

CHAPTER I

INTRODUCTION

A. Background

As mandated in the Constitution Number 17 of 2003 concerning State Finance that the governor/regent/mayor as the head of the local government has the task of compiling and submitting financial reports of the local government they lead. As a reporting entity, the local government is required to carry out accounting and prepare financial reports comprising Budget Realization Report (LRA), Financial Position, Cash Flow Statements (LAK), and Notes to Financial Reports (CaLK) prepared according to Government Accounting Standards (SAP).

As the fiscal decentralization of the central government to local governments as a consequence of regional autonomy, this has led to significant changes in the composition of budget expenditure on central government and local governments. As a result, the government should be able to increase the transparency and accountability of state financial management both central and regional level (Hehanussa, 2015).

According to Tisnarningsih (2007), the basic principles of the concept of efforts to realize good governance are fairness, transparency, accountability and responsibility. The government as the main actor in the implementation of good governance is demanded to provide more transparent and more accurate accountability. This is increasingly important

to do in this reform era through empowering the role of control institutions as a counterweight to government power (Sadjiarto, 2000). The implementation of good governance will create transparency and public accountability in response to demands of societies in the management of state finances (Suhardjanto and Yulianingtyas, 2011).

Ningsih (2016) stated that the financial reports will be useful for decisions making if the local government financial reports produced by the Local Government meet the expected quality. The financial reports are considered to have an acceptable quality if complying with the qualitative characteristics specified in the standard, in this case the Government Accounting Standards (SAP) as stated in Government Regulation Number 24 of 2005. One way to improve the quality of financial reports is to conduct an audit by an independent auditor.

Based on Article 1 of the Regulation of State Audit Board of the Republic Indonesia Number 2 of 2017 stated that the Supreme Audit Board, hereinafter referred to as BPK, is a state institution whose task is to examine the management and responsibilities of state finances. The auditing of state financial reports by BPK is carried out in order to assess the fairness of the information presented on financial reports. The results of the examination are in the form of an audit report containing the opinion (Kusumawati and Ratmono, 2017).

The BPK provides an opinion on financial reports based on the results of examination which contains findings, conclusions, and

recommendations. Each finding comprises one or more problems, which are in the form of weaknesses in the internal control system (SPI) and/or non-compliance with legislation. Financial reports audited by BPK are form of government accountability in order that the reliability and quality of its audits should be trusted to prevent misappropriation of authority (BPK, 2015).

Results of BPK's examination of 537 LKPD in 2016 revealed unqualified opinions on 375 (70%) LKPD, qualified opinions on 139 (26%) LKPD and disclaimer opinions on 23 (4%) LKPD (IHPS I, 2017). When compared with the achievements in 2016, the quality of LKPD in 2017 has increased with an increase in unqualified opinion by 6 percentage points, namely from 70% in LKPD in 2016 to 76% in LKPD in 2017 (IHPS I, 2018). The quality of LKPD in 2018 has improved as indicated by an increase in unqualified opinion by 6 percentage points, from 76% in LKPD in 2017 to 82% in LKPD in 2018 (IHPS I, 2019).

Table 1. 1 Opinion of Provincial Government Financial Reports 2016-2018

Year	BPK Opinion				Total
	Unqualified Opinion	Qualified Opinion	Adverse Opinion	Disclaimer Opinion	
2016	31	3	0	0	34
	91%	9%	0%	0%	
2017	33	1	0	0	34
	97%	3%	0%	0%	
2018	32	2	0	0	34
	94%	6%	0%	0%	

(Source: BPK Examination Reports Provincial Government 2016-2018)

In the National Medium-Term Development Plan (RPJMN) for 2015-2019 it is stated that for 2018 the target of the number of local governments implementing accrual-based accounting is 26 provinces and 325 regencies/cities. Since the preparation of LKPD 2015, all local governments have adopted accrual-based accounting as the implementation of Government Regulation Number 71 of 2010 concerning Government Accounting Standards (SAP) (IHPS I, 2019).

The results of the BPK examination of 542 LKPD in 2018 found 5,858 weaknesses of internal control system comprising 1,826 findings with accounting and reporting control system weaknesses, 2,753 findings weaknesses of control system for implementing the revenue budget and expenditure, and 1,279 findings weaknesses of internal control structures. In addition to the SPI issue, BPK's audit results revealed 6,259 findings of non-compliance with legislations. These findings include non-compliance issues that could result in losses, potential losses, and lack of revenue (financial impact) of 4,001 findings totaling Rp2.19 trillion, and administrative irregularities (non financial impact) of 2,258 findings (IHPS I, 2019).

