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Analyzing Relationship Between Internal Auditor Capability and Financial Management Quality: A Study at Indonesia Local Governments

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ABSTRACT

The purpose of this study is to analyze whether there is relationship between level of local government internal auditor (LGIA) capability and local government financial management (LGFM) quality. Furthermore, this study also identifies factors affecting the presence or the absence of a significant relationship between LGIA capability and LGFM quality. This research uses in-depth interviews and focus group discussion to identify factors affecting the presence or the absence of relationship between LGIA capability and LGFM quality. The results show that there is no relationship between LGIA capability and LGFM quality. The absence of the relationship is caused by dominant role of Local Government Working Units (LGWU) in the process of financial management; improvement of LGIA capability is not followed by improvement on the roles and services provided by LGIA; and potential weakness in assessment process of LGIA capability by The Finance and Development Supervisory Agency. Findings of this study will assist both central and local governments to evaluate “what went wrong” with their Improvement of LGIA Capability Programs and assist central government to formulate a better policy on relationship and coordination among head of local government, LGWU, and LGIA. This research develops a new method to measure LGFM quality comprehensively. This study also fills gap in the literature exploring the relationship between LGIA capability and LGFM quality, which is still rare at present.

KEYWORDS: Financial Management Quality; Internal Audit; Internal Audit Capability Model; Local Government

INTRODUCTION
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In order to improve performance, transparency, accountability, and management of state finance, governors/regents/mayors have to organize an internal control system within their local governments (Republik Indonesia, 2004a). One out of five components of internal control system is environmental control. Environmental control provides a basis for carrying out internal control across organization and acts as foundation for all other components of internal control systems (IIA, 2016). This is because an effective control environment will be generate positive and conducive behavior for the application of an internal control system in the work environment. An effective control environment can be created through upholding integrity and ethical values, commitment to competence, conducive leadership, forming an organizational structure in accordance with needs, delegating appropriate authority and responsibility, formulating and implementing sound policies on human resource development, the role of an effective government internal control apparatus, and a good working relationship with related government agencies (Republik Indonesia, 2008b) . Governors/regents/mayors are required to establish and to maintain an environmental control that creates positive and conducive behaviors. One way to achieve it is through effective role of local government internal auditor (LGIA) as an internal audit function of local government (Republik Indonesia, 2008b). The Effective role of LGIA is expected to be able to better assess the efficiency, effectiveness, economy of an activity and be able to provide consultation on governance, risk management and internal control, including improving the quality of financial management.

To perform its role effectively, LGIA need a sufficient capability. Capability is the ability of an organization, person or system to achieve objectives related to its mission (Kemdikbud, 2020). LGIA capability is defined as the ability needed by LGIA to perform its role as an internal audit function effectively (BPKP, 2011). This means that the higher the level of LGIA capability, the more LGIA will be able to perform an effective role in improving performance, transparency, and state financial management. In Indonesia, LGIA capability is measured using the Internal Audit Capability Model (IA-CM) developed by the Institute of Internal Auditors Research Foundation (IIARF). In the 2015-2019 National Medium Term Development Plan, the central government targets level of LGIA capability of all local governments in Indonesia must achieve level 3 by the end of 2019¹ (Republik Indonesia, 2015). Table 1 below shows results of assessments of LGIA capabilities issued by the Finance and Development Supervisory Agency (hereinafter referred to as the FDSA). In 2014, most of LGIA were at level 1 and there was no LGIA at level 3. However, in 2016, there was a significant improvement in the LGIA capabilities which was indicated by the decreasing number of LGIA with capability at level 1 (from 88.01% to 51.87%) and the increasing number of LGIA with capability at level 2 (from 11.99% to 44.76%) and level 3 (from 0% to 3.17%). This means that the LGIA have performed better effective role in improving performance, transparency, and state financial management.

One positive impact expected from improvement of LGIA capability is the improvement of local government financial management (LGFm) quality. Local government financial management refers to “overall activities including planning, budgeting, implementing, administrating, accounting, reporting, and supervising of local finance” (Republik Indonesia, 2005).

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¹ Level of LGIA capability consists of five levels of capability which is adopted from Internal Audit Capability Model (IA-CM). Level 1 is the lowest, and level 5 is the highest.

Table 1.
Level of
LGIA
Capability
in 2014 and
2016

Level of LGIA Capability	2014		2016	
	N	%	N	%
Level 1	367	88.01%	278	51.87%
Level 2	50	11.99%	241	44.96%
Level 3	0	0.00%	17	3.17%
	417	100.00%	536	100.00%

Governors/regents/mayors as the head of local government has authorities to manage local government finance. LGFM must be accounted for by governors/regents/mayors in the form of local government financial statements (LGFS) (Republik Indonesia, 2003).

