualitative characteristic of accounting and is the basic element for the relevance of financial statement information (Clatworthy, 2010), as it is crucial for decision-making (Bimo et al., 2019). Ashraf, Michas, and Russomanno (2019), and Oussii and Boulila Taktak (2018) underline that timeliness is one of the main attributes of high-quality financial reporting. Moreover, the timeliness of financial reporting also becomes one of the priorities for regulators (Ghafran and Yasmin, 2018). It has also been pointed out that timeliness of financial information matters for local government (Edmonds et al., 2017). In the Indonesian context, the local government financial report (LKPD) is a form of accountability tool for local government financial management as mentioned in the Government Regulation Number 8 of 2006. As an important qualitative characteristic and element of financial report relevance, LKPD submission timeliness is a reflection of a local government's readiness and compliance in terms of financial reporting. The reporting delay has several implications such as local government cannot issue regional bonds, a written sanction from the Minister of Finance, delay in the distribution of current funds, and do not get incentive fund (DID) as regulated by Government Regulation Number 8 of 2006.

In the private sector, it has been evidenced that financial reporting timeliness and audit opinion have a strong relationship (Al Daoud, Ismail, and Lode, 2014). Companies with 'unqualified' audit opinion publish their financial reports earlier than those that fail to earn clean audit opinions. Financial reporting timeliness is also found to have positive association with financial reporting quality (Bimo et al., 2019), that increase the possibility to earn better audit opinion. The same also applies to the public sector context. Rosadi et al. (2017) state that the timeliness of financial report submission has a significant effect on the audit opinion. This is supported by Rachmawi, Rini, and Fitri (2016) find a positive association between these two variables. Local governments that earn 'unqualified' audit opinion are generally more discipline in preparing the financial report. In addition, audit opinions other than 'unqualified' also have consequences in terms of communication with auditee that takes more time. Based on the argument above, the fourth hypothesis is formulated as follows:

H4: LKPD submission timeliness affects the audit opinion of local government financial report.

### **Local Government Size and Audit Opinion of Local Government Financial Report**

The size of an organization refers to how big the organization is. Organization size can be measured using various methods, Damanpour (1991) states that organization size can be represented by using the total assets, number of employees, productivity level, and total revenue. In terms of financial perspective, organization size is generally reflected by the amount of total resources that an organization has (Askim, 2009; Kusumawardani, 2012). In the context of local government, size can be proxied by local government total assets. Baltaci and Yilmaz (2006) posit that local government with larger size has an advantage due to the larger amount of resources and transfer of value. However, large local government will have more complex processes that requires good financial management.

Nuraeni (2017) states that total assets have a negative significant effect, this indicates that the bigger the assets owned by a local government, the lower is the audit opinion. Muhtar, Sutaryo, and Suryanto (2018) states that obstacle often occurs in the asset reporting by the local government due to the lack of adequate capability to record assets according to the prevailing standards. Garrido et al. (2019) also find that larger financial resources in terms of budget sustainability and financial dependence negatively affects transparency of local governments in Spain. The findings from previous studies above implies that local government size may reduce the opportunity for local government to obtain 'unqualified' audit opinion. Therefore, the fifth hypothesis is formulated as follows:

H5: The size of the local government negatively affects the audit opinion of local government financial report

## **RESEARCH METHODOLOGY**

The population of this research is all local governments in Indonesia that have been audited by BPK for 2014 and 2015. The study uses purposive sampling in which the samples are selected based on the specified criteria. The sample selection criteria are: (1) local government is included in the List of Audit Opinion of LKPD for 2014 and 2015<sup>2</sup>; and (2) local government published complete data concerning the research variables. This research uses audit opinion on the local government financial report (LKPD) as the dependent variable, with timeliness of budget (APBD) ratification, local government complexity, local government financial supervision, LKPD submission timeliness, and local government size as independent variables. We also control for local government type and geographical location, as well as surplus/deficit of budget realization. Research data are analyzed with STATA 14.2 application as panel data, categorized based on the observation year. The measurement of the research variables is presented in Table 1.

