

## The Effect of the Audit Results of the Supreme Audit Board on the Financial Performance of Local Governments

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**Abstract:** The purpose of this study was to examine the effect of the audit results of the Supreme Audit Board (BPK). It was consisted of audit opinion and audit findings on the financial performance of local governments from the economic ratios, effectiveness, and efficiency. The sample in this study used 15 regency/city governments in Lampung province. This study used multiple linear regression to test the hypothesis. The result of this study indicated that audit opinion had no effect on economic and efficient financial performance but it had an effect on effective financial performance. In addition, audit findings had no effect on efficient and effective financial performance but it had an effect on economic-financial performance.

**Keywords:** *Audit Opinion, Audit Findings, Financial Performance of Local Governments*

### 1. INTRODUCTION

Constitution of Republic of Indonesia Number 32 and 33 Year 2004 is the main basis for the implementation of autonomy in local government. Local governments have the authority to regulate and manage their own government affairs. Basically, the aim of implementing regional autonomy is to optimize the potential of the local to achieve public welfare (Mercy, 2013).

The implementation of local autonomy requires the government to be transparent. Local government transparency is by providing accountability for the implementation regional budget revenue and expenditure (APBD). Financial management of local government needs a predetermined standard, in order to achieve local government that is independent, effective, efficient and accountable. The accountability of local governments to house of regional people's representative council (DPRD) is an important matter for assessing the accountability of financial reports that have been prepared by local governments.

Accountability in the context of the public sector is described in agency theory. Agency theory explains that an agent which is defined as government have the responsibility to present, report and disclose all their activities to the principle which is defined as the community or house of DPRD, principles have the right and authority to hold accountability (Mardiasmo, 2009). This statement implies that in management of local government there is an agency relationship (agency theory) between the community as the principal and the local government as the agent.

Apart from being a public accountability, information on the performance of local government management can be used as a means to provide signals to the public. Furthermore, the signal will be interpreted as a good signal (good news) or a bad signal (bad news) by the community. Evans and Patton (1987) stated that in the context of signaling theory, the government tries to give a good signal to the community that government works independently, effectively and efficiently. On this basis, some researchers stated that the accountability report cannot be recognized if there is no external auditor who audits the report. As stated in the Constitution of Republic of Indonesia

Number 17 Year 2003 Article 31 which states that in order to comply with the standards set by the government, the Financial Reports of Local Government need to be examined by the Supreme Audit Board (BPK).

The audit opinion and audit findings provide material information for the public to assess the financial performance of local governments. The audit opinion and audit findings provide material information for the public to assess the financial performance of local governments. Research conducted by Virgasari (2006); Purwanto and Harto (2017) states that a good audit opinion represents a good local government financial performance.

This also applies to the audit findings of the Supreme Audit Institution, the results of the audit findings conducted by BPK illustrate the performance of local governments. The large number of audit findings by the BPK will be a bad signal to the public that the local government is not able to perform optimally. The large number of audit findings by the BPK also shows weaknesses in internal controls of governments that can harm state finances (Artha et al. 2015).

Thus, this study will examine the effect of the Audit Result of BPK on the financial performance of local governments. Researchers are a replica of previous studies namely Artha et al. (2015) by adding the audit opinion variable issued by the Supreme Audit Institution. Researchers used a sample of regency and cities in Lampung province as research objects on the reason that in 2018- 2019 the audit opinion on Financial report of local governments (LKPD) almost all regency and cities in Lampung province was Unqualified Opinion (WTP) although in 2019 many local governments were caught by the Commission Corruption Eradication (KPK) commits a criminal act of corruption.

## **2. LITERATURE RIVIEW**

### **a. Agency Theory**

An agency relationship is a contract in which one or more people (principal) order another person (agent) to perform a service on behalf of the principal and authorizes the agent to make the best decisions for the principal (Jensen and Meckling, 1976). Agency theory will occur in various organizations including government organizations and focuses on the problem of inequality / asymmetry of information between the manager (agency/government) and the public (represented by the principal/board). Principals must monitor the work performed by agents, so that organizational goals can be achieved efficiently and achieve public accountability (Lane, 2002). Public accountability can be defined as the obligation of the agent to provide accountability, present, report, and disclose all activities that are their responsibility to the principal who has the right and authority to ask for this accountability (Mardiasmo, 2006). One of the agency problems is the information asymmetry. In government, this information asymmetry can lead to irregularities or corruption by the government as an agent. Therefore, government management must be supervised to ensure that government administration is carried out in accordance with applicable regulations. One form of this supervision is the audit conducted by the BPK of financial reports of local governments.