To ensure the fairness of state financial management and its accountability, LGFS must be audited by The Supreme Audit Board of Republic of Indonesia (hereinafter referred to as The SAB). An audit by The SAB is the process to evaluate correctness, accuracy, credibility, and reliability of information of state financial management and accountability (Republik Indonesia, 2004b). The scope of audit on LGFS includes all phases of state financial management. Results of audit on LGFS consists of three reports, namely audit report on LGFS (which includes audit opinion on LGFS), audit report on internal control system (which includes weaknesses findings of internal control system), and audit report on compliance (which includes non-compliance findings and their financial impact). As LGFM is accounted for in the form of LGFS and scope of audit on LGFS includes all phases of LGFM, audit opinion on LGFS, number of weaknesses findings of internal control system, then number of non-compliance findings and financial impact of the non-compliance findings as results of audit on LGFS can be used as the attributes of financial management quality.

Improvement of LGIA capability is expected to affect the improvement of LGFM quality which is indicated by improvement on its attributes. As a consequence, when level of LGIA capability improves, local government should achieve better audit opinion on its LGFS, less weaknesses findings of internal control system, less non-compliance findings, and less financial impact on the non-compliance findings.

LGIA conducts performance and compliance audit (Republik Indonesia, 2008b). Performance supervision provides assurance that state finances are managed efficiently, economically, and efficiently. Compliance supervision provides assurance that state finances are managed orderly and obedient to laws and regulations. In the accounting and supervising phase, LGIA conducts a review on LGFS (Republik Indonesia, 2008a). Review on LGFS provides an assurance that LGFS are in accordance to government accounting standards and related laws and regulations.

In addition, LGIA also perform consulting activities for all phases of financial management based on the needs of LGWUs, such as dissemination of new planning and budgeting regulation or technical assistance on procurement activities. To perform their role effectively, LGIA need a sufficient capability. Internal audit function's capability to provide useful findings and recommendations is central to audit effectiveness (Mihret & Yismaw, 2017). Internal audit can have a more effective and important role if it has a better capability. Internal audit (including LGIA) with a better level of capability will certainly be

able to perform a more effective role so that the quality of financial management in the organization will be better.

To the best of authors' exploration, there has not been a study in Indonesia that analyze relationship between level of LGIA capability and LGFM quality comprehensively. Previous studies only analyze relationship between LGIA capability and audit opinion partially, and their conclusions were not supporting each other. The study of Wulandari & Bandi (2015) concludes that LGIA capability does not have a significant effect on audit opinion on LGFS. On the other hand, study of the FDSA concludes that financial accountability, using audit opinion on LGFS as indicator, could be improved moderately by improving the level of LGIA capability (Pusat Penelitian dan Pengembangan Pengawasan (Puslitbangwas) BPKP, 2016). Wulandari and Bandi (2015) conducted research on the effect of e-government, LGIA capability, and the percentage of follow-up completion of the audit opinion on LGFS in Indonesia using a quantitative approach. The analytical instrument they use is multiple regression with a total sample of 177 local government financial reports. The results showed that the LGIA capability do not have a significant effect on the audit opinion on LGFS. Puslitbangwas BPKP (2016) also conducted a study to examine the effect of internal auditor capability on the accountability of the financial statements of ministries/institutions. The research was conducted on 87 ministries/agencies. This study uses a regression model with audit opinion on financial statements as the dependent variable and the working unit entity, the auditor with the functional position of auditor, and the LGIA capability level as the independent variables. The conclusion of the research is that the accountability of financial reports (i.e. audit opinion on financial reports) can be increased moderately by increasing the level of LGIA capability.

Research by Wulandari and Bandi (2015) and Puslitbangwas BPKP (2016) resulted in conflicting conclusions on the relationship between LGIA capability and audit opinion on financial reports so that the relationship between LGIA capability level and financial management quality is unclear. The above research also has a fundamental weakness, namely the use of indicator of audit opinion that are too simple to measure the quality of LGFM. Audit opinion does not cover all aspects of LGFM because audit opinion only covers aspects of orderly and obedient to laws and regulations. There are still aspects of the quality of LGFM that have not been covered, namely economy, efficiency, effectiveness and transparency (Republik Indonesia, 2003; 2005).

