

THE IMPACT OF LOCAL GOVERNMENTS CHARACTERISTICS TO AUDIT QUALITY INDONESIA PERSPECTIVES

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ABSTRACT

This research exposes the impacts of local government characteristics, i.e.: size, dependency level, population, welfare level, local government type, and BPKP assistance toward audit quality on financial reporting of local governments. Audit quality will be reviewed from audit opinion side and audit findings side (internal control weaknesses, compliance deficiencies, and deviation level) of 297 local governments in Indonesia from 2008 to 2009. This research finds that audit quality has a positive correlation with audit opinion. In contrast, it has negative correlation with audit findings. From audit opinion side, population and local government type have positive impact on audit quality. On the contrary, size and BPKP assistance have negative impact on audit quality. In terms of compliance deficiency, number of population gives positive impact on audit quality. Meanwhile, from deviation level side, dependency, population and welfare level have positive impact on audit quality. This research does not find the correlation between local government characteristics toward internal control weaknesses.

Keyword: *Audit quality, size, dependency level, population, welfare level, local government type, BPKP*

1. INTRODUCTION

Regional autonomy is mandated by Law No. 22 of 1999 and then amended as Law No. 32 of 2004 on Regional Government delegating authority to the autonomous regions to organize and manage the affairs of government and community interests independently in accordance with statutory regulations. This delegation raises a good agency relationship between the public / voters (principal) with local governments (agent), local government (agent) with the legislature / parliament (the principal) as well as between the public (the principal) with the legislature / parliament (agent). The existence of differences in the interests of each party causes a conflict called as agency conflict that allows existence of irregularities done by agents.

Good governance is needed to minimize arising agency conflicts. To support the formation of good governance on the implementation of regional autonomy, the government reforms local financial management and accountability as outlined in several laws such as Law No. 17 of 2003 on State Finance and Government Regulation No. 24 of 2005 regarding Government Accounting Standards that emphasize on accountability and transparency in management of state finances. Embodiment of the accountability is reflected by the obligation for local governments to submit financial statements accountability that has audited

by BPK to DPRD.

In practice, there are still many local governments in Indonesia which are still not able to give a good account related to the financial management area. Based on the result of the BPK audits, it shows that the quality of local government audits in Indonesia is still low. This is shown by the low number of regions which are able to obtain an unqualified opinion for financial reporting of their areas. Until the year 2009, areas that are able to reach WTP opinion until 2009 are no more than 3%.

Low audit quality is also indicated by the number of cases found from audit results both related to internal control weaknesses and regulation noncompliance often generate losses for the country. In 2009, BPK data reported 4639 cases of internal control weaknesses and 6978 noncompliance cases valued at Rp 4.98 trillion.

Various problems occurred in the area of financial management accountability in Indonesia is what lies behind the author to explore more about the characteristics of local government as anything that can affect the quality of the audit. The relationship between opinion and the number of findings are also other things that will be studied here.

Researches related to financial management responsibilities of local governments been done previously found that the factors which have a significant relationship with the level of disclosure of financial statements is wealth of local government (income per capita) (Ingram; 1984, Laswad, Fisher and Oyelere; 2005, Liestiani; 2008), types of area (Laswad, Fisher and Oyelere; 2005), complexity, number of audit findings, and degree of region deviation (Liestiani; 2008).

In another study, Zaelani (2010) found that size of region, growth area, as well as complexity of regions represented by local revenue to be factors that significantly affect internal control weaknesses of local

governments in Indonesia. Furthermore, the study explained that local governments' internal control weaknesses were positively correlated with regional growth rate but negatively correlated with size and complexity of the regions. Associated with the compliance rate, variable rate dependence (Misra; 2008), population size and type of government (Aldizer; 1994) proved to be significant influential factors.

This study is an extension of the research performed by Zaelani (2010) and Liestiani (2008). If Zaelani (2010) focused on internal control weaknesses, and Liestiani (2008) focused on the level of disclosure, then this study will look at overall audit quality. Quality audits will be viewed from various aspects of audit opinion that describes quality of financial reporting and aspects of audit findings describing internal control weaknesses, level of noncompliance and level of irregularities committed by local governments. Each aspect has a close relationship, where internal control weaknesses, noncompliance rate and degree of deviation can affect audit opinion will be provided by BPK. Regions having good audit opinions usually have a small number of findings. The relationship among the types of audit quality is also a thing that will be examined in this study. Determinants of audit quality will be seen from the side of audited party and in this case are local governments.

International studies ever been conducted related to government finance management accountability will be one basis for the author in examining the conditions in Indonesia. The results of examination of local government financial reports by BPK contain a variety of fairly detailed information related to financial management responsibilities of each region particularly opinions and kinds of findings will be use to analyze and draw general conclusions about the outcome of the audit.

