

INTERNAL CONTROL SYSTEM AND AUDIT OPINION: CASE FROM SOUTH SULAWESI IN INDONESIA

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Abstract: This research aims at testing the effect of internal control system on the audit opinion. The type of this research is quantitative. The sample of this research was local governments in South Sulawesi of Indonesia. The data were analyzed using ordinal logistic regression. The result of this research found that internal control system identified through weaknesses in the accounting and reporting system, the control system of the implementation of revenue and expenditure budget, and the internal control structure, have negative effects on the audit opinion of financial statements. The higher the weaknesses found in the internal control system, the more difficult the local governments to obtain unqualified opinion

Keywords: Audit Opinion, Financial Statements, Internal Control System, Local Government

INTRODUCTION

Governmental financial statements prepared by each local government as accountability must already be audited by the Financial Audit Board (hereinafter referred to BPK) so as to ensure the fairness of the information contained in the financial statements as well as compliance with the prevailing laws and regulations. Auditing must be conducted by competent and independent people. Arens et al. (2011) stated that auditing is data collection and evaluating evidence about information to determine and report the degree of conformity between that information and the established criteria. The purpose of the audit is to provide the accountant's opinion on the presentation of local government financial statements. Audit opinion is based on compliance with governmental accounting standards, adequate disclosure, compliance with the laws and regulations, and effectiveness of internal control system.

The average district government in South Sulawesi obtained unqualified opinion only about 34.7% over the last three years. This indicates that the performance of local financial management is still not optimal. Given the importance of the assessment of the financial performance of local governments set out in the financial statements of local governments associated with the results of BPK's audit. It is interesting issue to do research. Auditya & Husaini (2013) disclosed that regional financial management can be said to be good if the area is able to manage the regional finances so as to provide welfare to its people as a whole.

Related to this research, the information disclosed by the local government presented using the Local Government Financial Report will provide a signal that describes how the quality of the management of the local government is. The encouragement of an entity to provide information due to the asymmetry of information between that entity and an external party. This signal is in the form of an opinion given by BPK about what has been done by the local government to realize the wishes of the society as users of regional financial statements. They also demand transparency of all information presented in the financial statements of their local government. Therefore, local governments are obliged to provide information to meet people's wishes and reduce the asymmetry of information. As stated by Gutomo (2013), good regional financial management can be seen from several indicators, such as the determination of local regulations on the local revenue and expenditure budget and local regulation on changes in the budget, the quality of income, the percentage of the realization of the budget, the remaining budget calculation, the timely delivery of the Local Government Financial Report, and the BPK's opinion on the Local Government Financial Report.

Kawedar (2009), Taufikurrahman (2014), and Nalurita (2015) showed that there was a decrease in opinion given by auditor on local government financial statements caused by weaknesses or material errors in the effectiveness of the internal control system, compliance with the laws and regulations, and the suitability of the presentation of financial statements with Government Accounting Standards in Indonesia. Sipahuntar & Kairani (2012) also stated that there are several factors that cause differences in audit opinion on the financial statements of the district of Four Lawang, namely due to the incompatibility of the three elements examined consisting of the effectiveness of the internal control system, compliance with the prevailing laws and regulations, and the presentation of financial statements with the established criteria. Atyanta (2011) found that the low quality of human resources and mutations often carried out by regional staffing agencies in financial administration resulted in problems in regional financial management, as well as the audit opinion. Hence, this research actually aims at testing the effect of internal control system on the audit opinion of financial statements.

Signal Theory and Hypothesis, governmental regulation of No. 60 of 2008 on the system of internal government control is an internal control system that is held thoroughly in the environment of the central government as well as the local government. Article 2 on paragraph 3 outlining that the objective of the government's internal control system is to provide adequate confidence in the effectiveness and efficiency of achieving the objectives of government, reliability of financial reporting, securing state assets, and compliance with the laws and regulations.

Atyanta (2011) shows that the qualified opinion is partly due to the finding of the case of internal control system ineffectiveness with the highest findings namely, the weakness of the system of control of the implementation of revenue and expenditure budgets. The factors affecting it due to the low quality of human resources, and the mutation of employees that are often carried out by the regional staffing agency, and the mutation is not offset by the construction of a replacement employee to replace the

employee who has been mutated, so that the new employee in the position must start from scratch to learn the things related to the job.

Jiang et al. (2010) found that there is a positive relationship between the disclosure of material internal control system weaknesses and the tendency of auditors to issue *opinions going concern*. Taufikurrahman (2014) and Nalurita (2015) stated that the weaknesses of accounting and reporting control systems, weaknesses in the implementation system of revenue and expenditure budgets, and weaknesses in the internal control structure have a significant effect on the provision of audit opinions. This means that there is an influence of internal control system on audit opinions by BPK.