### **b. Signaling Theory**

Signaling theory according to Brigham and Houston (1999) is a company's action in giving signals to investors about how management views the company. Signal theory discusses how the signals of success or failure of management (agent) should be conveyed to the owner (principal). The impetus for providing signals arises because of the presence of asymmetric information between the company (management) and outsiders, where investors know that the company's internal information is relatively small and slower than management.

Signaling theory explains that the government as a party that is given a mandate from the people has a desire to show a signal to the public. The government will provide a signal to the public by providing quality financial reports, improving the internal control system, more complete and transparent disclosure. The local government shows financial reports to the community to show that the local government has carried out the community's mandate well (Puspita et al, 2010).

According to Artana (2016) signaling theory is used to explain that the government is the party given the mandate and the people as the trustee and the existence of a third party as the financial report auditor who audits financial reports in order to produce quality financial reports so that they can provide reliable and relevant information so that it can be trusted by the community as the trustee.

c. Hypothesis Development

1. Effect of Audit Opinion on Financial Performance of Local governments.

In accordance with Constitution Number 15 Year 2004 concerning State Management and Responsibility Audit, the State as the principal appoints BPK to assess the accountability report in the form of financial reports prepared by local governments, so that the State, in this case the public as the principal has confidence in the truth of the reports prepared so that it can be accounted for. Therefore, the audit results of the BPK namely audit opinion are very important for the public as a measuring tool for assessing the performance of state financial management. Audit opinion is often used as a measure of local financial management performance. Research conducted Virga sari (2006) states that the audit opinion has a positive effect on the performance of the local government, where the better opinion of local government obtained the better the performance of the local government. Another study that examined the effect of audit opinion on local government performance was also conducted by Marfiana (2013) which showed that there was a relationship between BPK audit opinions on local government financial performance. Referring to these studies, a hypothesis can be formulated:

- H1a : Audit opinion of the Supreme Audit Board (BPK) has a effect on the financial economic performance of local governments.
- H1b : Audit opinion of the Supreme Audit Board (BPK) has a effect on the financial efficient performance of local governments.
- H1b : Audit opinion of the Supreme Audit Board (BPK) has a effect on the financial effective performance of local governments.

2. Effect of Audit Findings on Financial Performance of Local governments.

BPK Regulation Number 1 of 2007 concerning State financial audit standards which states that audit findings may include weaknesses in internal control, fraud, irregularities or non-compliance with statutory provisions that have the potential to harm State finances. Thus, the audit findings which are the audit results of the BPK can be used as a benchmark for the financial performance of the local government whether the local government has worked without any violations and fraud. Research conducted by Mustikarini and Fitriasisi (2012) found that audit findings had a negative effect on the performance of regency/city governments in Indonesia by using 2007 data. Similar results were also produced by Sudarsana (2013) using 2010 data, which shows that the more audit findings conducted by local governments illustrate the worsening performance of the local government. In accordance with the concepts and results of the study, the authors have a hypothesis:

- H2a : Audit findings of the Supreme Audit Board (BPK) has a effect on the financial Economic performance of local governments.
- H2b : Audit findings of the Supreme Audit Board (BPK) has a effect on the financial

- H2c : Efficient performance of local governments.  
: Audit findings of the Supreme Audit Board (BPK) has a effect on the financial  
Effective performance of local governments.

d. Framework

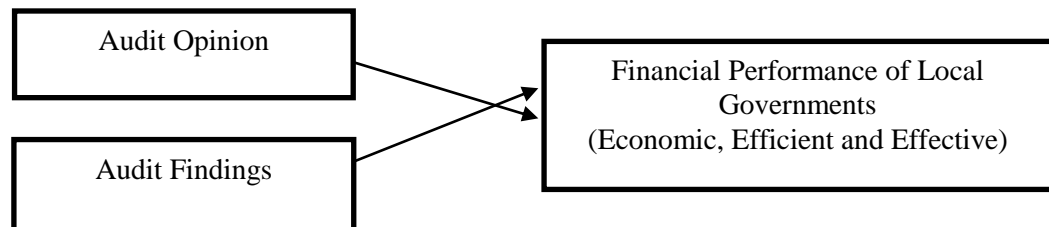


Figure1. Framework

### 3. RESEARCH METHODOLOGY

a. Population and Sample

The object of this study was local governments of Lampung Province. The samples were financial statements of local governments of Lampung Province. Lampung Province had 13 regency governments and 2 city governments. The data in this study used secondary data. Secondary data used documentation data obtained from other parties. This study used data sources from IHPS BPK and government financial reports (LKPD).