2. Literature Review and Hypothesis Development

2.1 Theories on Local Government Agency

Zimmerman (1977) stated that no agency relationship arises when one party (principal) delegated decision making authority to another party (agent). There are several assumptions of conditions occurred in such agency relationship, namely: subordinate or in this case is the agent who won the trust of principal assumed to be homo-economicus that are individualistic, opportunistic, and selfish desires of the individual (Davis, Schoorman & Donaldson; 1997), and also with the assumed principal emphasizing on individual interests. Principal welfare is affected by the performance of agents (Zimmerman; 1977), as well as the existence of asymmetric information between principal and agent (&McCubbins; Lupia 1994).

Divergence of interests between principals and agents which are accompanied by the opportunistic behavior can be detrimental to public interest (&Davis; Donaldson 1991). In the public sector, this agency relationship should be run to maximize the public interest. But in fact, state officials often use their strengths to maximize the goals that only concern on private interests by sacrificing public interests (McKean; 1964).

In the sphere of local governments in Indonesia, it can be said that there are some agency relationship that exists are: Public (principal) - Local governments (agents), public (principal) - Parliament (the agent), and the DPRD (Principal) - Local government (agent). The emergence of agency problems is no other than because of the view that the two parties, both agents and principals are rational individuals who will act for their own interests.

Agency problems can be minimized by the principal to monitor and supervise the agent (Zimmerman; 1977). Therefore the

local government should be able to provide a transparent and accountable information so that people can know the actions of their representatives in managing public affairs (Laswad, Fisher, Oyelere; 2005).

2.2 Regional Finance

According to Law 17/2003, the state finances are all the rights and obligations of states which can be valued in money, and everything in cash or in kind that can be used as state property in connection with the execution of the rights and obligations. In article 4 of Law No. 58 Year 2005 regarding Regional Finance states that the finances are managed in an orderly area, obey the laws and regulations, efficient, economical, effective, transparent, and responsible with regard to the principle of justice, decency, and the benefits to society.

In the Law No. 33 of 2004 concerning Financial Balance between Central Government and Local Government stated that in furtherance of the responsible regional autonomy, delegation of local government affairs should be accompanied by the arrangement, distribution, and utilization of national resources equitably included in the funding of government execution. According to Law 33/2004, the funding sources of government execution consist of original local government revenue, fund balance, borrowing regions and other legitimate income including legitimate grants, emergency funds, and other income set by government.

One of the real efforts is done to bring transparency and accountability in the management of state finances is by creating and submitting reports of financial accountability of local government in accordance with applicable standards, in this case is the Government Accounting Standards. The accountability reports include at least the budget realization report, balance sheet, cash flow statement and notes to the finan-

cial statements accompanied by financial statements of the local government. This report must be audited by BPK and submitted to Parliament not later than 6 months after the fiscal year ended.

2.3 Local Government Audit

In Act No. 15 of 2004 about Financial Audit noted that the examination is the process of problem identification, analysis, and evaluation of independent, objective, and professional based on examination standards, to assess the truth, accuracy, credibility, and reliability of information regarding the management and responsibility of state finances. There are three types of audit examination; financial audit, performance examination, and examination with a specific purpose.

2.3.1 Quality of Inspection Results

2.3.1.1 Audit Opinion

In essence, the audit is said to have good quality when it is able to find and present violations or irregularities in the financial statements examined to obtain adequate reliability of the financial statements. This is consistent with the definition of audit quality provided by De Angelo (1981); that is a probability in which an auditor discovers and reports on the existence of a breach in the client's accounting system.

From the auditor side, an auditor is said to produce good audit quality when the auditor is able to uncover and present many findings. But it is different when viewed from side of audited party, in this case is local government. The region is said to have good audit quality when the region is able to have a strong system of internal control and compliance with laws and regulations. In other words, the fewer the finding is, the better the region will be.

Quality of a good audit results can be used by users of financial statements to know whether information contained in fi-

nancial statements is relevant to be used or not. The quality of results is evident of confidence provided by the auditor stated in the opinion of the audit results. The higher the audit opinion is, the better the quality of audits will be. Here are the types of opinions can be given by the examiner, i.e.: unqualified opinion - WTP, natural opinion with exception - WDP (qualified opinion), unfair opinion - TW (adverse opinion), statement of rejecting or not to give opinion - TMP (disclaimer of opinion).

2.3.1.2 Audit Findings

a. Internal Control Weaknesses

In the explanation of Article 16 of Law No. 15 of 2004 stated that the reasonableness of the information in the financial statements are expressed through the auditor's opinion, based on four criteria: (i) conformity with governmental accounting standards, (ii) the adequacy of disclosure (adequate disclosures), (iii) compliance with laws and regulations, and (iv) the effectiveness of internal control systems.

Based on the criteria of the given opinion, the auditor of government in this regard is BPK, does not only provide an opinion on these financial statements in case of audit results been done, but also report the results of examination of the internal control system, as well as the examination report on compliance toward applicable laws and regulations.

According to the Committee of Sponsoring Organizations (COSO) internal control is a process, which involves the board of directors, management, and employees, designed to provide reasonable assurance of three things: 1) Effectiveness and efficiency of operations, 2) Reliability of financial reporting, 3) compliance with laws and regulations.