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<sup>2</sup> BPK Summary of Semester Audit Results (Semester 1, 2014)

Table 1 Research Variables and Variable Measurement

Variable	Acronym	Measurement
Audit opinion on LKPD	<i>OPINION</i>	Dummy, Adverse=1; Disclaimer=2; Qualified=3; Unqualified with explanatory paragraph= 4; Unqualified = 5
APBD ratification timeliness	<i>APBD</i>	Dummy, on time, approved latest by December 31st before the next budget period= 1; Late/delayed, approved after December 31st = 0
Local government complexity	<i>SKPD</i>	The number of SKPD
Local government financial supervision	<i>IACM</i>	Dummy, Level 1 = 1; Level 2 = 2; Level 3 = 3; Level 4 = 4; Level 5 = 5.
LKPD submission timeliness	<i>LKPD</i>	Dummy, on time (submitted the latest by March 30th after the budget period ends) =1; Late/delayed, submitted after March 30th=0
Local government size	<i>ASSET</i>	Total assets of local government
Local government type	<i>TYPE</i>	Dummy, Provincial government= 0; City government= 1; District government = 2
Local government geographic location	<i>GEO</i>	Dummy, Java= 0, Outside Java= 1
Surplus/deficit of budget realization	<i>SURDEF</i>	Total revenue realization subtracted by total budget realization

The hypotheses testing is performed using unbalanced panel data regression analysis with the following model:

$$OPINION = \alpha + \beta_1 APBD - \beta_2 SKPD + \beta_3 IACM + \beta_4 LKPD - \beta_5 ASSET + \beta_6 TYPE - \beta_7 GEO + \beta_8 SURDEF + \varepsilon$$

Notes:

OPINION = Audit opinion on local government financial report

$\alpha$  = Constant

$\beta_1 - \beta_7$  = Regression coefficient

APBD = Timeliness of APBD ratification

SKPD = Local government complexity

IACM = Local government financial supervision

LKPD = LKPD submission timeliness

ASSET = Local government size

TYPE = Local government type

GEO = Local government geographic location

SURDEF = Surplus/deficit of budget realization

$\varepsilon$  = Error

## RESULT AND DISCUSSIONS

Based on the formulated criteria, we obtain the total of 1038 research observations as summarized in Table 2.

Table 2 Sample

No	Explanation	2014	2015	Total
1	Local governments in Indonesia	539	542	1,081
2	Local government with no LKPD data submission	(38)	(9)	(47)
	Total observation of research	501	533	1,034

We generate 1,034 observations for the 2014-2015 time period. The total number of local governments in Indonesia in 2014 is 539 that increases to 532 local governments in 2015 as a result of the autonomy of 3 districts. However, there are several local governments with unaccessible financial statements, 38 local governments in 2014 and 9 local governments in 2015.

### Descriptive Statistic and Correlation

The result of the descriptive statistic and correlation is presented in Table 3, 4, and 5 as follows.



Table 3 Descriptive Statistics

		OPINION	SKPD	ASSET	SURDEF
Mean.		3.90	53.25	4,088.27	80,387.78
Min.		1.00	20.00	73.58	-1,696,618.50
Max.		5.00	214.00	425,757	46,011,934.00
Std. Dev.		1.12	21.12	18,940.80	1,458,076.90
Percentiles	25	3.00	40.00	1,404.24	-17,237.20
	50	4.00	48.00	2,049.70	26,270.08
	75	5.00	60.00	3,291.14	70,243.71
Observation		1,034	1,034	1,034	1034

*Notes: OPINION= Audit opinion on LKPD; SKPD= Number of SKPD; ASSET= Total assets; SURDEF= Surplus/deficit of budget realization.*

Table 4 Descriptive Statistics

Variables	APBD		IACM		LKPD		TYPE		GEO	
	Freq	%	Freq	%	Freq	%	Freq	%	Freq	%
Dummy 0	232	22.40	7	.70	341	32.98	68	6.60	238	23.00
Dummy 1	802	77.60	843	81.5	693	67.02	182	17.60	796	77.00
Dummy 2	-	-	184	17.8	-	-	784	75.80	-	-
Dummy 3	-	-	-	-	-	-	-	-	-	-
Dummy 4	-	-	-	-	-	-	-	-	-	-
Dummy 5	-	-	-	-	-	-	-	-	-	-
Percentiles	25	1	1		0		2		1	
	50	1	1		1		2		1	
	75	1	1		1		2		1	
Observation	1,034	100	1,034	100	1,034	100	1,034	100	1,034	100