b. Measurements

Audit Opinion (X1), Audit Findings (X2), and one dependent variable, namely the financial performance of local governments (Y). BPK audit opinion variable was measured by giving an ordinal scale score with details: WTP=5, WTP-DPP=4, WDP=3, TMP=2, TW=1. Audit findings was measured by the number of BPK RI audit findings, whereas local government performance variable (Y) was measured by calculating the respective economic, efficiency, and effectiveness ratios.

c. Research Method

This study uses multiple linear regression method with the following equation model:

$$KRP = \alpha_0 + \beta_1 OPINI + \beta_2 TMN + \varepsilon$$

KRP = Local government performance

$\alpha_0$  = Constant

$\beta_{1, \dots}$  = Regression Coefficient

OPINI = Audit Opinion

TMN = BPK Audit Findings

$\varepsilon$  = error

d. Classical Assumption Test

This study conducted a classical assumption test consisting of normality test, heteroscedasticity, multicollinearity, and autocorrelation testing. These four assumptions must be fulfilled to meet BLUE (Best, Linear, Unbiased, and Expected). In addition to the classical assumption test, we conducted a model test with the F test to determine whether the research model is fit or not. We also tested the coefficient of determination to determine whether the independent variable describes the dependent variable, and the last was the t test. The t test

was used to partially test the effect of independent variables on the dependent variable. The t test was able to determine whether the hypothesis is accepted or not.

#### 4. RESULTS AND DISCUSSIONS

The research data showed that the financial reports of local governments in Lampung province have mostly fulfilled the 3E principles (economy, effectiveness and efficiency). Regarding the principles in economics, the data showed that the maximum value is 1.14 and the minimum value was 0.50 and the average value was 0.87. It meant that almost all LKPD in Lampung province had met the principles of economic performance (categorized as fulfilling the principle if the value is less than 1).

The principle of efficiency had a maximum value of 1.14 and a minimum value of 0.14. Meanwhile, the average of 0.889 was close to 1. It meant that almost all LKPD in Lampung province had met the minimum efficiency principle.

The effectiveness ratio had a maximum value of 31.55 and a minimum value of 0.000 and an average value of 13.50. It meant that almost all the performance of the Lampung provincial government was not working effectively. The ratio value exceeded the value of 1.

The results of the classical assumption test showed that the data used in the study with the Y1 and Y2 variables were normally distributed. Meanwhile, Y3 was not normally distributed. This study also proved that it had met autocorrelation and multicollinearity. However, it did not meet the heteroscedasticity assumption.

This research model was also declared feasible, as evidenced by the sig value on the F test which was less than 0.05. In addition, this research showed that the independent variable was only able to describe the dependent variable of 6.8%.

The sig value on the partial test shows H1a and H1b had a value of  $>0.1$ . H1c had a sig value  $<0.1$ . The sig value in H2b and H2c had a value greater than  $>0.1$ . Based on the regression results, H2b and H2c were not supported. Meanwhile, H2a was supported with a sig value  $<0.1$ .

This study had proven that the audit opinion had no effect on the economic performance of local governments (H1a and H1b is not supported). It was able to be concluded that the audit opinion issued by the BPK does not affect the economic performance or efficiency of the local governments. Meanwhile, H1c was supported. It meant that the audit opinion resulted local governments working more effectively in managing local government funds.

Moreover, the number of audit findings was found by BPK resulted in local governments working more economically (H2 is supported). However, the audit findings did not result in the government working effectively and efficiently, thus hypothesis 2b and 2c were not supported.

#### 5. CONCLUSION

This study was to analyze the effect of the BPK examination results on local government financial performance. The results showed that not all BPK audit results had an effect on the financial performance of local governments. These results confirmed that agency theory was not fully applicable. It found that not all local government financial performance was fulfilled. This result found that audit opinion and audit findings affect local government performance, as well as economy, efficiency, and effectiveness. The difference in the results of these studies was because the previous research sample used Central Java Province as the research object. The provincial financial performance in Java Island was certainly better because the province of Java was one of the economic and government centers. The PAD of Central Java Province was higher, so the local government was more flexible in using its resources. Meanwhile, the province beyond from Java,

especially Lampung Province was still rarely on transfer funds from central government. Therefore, the 3E concept in local government performance was not optimal.

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