In line with COSO, Audit Standards State (SPKN) No.19 (b) states that the implementation of effective internal control sys-

tem intended to: (1) achieving goals as planned, (2) safety / security of wealth management, (3) compliance with the provisions legislation, (4) acquisition and maintenance of data / reliable information, and disclosure of data / reasonable information.

Internal control weakness occurs when the design or implementation of control is not able to make management or employees to prevent, detect, or correct mistakes made by management in a timely manner. It is based on the definitions contained in Government Auditing Standards (GAO) section 6:12, as follows:

“A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, detect, or correct errors in assertions made by management on a timely basis”

INTOSAI in Auditing Standards in paragraph 1.0.6g mention that one of the basic principles of government audit is that the existence of adequate internal control system will minimize the risk of mistakes and chaos in an organization.

“The existence of an adequate system of internal control minimises the risk of errors and irregularities”

From concept of the internal control, it is illustrated the close relationship between the internal control system with audit quality. Internal control weaknesses owned by a local government will encourage the poor quality of audit of LKPD. Findings related to internal control weaknesses are divided into three groups, namely:

1. Weakness of accounting controls and reporting systems. This weakness may affect the reliability of financial reporting and the safeguarding of assets.
2. Implementation of the budget control system weaknesses. This weakness may affect the efficiency and effectiveness of implementation of activities as

well as open up opportunities for non-compliance with laws and regulations.

3. The weakness of the internal control structure. This weakness may affect the effectiveness of internal control systems as a whole.

b. Disobedience against Regulation and Diversion Rate

As mentioned previously, one of the criteria in determining the audit opinion on these financial statements is the local government compliance with laws and regulations. The existence of non-compliance indicates that there is a problem in local finance management. The more non-compliance is done by local governments, the lower the audit quality is held by the local government. The findings related to non-compliance are divided into seven groups for the following:

1. Losses of countries / regions (including damage caused to the company's country / region) are reducing wealth of the country / region which are real and definite amount as a result of an unlawful act, either intentionally or unintentionally.
2. Potential losses to the state / region (including the potential damage caused to the company's country / region) are unlawful act either intentionally or unintentionally that can result in the risk of losses in the future.
3. Lack of income is the revenue that has become the right of country / region but does not or has not been entered into the state treasury / regions.
4. Administrative findings revealing the presence of deviations toward the applicable provisions both in the implementation of the budget and the asset management and operational, but the deviation does not result in losses, does not inhibit the program and does not contain any indication of criminal ele-

ments.

5. The findings on expenditure reveal the use of input with higher price or higher quantity / quality than the standard, the quantity / quality exceeding the requirement, and the price is more expensive compared to the similar provision at the same time.
6. The findings about the inefficiency reveal problems of quantity / quality utilization ratio of input to one unit of output which is larger than it should.
7. The findings about the ineffectiveness are oriented on achieving results (outcomes), those are findings that reveal the presence of activities that do not provide the benefits and functions of agencies that are not optimal so that organizational objectives are not achieved.

Poor adherence of local government toward laws and regulations may cause losses to the state. In addition to the findings, Result of BPK audit also reports losses rupiah found on non-compliance toward laws and regulations. Liestiani (2008) found that the level of deviation measured from finding value ratio (in rupiah) and total expenditures have negative correlation toward the level of disclosure of the financial statements. As more and more irregularities are done, the more information that is not disclosed in the financial statements. This shows that the financial statements do not provide relevant information. Irrelevant information contained in the financial statements indicates that low-quality of audits.

The results of the audit opinion, findings related to internal control, and the number and value of findings related to non-compliance with laws and regulations can be proxies of the audit quality of LKPD. Opinions and findings are usually interconnected. Regions that get TW or TMP opinion tend to have weak internal controls, and low adherence to laws and regulations.

2.4 Previous Research and Hypotheses Development

Copley (1991) in his research revealed that there is a positive relationship between quality of disclosure with quality of audits in local government. For the case in Indonesia, Liestiani (2007) revealed that there is a positive relationship between level of disclosure with number of relevant findings of noncompliance, but this correlation has negative relationship toward the value (nominal) findings related to non-compliance. The type and value (nominal) of this finding are criteria in determining the quality of audits. Therefore, although research related to the quality of government audits that specifically look at the characteristics of local government as the audited party still has not been done yet (the author's knowledge), research related to audit quality emphasizing on the quality of audits in general such as about the weakness of internal control, compliance and researches related to the level of disclosure of financial statements of local governments will be the foundation for researching the characteristics of any area which may affect the audits quality of LKPD in Indonesia.

2.4.1 Size of Local Government

Petrovits, Shakespeare, and Shih (2010) and Zaelani (2010) in their research on determinants of internal control weaknesses found a negative correlation between internal control weaknesses and the size of the organization. In other words, large organizations generally have a better internal control quality and thus it reduces internal control problems. Some researches related to level of financial statement disclosure as done by Laswad, Fisher, and Oyelere (2005) proved that the size of local governments does not have significant correlation toward the level of disclosure of financial statements, while Baber (1983) in Laswad, Fisher and Oyelere (2005) proved the opposite.