*Notes: APBD= Timeliness of APBD approval; IACM= APIP Capability level; LKPD= Timeliness of LKPD submission; TYPE= Provincial/municipality/city; GEO= Java/outside Java.*

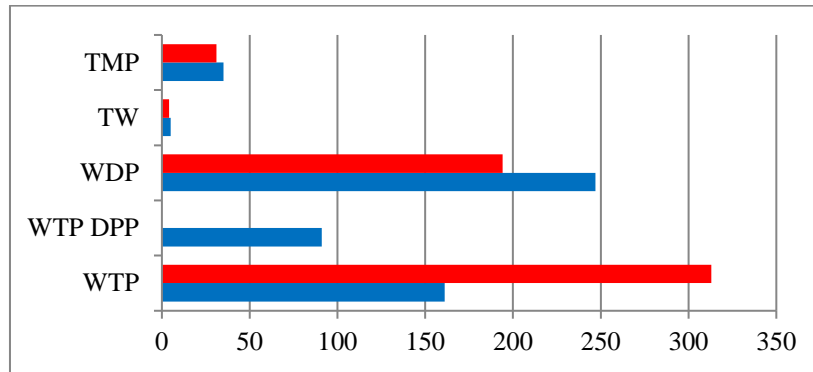
It is also necessary to test the correlation among the variables. The result is presented in Table 5 as follows.

Table 5 Correlation Matrix

	OPINION	APBD	SKPD	IACM	LKPD	ASSET	TYPE	GEO	SURDEF
OPINION	1								
APBD	.185**	1							
	.000								
SKPD	-.003	.071*	1						
	.923	.022							
IACM	.237**	.139**	.066*	1					
	.000	.000	.035						
LKPD	.235**	.037	.075*	.091**	1				
	.000	.235	.016	.004					
ASSET	-.004	-.084**	.018	.113**	.067*	1			
	.886	.007	.568	.000	.032				
TYPE	-.178**	-.045	.115**	-.124**	-.129**	-.217**	1		
	.000	.150	.000	.000	.000	.000			
GEO	-.046	-.035	-.209**	-.130**	-.286**	-.128**	.034	1	
	.136	.257	.000	.000	.000	.000	.268		
SURDEF	-.013	-.068*	.028	-.007	.032	-.005	.015	-.083**	1
	.680	.029	.362	.819	.308	.862	.636	.008	
	1034	1034	1034	1034	1034	1034	1034	1034	1034

*Notes: OPINION= Audit opinion on LKPD; APBD= Timeliness of APBD approval; SKPD= Number of SKPD; IACM= APIP capability level; LKPD= Timeliness of LKPD submission; ASSET= Total assets; TYPE= Provincial/municipality/city; GEO= Java/outside Java; SURDEF= Surplus/deficit of budget realization. \*Correlation is significant at the 0.05 level, \*\*Correlation is significant at the 0.01 level.*

Based on the results of the descriptive statistics, the average score for audit opinion on LKPD for 2014 and 2015 is 3.9, which is within the category of 'qualified' opinion. Further, the distribution of BPK audit opinions in 2014 and 2015 is presented in Figure 1. In 2014, BPK audit opinions are dominated by 'qualified' opinions with a total of 247 LKPDs. The score develops significantly in 2015 in which 313 LKPDs earn 'unqualified' opinion. Thus, there is a significant increase in terms of scores from 2014 to 2015. Previously, there was a concern that predicts that the number of local governments with 'unqualified' opinion will decrease in 2015, considering that local governments in Indonesia need to apply accrual basis accounting for the first time. The financial reporting practice, however, still experience obstacles for a number of local governments, indicated by the existence of adverse and disclaimer opinion despite the number also decreases.