In signal theory, Akerlof (1970) stated that signal model starts from the seller who has much information in terms of merchandise. Seller may deliver much information as a part of the quality of product. Information presented by financial statements becomes basis of obtaining the signal. The firm with good performance can be a signal for the stakeholders (Abbas et al., 2015). In this research, the tenet of signal theory is utilized. Puspita & Martani (2010) stated that the government will signal to the public by providing quality financial statements, improving the internal control system, and more complete disclosure. The more reliable financial statements, and the more obedient to the legislation then the better opinions will be obtained, and the implementation of an internal control system in financial management can be better and it is the signal to *stakeholders*.

Based on the overview of semester examination results, the weaknesses of the internal control system on financial statements identified by BPK are grouped into weaknesses in the accounting and reporting control system (hereinafter referred to as SPAP), weaknesses in the control system of the implementation of revenue and expenditure budgets (hereinafter referred to as SPPAPB), and weaknesses in the internal control structure. If one of the internal control system groups is found there is a weakness, it will affect the level of audit opinion. Previous study found by Kawedar (2009) showed that there has not been a system and procedure for the preparation of local government budget which is one of the weaknesses of the internal control structure resulted in a decrease from qualified opinion to *disclaimer*. Atyanta (2011) also stated that the weakness of the system of controlling the implementation of government budgets is an obstacle in the achievement of unqualified opinion. For Nalurita (2015), the study showed that internal control system weakness negatively affects auditors' opinion. The finding of Fatimah et al. (2014) also showed that the weaknesses of the beaked internal control system towards the acceptance of unqualified opinions are the weakness of the accounting and reporting control system, while the weakness of the control system of the implementation of revenue and expenditure budgets and the weakness of the internal control structure have no effect on the acceptance of unqualified opinion.

H1a: Weaknesses in accounting and reporting control systems negatively affect the audit opinion.

H1b: Weaknesses in the control system of implementation of revenue and expenditure budget negatively affect the audit opinion.

H1c: Weaknesses in internal control structure negatively affect the audit opinion.

METHODS

The sample of this research consists of 25 districts or cities in South Sulawesi. There are 75 objects of observation of BPK RI on local government financial statements in 2013 to 2015 consisting of 25 financial reports in 2013, 25 reports in 2014, and 25 reports in 2015. The financial statements taken in this study are financial statements that have been audited by BPK.

The variables of this research are audit opinion and internal control system. The audit opinion serves as dependent variable defined as a professional statement as a conclusion of the auditor regarding the level of fairness of financial information presented in the financial statements (Article 1 of Law No. 15/2004). This research categorizes each opinion into the form of ordinal scale. Ordinal scale is not only categorized data into groups, but it also ranks the categories (Ghozali, 2011). Here are the ordinal scale results for each opinion category.

- 1= Disclaimer
- 2= Adverse Opinion
- 3= Qualified Opinion
- 4= Modified unqualified opinion
- 5= Unqualified Opinion

From those scale, this research explained that the lowest score is one to disclaimer and the highest score of five is given to unqualified opinion.

The independent variable of this research is internal control system. According to Government Regulation No. 60 of 2008 on Internal Control System is an integral process in actions and activities carried out continuously by the leadership and all employees to provide adequate confidence in the achievement of organizational objectives through effective and efficient activities, reliability of financial reporting, safeguarding of State assets, and compliance with the laws and regulations. In this research, the weakness of the internal control system is a proxy against the weak assessment of the internal control system of the local government. Weaknesses in the internal control system are obtained from the report of BPK's audit results from 2013 to 2015. Its findings are summarized by three categories of the weaknesses, namely weaknesses in accounting and reporting control systems (SPAP), weaknesses in the implementation of revenue and expenditure budgets (SPPAPB), and weaknesses in the internal control structure (ICS). These three weaknesses are measured using the number of findings (ratio scale) of weaknesses in each year of examination related to the internal control system.

In analyzing the data and testing the hypotheses, ordinal logistic regression method was employed in this research. Logistic regression is a method of regression used to find relationships between dependent variable using a nominal scale with an independent variable that has a mixture of ratio scale with ordinal scale. Ordinal logistic regression is used if dependent variable uses ordinal scale.

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_{2a} + \beta_2 X_{2b} + \beta_2 X_{2c} + \beta_3 X_3$$

Where,

- Y = Audit Opinion (ordinal logit)
 X1 = Weaknesses in accounting and reporting control systems
 X2 = Weaknesses in the implementation of revenue and expenditure budgets
 X3 = Weaknesses in the internal control structure

RESULTS AND DISCUSSION

Descriptive Statistics

An audit opinion is a professional statement as a conclusion of the examiner regarding the level of fairness of financial information presented in the financial statements (Article 1 of Law No. 15/2004). Here are the descriptive statistics of audit opinion variables.