From these studies, this research will try to test the following hypothesis:

H1: The size of local government has a positive effect toward audit quality of LKPD

2.4.2 Level of Dependence

Misra (2009) conducted a study on adherence index to test accounting practices of government consisting of the implementation of accounting techniques as well as issues of transparency. The results of these studies indicate that the dependence on the central government has a positive and significant impact on local government compliance index. This is in line with research of Ingram (1984) which proved that the degree of dependence of local governments to the central government has a positive correlation with the level of disclosure of government financial statements. Based on the previous studies, this research will test the hypothesis:

H2: Level of dependence of local governments has a positive correlation with audits quality of LKPD

2.4.3 Complexity

Ingram (1984) used population as a proxy of the complexity of an organization that also influenced the level of disclosure of government financial statements. Aldhizer (1994) revealed that the size of population of a region has a positive influence on the level of local government compliance toward applicable regulations. This is due to the size of population has a positive influence on the internal control system (Icerman and Hillison; 1990 in Aldhizer; 1994). In line with this, Copley (1991) in Aldhizer (1994) and Liestiani (2007) also stated that the size of population has a positive influence on the quality of disclosure of financial statements of local governments. This study will test the following hypothesis:

H3a: There is a positive correlation between population size and audit quality of

LKPD

Ingram (1984), Laswad, Fisher, and Oyelere (2005) proved that the wealth of local government proxied by own revenue per capita is one factor which positively affected the quality of disclosure. For the case of Indonesia, local government property can be measured from the PAD per capita (Liestiani; 2007). In other studies, Petrovits, Shakespeare, Shih (2010) and Zaelani (2010) used variable of complexity as measured by the amount of income source as one of positive determinant of internal control problems. Richer areas (more complex areas) tend to have weaker internal control so that they have high probability to make mistakes and more noncompliance and increase the probability of decline in audit opinion to be obtained.

H3b: The level of local government wealth negatively affects the audits quality of LKPD

2.4.4 Types of Region

Structure of government has an influence toward audit quality (Aldhizer; 1994). Aldhizer (1994) classified the forms of local government into two groups: the manager-council and mayor-council. Type of manager-council government is local government where the head of the region acts as a manager who is directly elected by the elected council members (council) and has the expertise to perform the financial management area having a positive influence on government compliance and audit quality (Aldhizer; 1994), as well as the quality of financial report disclosure (Copley; 1991 in Aldhizer; 1994). In Indonesia, there is a regional division of the provincial administrative regions, cities and counties which each of them has the same authority. Even so, counties and cities have different characteristics, especially in terms of investment competitiveness, where the city meets two competitive regional characteristics such as

high investment such as good economy, security conditions, political situation, conducive social and culture (Regional Autonomy Implementation Monitoring Committee; 2005 in Liestiani; 2007).

Seeing this, it is possible that differences in regions (districts and cities) have an influence on audit quality. Therefore, this study proposes the hypothesis:

H4: The types of regions have a positive influence toward audit quality of LKPD

2.4.5 BPKP Assistance

Financial and Development Supervisory Agency (BPK) is a state institution in charge to supervise the implementation of financial and development. In carrying out its duties, BPKP performs some activities such as consultations, assistance and evaluation. In these activities, BPKP performs the role as a consultant for its stakeholders to realize good governance. The local government is one of the stakeholders of the BPKP. One of the consultations that are often provided by the BPKP to local governments is related to Government Agencies Performance Accountability (AKIP) and Financial Accounting System (SAKD). Therefore, this assistance is reasonably likely to encourage

BPKP audit quality of LKPD. Then, this study will examine the influence of mentoring BPKP / LKPD consultant toward audit quality.

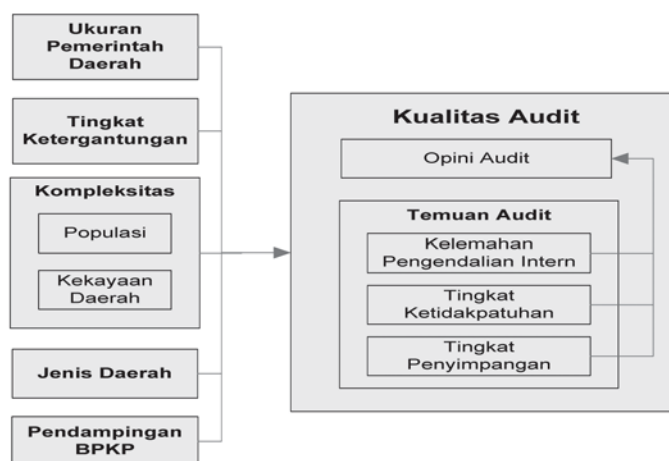
H5 : Assistance of BPKP / consultant has a positive correlation with the quality of LKPD

3. Methodology

3.1 Research Framework

This study will test the quality of audits of 297 local government financial statements (LKPD) during the year 2008-2009 as well as what factors which are affecting the quality of the audit. High quality of audit is characterized by high audit opinion obtained and the low internal control weakness, non-compliance and the level of irregularities occurred. To prove relationship among the types of quality audits, it will be firstly conducted Pearson correlation test. Factors that will be tested in this study focus on the local government as the audited party. Determinant factors of quality audits will be seen from five factors: 1) the size of local government, 2) the level of dependency, 3) complexity which consists of population and wealth of the region, 4) types of region, 5) BPKP Assistance.