Notes: WTP= Unqualified opinion, WTP DPP = Unqualified opinion with explanation, WDP = Qualified opinion, TW = Adverse, TMP = Disclaimer; Red: Audit opinion in 2015, Blue: Audit opinion in 2014

Figure 1 The Distribution of Frequency of Audit Opinion

The majority of local governments in this research are able to perform APBD ratification on time with total 802 local governments. This means that 77.6% of the local government in Indonesia were able to ratify their APBD on time, while the rest (22.4%) were not. There is an increase in the number of local governments that are able to ratify their APBD on time, from total 346 local governments in 2014 to 456 local government in 2015. This implies that there is an increasing awareness among local governments to be on time for APBD ratification. Local government complexity (SKPD) has a minimum value of 20 (South Manokwari Municipality) and a maximum value of 214 (Bulukumba Municipality). The average value of SKPD is 53.25 with standard deviation of 21.12. As for local government financial supervision (IACM), local governments in this research only earn scores that range from 0 to 2. The result shows that the level of APIP capability is relatively low. Until 2015, the highest APIP capability is the second level (infrastructure). There are also more local governments with level 1 (initial) than level 2 (infrastructure).

In terms of LKPD submission timeliness is, the majority of local governments have in Indonesia submitted their LKPD on time. Total 693 local governments (67.02%) are on time while the rest (32.98%) are delayed or late. Interestingly, there is a decline in the number of local governments that submit their LKPD on time from 394 in 2014 to 299 in 2015. Arguably, this may due to a reason that 2015 is the first year of accrual basis accounting implementation in Government Accounting Standard (SAP), thus it makes the local governments less confident in presenting their LKPD.

The average of total assets is 4,088.27 billion rupiahs. Further, the lowest total asset is 73.58 billion rupiahs owned by the South Manokwari District while the highest assets are owned by DKI Jakarta Province, reaching almost 425,757 billion rupiahs. The list of top ten local government with the biggest assets is presented in Table 6. The interesting finding from Table 6 is that there is only one local government with district type in the top 10 list namely Bandung district, while the rests are either city governments or provincial governments. Based on the data it can be concluded that most of the large assets are owned by the provincial government or city government as compared to district government. Moreover, five out of ten local governments with the biggest assets earn an 'unqualified' audit opinion. Further, it can be concluded that local government with large total assets have a greater chance to earn 'unqualified' opinion.

Table 6 Top 10 Local Government with the Biggest Assets

No	Local Government	Year	Total Asset	Opinion
1	DKI Jakarta Province	2014	425,756,995,051,083.00	WDP
2	DKI Jakarta Province	2015	421,061,389,203,531.00	WDP
3	Surabaya City	2014	38,985,392,674,262.00	WTP DPP
4	Surabaya City	2015	38,222,837,005,580.60	WTP
5	Kalimantan Timur Province	2014	30,089,700,173,299.00	WTP
6	Medan City	2015	29,940,354,805,687.60	WDP
7	Riau Province	2014	29,935,125,050,402.70	WTP DPP
8	Jawa Barat Province	2014	28,614,139,178,798.00	WTP
9	Jawa Timur Province	2015	26,958,068,256,119.10	WTP
10	Badung Municipality	2015	26,143,991,789,510.70	WTP

Notes: WTP= Unqualified opinion, WTP DPP = Unqualified opinion with explanatory, WDP = Qualified opinion, TW = Adverse; TMP = Disclaimer.

### Hypotheses testing

Gujarati (2009) states that we can use a random effect model (REM) if the dummy variable is used to define unknown condition about the real model. The dependent variable in this research, as well as several independent variables, are measured using dummy data, thus the most appropriate model is REM. The result shows an adjusted R2 score of 0.1332, which mean the independent variables can only explain 13.32% of the variation in the dependent variable, while the other 86.68% is explained by other variables that are not included in this research.