Surat Al-Baqarah (2): 282 is the basis of accounting in Islam. Recording and bookkeeping are the first steps of the accounting process. The purpose of recording as written in QS. Al-Baqarah verse 282 is to control every transaction that has been carried out.

يَأَيُّهَا الَّذِينَ ءَامَنُوا إِذَا تَدَايَيْتُمْ بِدِينٍ إِلَىٰ أَجَلٍ مُّسَمًّى فَآكْتُبُوهُ ۗ وَلْيَكْتُبَ
بَيْنَكُمْ كَاتِبٌ بِالْعَدْلِ ۗ وَلَا يَأْبَ كَاتِبٌ أَنْ يَكْتُبَ كَمَا عَلَّمَهُ اللَّهُ ۗ فَلْيَكْتُبْ وَلْيُمْلِلِ الَّذِي
عَلَيْهِ الْحَقُّ وَلْيَتَّقِ اللَّهَ رَبَّهُ وَلَا يَبْخَسْ مِنْهُ شَيْئًا ۚ فَإِنْ كَانَ الَّذِي عَلَيْهِ الْحَقُّ سَفِيهًا
أَوْ ضَعِيفًا أَوْ لَا يَسْتَطِيعُ أَنْ يُمِلَّ هُوَ فَلْيُمْلِلْ وَلِيُّهُ بِالْعَدْلِ ۗ وَاسْتَشْهِدُوا شَهِيدَيْنِ
مِنْ رَجَالِكُمْ ۖ فَإِنْ لَّمْ يَكُونَا رَجُلَيْنِ فَرَجُلٌ وَامْرَأَتَانِ مِمَّن تَرْضَوْنَ مِنَ الشُّهَدَاءِ
أَنْ تَضِلَّ إِحْدَاهُمَا فَتُذَكَّرَ إِحْدَاهُمَا الْأُخْرَىٰ ۗ وَلَا يَأْبَ الشُّهَدَاءُ إِذَا مَا دُعُوا ۗ وَلَا
تَسْمُوا أَنْ تَكْتُبُوهُ صَغِيرًا أَوْ كَبِيرًا إِلَىٰ أَجَلِهِ ۗ ذَلِكُمْ أَقْسَطُ عِنْدَ اللَّهِ وَأَقْوَمٌ لِلشَّهَدَةِ
وَأَدْنَىٰ ۖ أَلَّا تَرْتَابُوا ۗ إِلَّا أَنْ تَكُونَ تِجْرَةً حَاضِرَةً تُدِيرُونَهَا بَيْنَكُمْ فَلَيْسَ عَلَيْكُمْ جُنَاحٌ
أَلَّا تَكْتُبُوهَا ۗ وَأَشْهَدُوا إِذَا تَبَايَعْتُمْ ۗ وَلَا يُضَارَّ كَاتِبٌ وَلَا شَهِيدٌ ۗ وَإِنْ تَفَعَّلُوا فَإِنَّهُ
فُسُوقٌ بِكُمْ ۗ وَاتَّقُوا اللَّهَ ۗ وَيُعَلِّمُكُمُ اللَّهُ ۗ وَاللَّهُ بِكُلِّ شَيْءٍ عَلِيمٌ

The verse from surah Al-Baqarah verse 282 recommends recording every transaction that have been carried out. Thus, it is necessary to know the Islamic provisions regarding the terms and conditions in the recording. In surah Al-Baqarah verse 282 explain the provisions regarding the recording and witnesses in recording.

Research on the factors that influence audit opinion directly has been done by previous researchers. The research results of Kusumawati and Ratmono (2017) found that the findings of weaknesses in internal control system and non-compliance with legislations as well as the quality of human resources had negative effect on audit opinions of local government financial reports. Meanwhile, the follow up of audit recommendations had positive effect on audit opinion of local government financial reports. Whereas Setiawan (2017) found that the internal control system had a positive effect on the opinion of local government financial reports, while

compliance of laws and regulations had negative effect on opinion of local government financial reports.

BPK monitored 148,762 recommendations on the examination results of the 2015-2019 period of Rp31.48 trillion to 542 local governments. Of this amount, recommendations that have been followed up in accordance with recommendations are 91,262 recommendations (61.6%) in the amount of Rp. 15.84 trillion.

Several researchers related to follow-up of audit recommendations found that follow-up of financial investigation and audit opinion has a positive significant effect (Din, et al., 2017). In addition, Sari *et al.*, (2015) stated that through disclosure level of financial reports, follow-up of audit recommendations and audit opinion has a positive effect. It is also supported by Setyaningrum *et al.*, (2013) research which shows that follow-up of audit recommendations in the previous period can decrease and minimize audit findings for next period. By that, the financial accountability can be improved as well as increase the audit opinion's result equally.