Figure of Determinant Factor of Audit Quality



3.2 Research Model

3.2.1 Testing the Relationship among the Types of Audit Quality

This test is done to see how the relationship of the four types of audit quality and consistency of audit opinion given by BPK based on audit findings obtained. Testing is done by looking at descriptive statistics and Pearson correlation test results.

3.2.2 Testing the Effect of Characteristics of Local Government and Supporting Factors against the Audit Opinion

Based on data from the ordinal dependent variable, then this study will use ordinal logistic as a research method to test the hypotheses that have been formulated. Ordinal logistic is one type of logistic re-

gression models for dependent variable models having a ranking. Logistic regression is a regression method that is used to test the response or regressand that are not in the form of quantitative or interval scale, but the qualitative response such as yes or no, present or absent (Gujarati, 2003) and follow the logistic distribution, so that the distribution of the dependent variable in response to expected is nonlinear (Kuncoro, 2000). Unlike OLS regression, logistic regression does not assume linearity of the relationship between the basic values of bound independent variables, does not require normally distributed variables, and does not assume homoskedastisitas, so that in general it has laxer requirements (Statnotes, North Carolina State University).

Model 1

$$\text{Logit (p)} = \text{Log} \frac{p}{1-p} = \beta_1 \text{LnTA} + \beta_2 \text{DEPEND} + \beta_{3a} \text{LnCOMPPop} + \beta_{3b} \text{LnCOMPWealth} + \beta_4 \text{TYPE} + \beta_5 \text{BPKP}$$

Where :

Dependent Variable

OPINION Audit opinion with category 4 for WTP opinion; 3 for WDP opinion; 2 for TW opinion; and 1 for TMP opinion.

Independent Variable

LnTA Area Size (natural log of area total aset)
 DEPEND Dependence Level ($\frac{\text{Pendapatan Transfer}}{\text{Total Pendapatan}}$)
 LnCOMPPop Regional Population (natural log of the total population)
 LnCOMPWealth Level of Government Wealth (natural log of $\frac{\text{Pendapatan Asli Daerah}}{\text{Jumlah Penduduk}}$)
 TYPE Types of Region: 1 for city; 0 for district
 BPKP BPKP Assistance: 1 for available; 0 for not

3.2.3 Testing the Effect of Characteristics of Local Governments and Factors Supporting of Audit Findings

Dependent variables will be tested here is a variable with an interval scale and in the form of panel data. Here is a model that will

be used to test the quality of the audit seen from the weakness of internal controls (model 2), non-compliance with regulations (model 3), and the degree of deviation (model 4)

Model 2

$$ICW_{it} = \alpha + \beta_1 \text{LnTA}_{it} + \beta_2 \text{DEPEND}_{it} + \beta_{3a} \text{LnCOMPPop}_{it} + \beta_{3b} \text{LnCOMPWealth}_{it} + \beta_4 \text{TYPE}_{it} + \beta_5 \text{BPKP}_{it} + \epsilon_{it}$$

Model 3

$$AUDFind_{it} = \alpha + \beta_1 LnTA_{it} + \beta_2 DEPEND_{it} + \beta_{3a} LnCOMPPop_{it} + \beta_{3b} LnCOMPWealth_{it} + \beta_4 TYPE_{it} + \beta_5 BPKP_{it} + \epsilon_{it}$$

Model 4

$$AUDNOM_{it} = \alpha + \beta_1 LnTA_{it} + \beta_2 DEPEND_{it} + \beta_{3a} LnCOMPPop_{it} + \beta_{3b} LnCOMPWealth_{it} + \beta_4 TYPE_{it} + \beta_5 BPKP_{it} + \epsilon_{it}$$

Where the definition of other variables is the same on the definition of variables in model 1 except:

- ICW Internal Control Weaknesses ICW (the number of cases related to the findings of the internal control weaknesses)
- AUDFIND Noncompliance to Regulation (number of cases of non-compliance findings toward legislation)
- AUDNOM Level of Deviation ($\times 100 \frac{\text{Total Temuan (dalam rupiah)}}{\text{Total Belanja Daerah}}$)

4. Result and Discussion

4.1 Relationship among Types of Audit Quality

Pearson correlation test results in table 4.2 show that the four types of audit quality

having a significant correlation to one another. These results indicate that audit quality is positively related to audit opinion, but negative with the audit findings.