Table 7 Panel Regression – Dependent OPINION  
*Random Effect Model*

Variables	Expected Sign	Coefficient	P-Value
APBD	+	<b>0.386</b>	<b>0.000**</b>
SKPD	-	-0.001	0.418
IACM	+	<b>0.559</b>	<b>0.000**</b>
LKPD	+	<b>0.510</b>	<b>0.000**</b>
ASSET	-	<b>-0.003</b>	<b>0.000**</b>
TYPE	+	<b>-0.254</b>	<b>0.000**</b>
GEO	-	-0.103	0.646
SURDEF	+	0.003	0.207
Wald Chi.		171.66	
Sig.			<b>0.000**</b>
R-Square:			
Within		0.143	
Between		0.192	
Overall		0.144	

*Notes: APBD = Timeliness of APBD approval; SKPD= Number of SKPD; IACM= APIP capability level; LKPD= Timeliness of LKPD submission; ASSET= Total assets; TYPE= Provincial/Municipality/City; GEO= Java/outside Java. \*\*significant at level 0.01.*

Table 7 shows the Wald chi value is 171.66 with a significance level of 0.000 (lower than 0.05). This means that the regression model is fit for hypotheses testing purpose. Table 7 also shows that the APBD variable has a p-value of 0.000, which is lower than the  $\alpha$  value of 0.05 with a positive coefficient of 0.386, thus H1 is supported. Hence, on time APBD ratification positively affects the audit opinion of LKPD. This finding confirms the previous research by Boex and Muga (2009) who state that a local government with better planning and budgeting tend to have a higher possibility to obtain a ‘clean’ audit report. If the budget (APBD) is ratified on time, the implementation of the programs and activities in the budget can be implemented properly (Sam-Tsokwa and Ngara, 2016) and the absorption of the budget will also be optimum (Erlina et al., 2017). With a proper budget ratification and implementation, the financial reporting will not get rushed as the preparation has comply with the timeline.

As a result, the LKPD quality will be better in which improves the opportunity to obtain the ‘unqualified’ opinion. Sutaryo et al. (2018) also state the same idea that the local governments that are able to arrange the budget in timely manner indicate the better financial management process so that the local governments are able to perform and compile the financial statement well. It opens the possibility for fairer audit opinions. The regression result for SKPD shows a negative coefficient of -0.001 with a p-value of 0.418, which is greater than  $\alpha$  value of 0.05, thus the H2 is not supported. In general, the greater the number of SKPD, the greater amount of information that must be disclosed to reduce information asymmetry and to show good local government performance accountability. Further, as one of the audit criteria is completeness (full disclosure), thus the more complete the disclosure, the greater is the chance to earn the ‘unqualified’ opinion.

However, there is no significant effect found in this model. In line with this finding, Setyaningrum and Syafitri (2012) also evidence no significant influence of local government complexity on LKPD disclosure quality. The result of this research can be justified that higher degree of local governments complexity can be accommodated by the usage of information technology. Local governments in Indonesia are provided with an integrated system named the SIMDA (Regional Management Information System) that has been adopted by 425 local governments as of December 31st, 2015. The financial management processes can be performed more effectively with better outcomes, no matter how complex the local government is (Rahman and Fachri, 2016).

The IACM variable has a p-value of 0.000, lower than  $\alpha$  level of 0.05, with a positive coefficient of 0.554 thus H3 is supported. This means that APIP capability has a positive effect on the audit opinion of LKPD. The concept of IACM itself is aimed at improving the role of internal auditors (APIP in Indonesian local

government context) in financial management (Institute of Internal Auditors, 2009). Theoretically, improvement in APIP capability should strengthen and support the effectiveness of internal control for better financial processes. In line with that, Gamayuni (2018) states that the effectiveness of APIP function is required to improve the quality of LKPD, supported by Rahmatika (2014) who also evidences positive effect. Higher internal audit capability supports the goals achievement of public sector organization, one of them is ensuring the reliability of local government financial statement (van Rensburg and Coetzee, 2016).

Reliable financial information within local government financial statement supports the probability for a local government to achieve 'unqualified' opinion from external auditor. Other than that, the result also supports Arifin et al. (2015) that the high quality of internal control represents the capability in monitoring the local governments' financial management that can help to minimize the potential of corruptions with the control and supervision activity through the compilation and inspection of local government financial statements. Table 6 shows a regression result for LKPD with a p-value of 0.000 (lower than 0.05  $\alpha$ ) and a positive coefficient of 0.246, thus the H4 is supported. This implies that the timeliness of LKPD submission affects audit opinion of LKPD.