Table 1. Descriptive Statistics of Audit Opinion

No.	Type	N (75)	Percentage
1	Disclaimer	7	9.3%
2	Adverse	2	2.7%
3	Qualified	31	41.3%
4	Modified	9	12.0%
5	Unqualified	26	34.7%

Source: SPSS 2019

In Table 1, the type of audit opinion was a *disclaimer* which means that BPK RI does not give an opinion to 7 local governments with a marginal percentage of 9.3%. The audit opinion was adverse of 2 or 2.7% of the total sample. The type of most opinion was qualified with the amount of 31 or 41.3% of the total sample. Modified unqualified audit opinion was 9 or 12% and unqualified opinion was 26 or 34.7% of the total sample.

Weaknesses of the Internal Control System

The internal control system is identified through the weaknesses. The findings are proxied by three categories of the weaknesses, namely weaknesses in accounting and reporting control systems (SPAP), weaknesses in the implementation of revenue and expenditure budgets (SPPAB) and weaknesses in the internal control structure (ICS). These three weaknesses were measured using the number of findings in each year of examination related to the internal control system. In Table 2, the average number of weaknesses findings was 0.99.

Table 2. Descriptive Statistics of Proxy of Weaknesses in Internal Control System

Type	N	Min	Max	Percentage
SPAP	75	0	6	1.01
SPPAB	75	0	3	0.52
ICS	75	0	7	1.44
Mean				0.99

Source: SPSS 2019

The Result of Data Analysis

The variables were tested using ordinal logistic regression. In Table 3, all independent variables had significance at the 1% level with the negative coefficients.

Table 3. The Result of Testing the Significance

Variables	Coef	Sig.
X1 Weaknesses in accounting and reporting control systems	-2.18	0.00
X2 Weaknesses in the revenue and expenditure budget	-3.45	0.00
X3 Weaknesses in the internal control structure	-0.84	0.00
Pseudo R-Square		71.4%
Likelihood		0.00
Parallel lines Test		0.58

Source: SPSS 2019

The results have shown that internal control system has negative effect on the audit opinion. Thus, the hypotheses (H1a, H1b, &H1c) in this research are **accepted**. Weaknesses in the accounting and reporting control system, the control system of the implementation of revenue and expenditure budgets, and the internal control structure have negative effect on audit opinion of financial statements.

The Effect of Internal Control System on Audit Opinion

The results of this research show that the weakness of the internal control system provides significant effects to the audit opinion. The weaknesses of the internal control system are divided into three proxies between the weakness of the accounting and reporting control system, the weakness of the control system of the implementation of the revenue and expenditure budget and the weakness of the internal control structure. These three variables negatively affect audit opinions.

The government tends to provide the signal to the public through quality financial statements, improved internal control systems, and more complete disclosure. The more reliable the financial statements, the better opinions obtained and the implementation of internal control systems in financial management. These are the form of government signal to stakeholders that the local government has carried out its obligations as a mandate of the people (Puspita & Martani, 2010). The more the number of findings related to the weaknesses of the internal control system, the less likely the local

government financial report to obtain an unqualified opinion. Arens et al. (2008) stated that Internal control provides adequate confidence about the achievement of three objectives, namely the reliability of financial reporting, effectiveness and efficiency of operations, as well as compliance with applicable laws and regulations. In addition to it, an effective internal control system may affect performance in achieving effectiveness, efficiency, compliance with applicable laws and regulations, and reliability of the presentation of government financial statements.

The implementation of the internal control system should rest on strengthening the control system that has been established and implemented by all parties in the organization ranging from policy, organizational formation, budget preparation, facilities and infrastructure, determination of personnel who carry out, determination of procedures and reviews at all stages

CONCLUSION

The internal control system in this research is proxied by identifying the weakness in the accounting and reporting control system, the control system of the implementation of revenue and expenditure budgets, and the internal control structure has led the decrease in the level of audit opinion. The greater the findings related to those weaknesses, the less likely the local government financial report to obtain an unqualified opinion. The quality of financial statements. The average number of weaknesses in the internal control system was 0.99 indicating that it reaches one so that each weakness was found on the internal control system over the observation period. This research has practical implications addressed to the Financial and Development Supervisory Board for guiding the local governments in the implementation of a good internal control system, and compliance with legislation.

For local governments should enhance their understanding and reference in the implementation of internal control systems so that they can obtain and maintain audit opinion quality. In future research, the observation case of research should be expanded that it is not limited to one province.

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