Table 4.1 Pearson Correlation

		OPINI	ICW	AUDFIND	AUDNOM
OPINI	<i>Pearson Correlation</i>	1	-.308**	-.219**	-.271**
	<i>Sig. (1-tailed)</i>		.000	.000	.000
ICW	<i>Pearson Correlation</i>	-.308**	1	.194**	.090*
	<i>Sig. (1-tailed)</i>	.000		.000	.014
AUDFIND	<i>Pearson Correlation</i>	-.219**	.194**	1	.261**
	<i>Sig. (1-tailed)</i>	.000	.000		.000
AUDNOM	<i>Pearson Correlation</i>	-.271**	.090*	.261**	1
	<i>Sig. (1-tailed)</i>	.000	.014	.000	

** Significant on the confidence level of 99% (1-tailed).

* Significant on the confidence level of 95% (1-tailed).

The relationship among the types of audit quality can also be seen from the description of the statistics in Table 4.2 showing that regions with higher audit opinion is

likely to have internal control weaknesses, noncompliance rates, and lower levels of distortion.

Table 4.2 Descriptive Statistics of Audit Quality

	OPINION		Mean ICW	Mean AUDFIND	Mean AUDNOM
	Frequency	%			
WTP (4)	22	3.70%	5.227273	12.13636	0.00852
WDP (3)	410	69.02%	7.539024	12.89512	0.009655
TW (2)	39	6.57%	9.923077	14	0.018914
TMP (1)	123	20.71%	10.20325	16.46341	0.028956

4.2 The Characteristics Influence of Local Government toward Audit Quality

Average different test results (Table 4.3) and the regression test results (table 4.4) do not show significant differences of the local government characteristics toward the internal control weaknesses. Because the characteristics of local governments studied here are not proven to affect the quality of audits from internal control weaknesses side, then further discussion will be focused on the quality audit from the side of audit opinion and audit findings (the rates of adherence and the levels of deviation).

4.2.1 Total Assets

a. The quality audit viewed from audit opinion

Average different test results showed that based on total assets owned, big local governments (having a total value of assets above the median value) on average have lower audit opinion than small local government. This is supported by the results of hypothesis testing which show that total assets have a negative and significant correlation with audit quality from the side of audit opinion. The negative sign indicates that the larger the assets owned by local governments, the tendency of the audit opinion will direct more to the lower audit opinion.

Marginal effects of changes in the assets toward the audit opinion indicate that when there is an increase in total assets, there

will be a decrease in the probability for the area to obtain WTP and WDP opinion, but it would increase the probability to get opinions TW and TMP. Magnitude of the change of probability can be seen in table 4.5.

The negative relationship between total assets with audit quality can be caused by local government asset management which is still not done well. This is indicated by the number of audit findings related to asset management incurring losses that are not small. For example, examination results to the financial statements for local government for the budget year of 2009 showed that there were 554 cases related to abuse or negligence in the management of regional assets that caused losses valued at USD 3.2265 trillion. Based on this, a negative relationship between total assets and audit quality can be caused by a growing number of assets owned by the local government, the greater the likelihood of abuse or negligence in the management of regional assets that could result in losses.

b. The audit quality viewed from audit findings

In line with the audit opinion, average different test results showed that the audit findings related to regulatory non-compliance in terms of both quantity and value (deviation level) are less common in large size of local governments compared with small-sized local governments. Meanwhile, the regression results indicate that the total assets give a negative but insignificant ef-

fect on non-compliance regulations. Judging from the value (rupiah), the findings that describe the irregularities, the total assets have a positive correlation but not significant to the level of deviation. This suggests that local governments having larger total assets, the number of findings related to noncompliance occurred is relatively small, but in great deviation of rupiah value.

Fewer non-compliance that occurred in larger local governments can be caused by better internal controls undertaken (Petrovits, Shakespeare, and Shih; 2010, Zaelani; 2010). With increasingly of good internal control, it can minimize risk of errors on occurred non-compliance fund. However, local governments with greater total assets, which the risk of losses due to non-compliance will be higher compared to small-sized of local governments.

4.2.2 Rate of Dependence

a. The quality of audit viewed from audit opinion

Average different test results show that areas with low levels of dependence (below median value) on average have higher audit opinion compared to areas with high dependency levels (above median value). Meanwhile, the hypothesis test showed that the level of dependence does not significantly influence the quality of the audit viewed from the audit opinion. These results indicate that the level of dependency of local governments does not so affect the quality of audits produced.

This can be caused due to the low rate of control provided by central government toward transfer funds management so that local governments are not motivated to improve the quality of regional financial statement audits. Negative sign on the coefficient indicates that it is precisely the area that is more independent (has a smaller dependency rate) is better quality audit. More independent regions indicate that the

area has a larger share of local revenue (PAD). The greater PAD indicates that the more stakeholders are owned by the area. The presence of more stakeholders make demands for more transparent and accountable financial management area becomes larger. This can encourage the government to conduct management and financial accountability of local government so that the better of the quality audit will be obtained.

b. The quality of audit viewed from audit findings

Viewed from the side of the audit findings, the results of different test indicate in line results with the audit opinion. The number of findings and the value of findings (degree of deviation) are more common in the area that has a high level of dependence. If different test results indicate significant difference in the quality of audits on the findings side, the regression test results show that the degree of dependence does not significantly affect the number of findings of noncompliance, but negatively and significantly correlated with the level of deviation. These results contrast with the research of Misra (2008) which stated that the level of dependence has a positive correlation with the level of disclosure and compliance index.