The society as one of the users of audit results is expected to supervise the financial management performance of local government. The improvements made must be continuous and at the same time be able to strengthen joint efforts to improve welfare of the society. Society income is one factor in the level of society welfare. This income can be seen from the Gross Regional Domestic Product (GRDP) per capita. In addition, the level of society development indicates the level of progress a society has

achieved. The level of society development is measured through the Human Development Index (HDI). Good governance requires the existence of a good level of society development (Ramachandran, 2002).

Research on the public welfare that directly influences audit opinion has been carried out by previous research. The research results of Adzani and Martani (2014) found that the public welfare has a significant positive influence on audit opinion and improvement of audit opinion. Meanwhile, research results of Istiyanto (2016) found that civil society has no effect on the audit opinion on LKPD. Variables that have no effect are the Human Development Index (HDI), Gross Regional Domestic Product (GRDP) per capita and Income Gap Level. Surya and Suparno (2019) found an index of human development, the level of public education, and level of public income equally influence audit opinion of LKPD.

The good quality of financial reports is reflected in the higher level of financial reports disclosure. The probability of audit opinion obtain will get better if adequacy disclosure level of financial reports is high (Sari, et al., 2015). This is according to the Constitution Number 15 of 2004 concerning the Audit of State Financial Management and Responsibility. Opinion is based on criteria, namely conformity to Government Accounting Standards (SAP), adequacy of disclosure, compliance with laws and regulations, and effectiveness of internal control system.

There are several factors that affect the level of disclosure of government financial reports. The research results of Priharjanto and

Wardani (2016) study found that audit findings has a negative effect on the level of disclosure of provincial government's financial reports. Simbolon and Kurniawan (2018) indicate that local government size has positive effect on disclosure level of financial reports. Meanwhile, the functional differentiation and job specialization has no effect on disclosure level of financial reports.

Based on the explanation above, this research will bring three main themes that influence provincial government audit opinions, which are audit findings, follow-up of audit recommendations, and public welfare. The provincial government financial reports examined or audited by BPK is a form of government responsibility. Societies as principals are expected to oversee financial management performance in their local governments.

This research contributes in two main areas, namely the first use of public welfare factors represented by Human Development Index (HDI), level of public health, and level of public income as factors that influence provincial government audit opinions. Second, the object of this research is provincial government financial reports in Indonesia.

In accordance with the background of the problems outlined earlier, this study is entitled "**THE INFLUENCE OF AUDIT FINDINGS, FOLLOW-UP OF AUDIT RECOMMENDATIONS, AND PUBLIC WELFARE ON AUDIT OPINION THROUGH DISCLOSURE LEVEL OF FINANCIAL REPORTS AS INTERVENING VARIABLE**".

B. Research Scope

This research focuses on the influence of audit findings, follow-up of audit recommendations, and public welfare on audit opinion through disclosure level of provincial government financial reports as intervening variable.

C. Research Questions

The questions of the study are, as follows:

1. Do the audit findings have a negative effect on audit opinion through the disclosure level of provincial government financial reports?
2. Do the follow-up of audit recommendations have a positive effect on audit opinion through the disclosure level of provincial government financial reports?
3. Do the human development index have a positive effect on audit opinion through the disclosure level of provincial government financial reports?
4. Do the level of public health has a positive effect on audit opinion through the disclosure level of provincial government financial reports?
5. Do the level of public income has a positive effect on audit opinion through the disclosure level of provincial government financial reports?

D. Research Objectives

The objectives of the study are, as follows:

1. To investigate the influence of audit findings on audit opinion through disclosure level of provincial government financial reports.

2. To investigate the influence of follow-up of audit recommendations on audit opinion through disclosure level of provincial government financial reports.
3. To investigate the influence of human development index on audit opinion through disclosure level of provincial government financial reports.
4. To investigate the influence of level of public health on audit opinion through disclosure level of provincial government financial reports.
5. To investigate the influence of level of public income on audit opinion through disclosure level of provincial government financial reports.

E. Significance of Study

The significance of the study are, as follows:

- 1) Theoretically
 - a. For author, this research is a means of adding insights and providing empirical evidence of indirect factors that influence audit opinion through the disclosure level of financial reports.
 - b. This research is expected to be the reference for future research about audit opinions.
- 2) Practically

The results of this research are to encourage the Provincial Governments in Indonesia to obtain an unqualified audit opinion, thus the Provincial Governments of Indonesia able to make improvements each year.

3) Making Decision

This research is expected to be an evaluation for Provincial Governments of Indonesia regarding their performance in compiling financial reports. Further, it is expected to be a reference for the responsible parties in BPK RI to address what policies need to be improved and continued.