This result confirms the statement from Rosadi et al. (2017) in which financial report submission timeliness has a significant effect on audit opinion and local governments that earn 'unqualified' audit opinion are more disciplined in preparing financial report for the sake of earning regional incentive funds. This also supports Al Daoud et al., (2014) and Rachmawi, Rini and Fitri (2016) who evidence positive association between financial reporting timeliness and audit opinion. Timeliness of LKPD submission indicates good local government financial management as the implementation is consistent to the specified timeline. Hence, the quality of LKPD will be better and finally opens higher possibility to obtain 'unqualified' audit opinion (Sutaryo et al., 2018).

The variable ASSET has a p-value of 0.119 (greater than 0.05) with a negative coefficient -3.560, thus H5 is not supported. This result implies that local government assets are accounts with high complexity level and hence still become the main problem in government accounting for local governments in Indonesia. This is indicated by the fact that assets become exception in most auditor opinion on local government financial statement. This result supports Pratiwi and Aryani (2017) who state that the local government with large assets will provide a financial report that is not free from misstatement, thus enhancing the probability to get an 'qualified' audit opinion. This is because big assets are a good resource to manage an organization. Moreover, it has become the responsibility of the local government to manage its assets in an accountable manner.

This research uses three control variables; local government type (TYPE), geographical location (GEO), and surplus/deficit of budget realization (SURDEF). Local government type has significant effect on the audit opinion of LKPD while geographical position and surplus/deficit of budget realization do not. This result supports Kusumawati (2017) and Rosadi et al. (2017) who state that local government geographic location do not significantly affect audit opinion on LKPD. This is because of the influence of globalization that demand for the openness in the state financial management accountability. Social control from the public become higher and tend to not differentiate whether the control is taking place in Java or outside Java Island. The influence of information technology in the global era becomes the bridge between government type and geographical location. Also, local government surplus/deficit of budget realization does not have significant effect, consistent with the results from Fatimah et al. (2014), and Pamungkas, et al. (2018) in which budget realization is not a significant predictor.

## CONCLUSIONS

This research aims to investigate the effect of APBD ratification timeliness, local government complexity, regional financial supervision, LKPD submission timeliness, and local government size on the audit opinion of LKPD. This research concludes that APBD ratification timeliness, regional financial supervision, and LKPD submission timeliness have a positive effect on the opinion of local government financial statements. Meanwhile, local government complexity and local government size have no effect on the opinion of local government financial statement. The implication of the result is that the local governments have to be able to formulate, arrange, approve the APBD, and submit the financial statements in timely manner so that the

implementation of the activities and program, as well as the reporting process and the accountability of regional financial management, can be carried out properly which is proven by 'unqualified' opinion from the auditor.

Moreover, local governments have to maintain and develop the capability of financial supervision so that the process of control and supervision on local government financial management can be done properly, start from planning, executing, to the reporting phase. Every phase should be carried out based on the established procedures and able to result in the financial statement with the fair information proved by the audit opinion from the auditor. The government has to adopt information technology in regional financial management, such as e-budgeting, e-auditing, e-procurement to simplify the complexity of government processes and administration. By adopting information technology, the financial management processes can be carried out accurately in a proper way.

This research still contains several limitations. Firstly, not all local government financial reports, especially for recent data, are available and accessible so that some local governments are not included in the observation. Second, not all local governments' internal control is assessed. This causes a reduction in terms of the number of research samples and the ability to generalize the results. Third, this study only uses secondary and quantitative data without obtaining qualitative data. Based on these limitations, future research can add additional data sources to increase the number of samples and get a more comprehensive result. Moreover, next research is suggested to combine the quantitative and qualitative data which can be gathered by doing an interview with the finance officers or staffs, such as the budget and financial statements compilers and the examiner or auditor of local government financial statements to get the comprehensive result that can be generalized.

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