Majority transfer revenues are used to finance local government operations such as personnel expenditure. Personnel expenditure is an expenditure that is rigid so that the gap for the deviation in this area is very small. It is thought to be the cause of a negative relationship between level of dependency of local governments and the level of irregularities that occurred.

4.2.3 Population

a. The quality audit visits of audit opinion

The results of different test and regression test showed that the population has a positive and significant relationship with the

quality audit of the audit opinion (P-value <0.05). In other words, the regions with high population have better audit opinion. The big effect caused by changes in population is indicated by the value of dy / dx in Table 4.5. From the table, it shows that the increasing in population will increase the probability of audit opinion of a region to obtain WTP and WDP and automatically will lower the probability of getting opinions of TW and TMP.

This positive relationship indicates that the large population will further increase the oversight of government management. The stronger supervision, the more it will encourage the government to have a good internal control (Zaelani; 2010). The better internal control, the more it will minimize the error or non-compliance occurs. The less mistakes and disobedience contained in the financial statements of the local government will further improve the quality of the audit obtained.

b. The audit quality viewed from audit findings

Similar results (both from different test and regression test) are also shown from the relationship between the number of residents with the audit findings correlating negatively and significantly. The regions having more population have less violation of the rules and fewer irregularities. In other words, the quality of audits is increasing. This is similar to the research result of Aldhizer (1994) who evaluated the link numbers of people with the level of compliance and audits quality, as well as Zaelani (2010) which examined the internal control weaknesses of local government.

4.2.4 Levels of Local Government Wealth

a. The audit quality viewed from audit opinion

It can not be seen significant differences on average of audit opinion at rich

regions and poor regions. Regression test results also showed that the level of local wealth does not significantly affect the audit opinion (P-value > 0.05). This shows that the rich or the poor of a region does not so affect the quality of auditing its financial statements. Positive sign on the coefficient indicates that areas with high levels of wealth tend to have a large probability of high-quality audits. This is in line with research of Ingram (1984), Laswad, Fisher, and Oyelere (2005) which stated that the level of local wealth had a positive relationship toward disclosure quality.

b. The audit quality viewed from audit findings

From the side of audit findings, it can not also be seen significant difference of average between the rich and the poor regions. Meanwhile, the results of hypothesis test show that the level of wealth has a negative but insignificant relationship with non-compliance but significant with the level of deviation. These results are consistent with the research results of Retina (2008) which stated that the wealth of the area positively correlated with the level of compliance. High wealth will trigger the higher quality of financial reports preparation.

The negative relationship between the audit findings with the level of wealth suggests that the richer regions are fewer of breaking the rules and doing irregularities. In other words, the both test results support each other to declare that the level of local wealth has a positive correlation with audit quality.

4.2.5 Types of Regions

a. The audit quality viewed from audit opinion

There is a significant difference on audit opinion average of municipalities and county governments. In line with the results of different test, the hypothesis test also

shows a positive and significant correlation of the type of region with the audit quality from the side of audit opinion (P-value <0.05). Types of regions are divided into cities and districts. Positive sign indicates that the municipal government (Type = 1) has a large probability for high quality of audits.

Marginal effect indicates that the municipality has a higher probability to obtain WTP and WDP opinion and has a lower probability to obtain TW and TMP opinion. Positive relationship between the type of regions and the audit opinion can be caused due to the characteristics of urban areas which generally have more complete facilities and infrastructure than the districts and have a higher quality of human resources (because the city is near to the center of education) so that the financial management can be done better.

b. The audit quality audit viewed from audit findings

Positive relationship between the type of regions and audits quality are also seen from the negative correlation between the types of regions with high level of deviation even though not significant. These results are consistent with the researches of Aldhizer (1994) and Liestiani (2008) who investigate the level of compliance and the level of disclosure.

4.2.6 BPKP Assistance

a. The audit quality viewed from audit opinion

Significant differences on average of audit opinion are also seen in areas gaining assistance from BPKP with areas that are not accompanied by BPKP, where the areas which are not getting assistance have higher average of audit opinion. This is supported by the results of hypothesis testing which also show that BPKP mentoring has a negative and significant correlation with

audit quality from the side of audit opinion (P-value <0.05). Negative sign on the coefficient of variable BPKP shows that the regions given assistance by the BPKP have a large probability for audit quality approaching group 1 (TMP). As shown in the marginal effect, regions gaining assistance from BPKP have greater probability to get TMP and TW opinion and have smaller probability to get opinion WTP and WDP opinion.

Negative relationship between BPKP and audit quality can be caused by mentoring / assistance undertaken by the BPKP to local governments which are not working effectively so that there is no effect in improving financial management of local governments so that it is not able to improve the audit quality of the financial statements of local government. Another reason that can explain the negative relationship between BPKP assistance and audit quality is that local governments have the freedom to conduct cooperation in terms of financial management assistance of local governments with consultants outside BPKP. The negative relationship between the presence of BPKP assistance with audit quality shows that mentoring done by outside consultants of BPKP is more effective in improving financial management of local government so that audit quality gained increases. In addition, there are some local governments such as Tangerang and Depok City having chief of financial bureau originated from BPKP. With such conditions, it is natural that the local government is no longer accompanied by BPKP again.

b. The audit quality viewed from audit findings

BPKP assistance has a negative correlation but not significant with the level of non-compliance and irregularities. This indicates that the presence or absence of BPKP mentoring has no significant effect on

the level of non-compliance or and level of deviation. This can reinforce the notion that BPKP assistance is less effective.

5. Conclusion

Audit quality has a positive correlation with audit opinion but negative with the audit findings. There is a consistency of audit opinion given which is conducted by the BPK, where the regions with a few findings tend to get a better opinion. Conditions of audit quality of local financial statements in the past two years show an improvement but not significant. Audit quality of financial statements local government is still relatively low. The low quality of the audit indicates a need to increase transparency and accountability in financial management of local governments in various areas mainly related to internal control and compliance toward the regulations so that it can encourage the improvement of audit quality attainment.

From the audit opinion side, audit quality has a positive correlation with the number of population and type of regions, but it is negatively correlated with the size of local governments and BPKP assistance. Based on the level of non-compliance, audit quality has a positive relationship with the population. Meanwhile, from the level of irregularities, the audit quality has a positive relationship with the level of dependency, population and level of wealth. This study is not able to find a relation between the characteristics of local government with internal control weaknesses.

Short period of research is the limitation in this study. Future studies are expected to extend the period of research. With more data, model testing can be done more accurately. The negative correlation between BPKP assistance with audit quality also becomes an interesting thing to be further investigated. In addition, these findings can be an input for the government to review the effectiveness of BPKP.

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Table 4.3 Different Test of Audit Quality Average Based on Variables

		OPINION		ICW		AUDFIND		AUDNOM	
		Mean	P-Value	Mean	P-Value	Mean	P-Value	Mean	P-Value
TA	Tinggi	2,5183		8,3333		12,8148		0,1046	
	Rendah	3,4317	0,057**	7,9899	0,295	14,4748	0,001*	0,1782	0,001*
DEPEND	Tinggi	2,7742		8,0943		14,3098		0,1738	
	Rendah	3,1758	0,000*	8,229	0,681	13,0471	0,016*	0,1105	0,006*
COMPOPOP	Tinggi	3,2923		8,2357		13,2222		0,1066	
	Rendah	2,6577	0,000*	8,0875	0,651	14,1347	0,081**	0,1778	0,002*
COMPWEALTH	Tinggi	2,9288		8,1178		13,4007		0,1476	
	Rendah	3,0212	0,419	8,2054	0,789	13,9562	0,289	0,1368	0,643
TYPE	Kabupaten (0)	2,8766		8,197		13,8766		0,1472	
	Kota (1)	3,3159	0,001*	8,0379	0,685	12,9849	0,144	0,1247	0,314
BPKP	Tidak ada (0)	3,1448		7,8869		13,2760		0,1342	
	Ada (1)	2,8737	0,022*	8,3244	0,189	13,9169	0,234	0,1469	0,598

* significant on confidence level of 95%

** significant on confidence level of 90%

Tabel 4.4 Result of Regression Test

	OPINION		ICW, RE		AUDFIND, FE Robust		AUDNOM, RE	
	Coef	Sig	Coef	Sig	Coef	Sig	Coef	Sig
Total Assets	-0.357634	0.0345*	0.665282	0.046*	-0.050767	0.4675	0.0421099	0.440
Level of Dependence	-0.030811	0.4935	-3.45423	0.1675	5.376924	0.173	-3.837204	0.0615**
Population	0.7926639	0.000*	-0.28946	0.203	-0.786848	0.0765**	-0.87192	0.000*
Level of Wealth	0.0938817	0.314	-0.00616	0.4935	-0.5714	0.173	-0.550556	0.020*
Types of Regions	0.8666549	0.000*	-0.38656	0.213	-0.433249	0.2885	-0.022734	0.463
BPKP Assistance	-0.364912	0.0285*	0.706606	0.022*	-0.002741	0.498	-0.0566643	0.4085
Constant			-3.94632		26.7985		21.13282	
Prob chi-square	0.0000*		0.1392		0.0763**		0.0007*	
R-square	0.0588		0.015		0.0245		0.0501	

Tabel 4.5 Summary of Marginal Effect of Independent Variable toward Probability of Each Group of Audit Opinion

Variable	dy/dx			
	Prob TMP = 0,18335293	Prob TW = 0,06864336	Prob WDP = 0,71798892	Prob WTP = 0,03001479
Total Assets	0,0447677	0,0115883	-0,0476515	-0,0087045
Population	-0,1092311	-0,028275	0,1162675	0,0212385
Types of Region	-0,114965	-0,0332932	0,1143813	0,0338768
BPKP	0,0552395	0,0146548	-0,0582599	-0,0116343