Therefore, a comprehensive study and more accurate indicators to analyze relationship of level of LGIA capability and LGFM quality is needed. In addition, the two studies above used a quantitative approach. The quantitative approach is not intended to understand meaning in depth. In this study, authors identify factors that can explain why there is or is not a relationship between the level of LGIA capability and the quality of financial management.

This research is expected to provide academic and practical contributions. The academic contribution provided by this study is to provide new ideas about the LGFM quality measurement method. The practical contribution of this study to the central government and local governments is to improve policies related to enhancing the capability of the LGIA.

METHOD

Research Design

This research uses a qualitative approach. (Hennink, Hutter, & Bailey, 2011) explain that a qualitative approach is the most suitable method for explaining "why" question and understanding issue of "how" questions that describe processes or behaviors. This study aims to answer question of how is the relationship between LGIA capability and LGFM quality. In addition, this study also identifies factors affecting presence or absence of a relationship between the level of LGIA capability and LGFM quality and how they work. Therefore, a qualitative approach is considered suitable for this study.

Population and Sample

Population of this study is all local governments in Indonesia which consist of 34 provincial governments, and 508 district/city governments. Among those local governments, in 2016, 536 local governments had begun their LGIA capability improvement program. Results of the program showed that 278 local governments were at level 1, 241 local governments were at level 2, and 17 local governments were at level 3 (Badan Pengawasan Keuangan dan Pembangunan (BPKP), 2017).

To compare local governments fairly, similar sample size is used for each level of capability. Qualitative studies collecting data through interviews commonly use concept of saturation to achieve appropriate sample size. The saturation occurs when information collected begins to repeat itself (Hennink et al., 2011). Besides concept of saturation, for both grounded theory and ethnography, Morse, (1994) recommends 30-50 samples. Adopting Morse's recommendation, this study observes 30-50 LGFS (or 10-17 LGFS at each level of capability) as samples. Anticipating possible errors in data and avoiding too much data to analyze, sample size for this study is forty two LGFS or fourteen LGFS at each level of capability.

From 536 LGFS, forty two LGFS samples are selected randomly by using RAND function in Microsoft Excel 2013. RAND function generates random numbers (between 0 to 1) to LGFS (population) at each level of capability. LGFS are then ranked based on these random number from highest to lowest. Top fourteen at each level of LGFM capability are the samples. The forty two samples selected consist of four provincial governments, twenty five district governments, and thirteen city governments spreading across twenty four provinces in Indonesia.

Data and Data Collection

This study uses primary and secondary data. Report of LGIA capability improvement program for the year 2016 from the FDSA is used to gather information on level of LGIA capability and audit reports on the LGFS for the fiscal year 2016 from The SAB is used to gather information on indicators of LGFM quality. These data are collected using documentation technique.

To identify factors explaining the presence or the absence of a relationship between the level of LGIA capability and LGFM quality, primary data are collected through in-depth interviews and focus group discussion (FGD). Interviews are conducted to internal auditors of one local government purposely selected from forty two research samples.

To gain wider range of views, FGD is conducted through online focus group by using WhatsApp messenger application (WhatsApp). Doing focus group online represents attempts to adapt conventional methodological approaches to keep pace with advances in communication technology (Fox, Morris, & Rumsey, 2007). Online focus groups enable researchers to overcome various challenges revolving around cost, location, and attracting specific types of participants (Stewart & Shamdasani, 2017). Using group chat feature in Whatsapp provides a synchronous or real time discussion where researchers act as moderator. In this study, researchers recruits six participants who are Heads of Accounting and Reporting in the Finance and Assets Management Office from several local governments. The office is a LGWU which responsible for administrating, coordinating, and providing services related to finance and assets management within local government. Interactive discussions between these participants provides views on factors explaining the presence or the absence of a significant relationship between the level of LGIA capability and LGFM quality from outside of LGIA.

Data Analysis

Measuring LGFM Quality

LGFM quality is measured by using information sourced from audit reports on the LGFS, which are audit opinion of LGFS, number of weaknesses findings of internal control system, number of non-compliance findings, and financial impact of the non-compliance findings. Each indicator has a maximum score of 25. Therefore, the total score is 100.

Audit Opinion on LGFS. Unqualified opinion (U) is given a score of 25 (maximum score) since it indicates a very good LGFM quality, while qualified opinion (Q) is given a score of 16.33 (2/3 of maximum score). Adverse opinion (A) is given a score of 0 because it shows a very poor LGFM quality. For disclaimer opinion (D), if scope limitation is caused by auditor's limitations during the audit engagement, score given is 8.33 (1/3 of the maximum score). If scope limitation is caused by auditee (local government), score given is 0 or equal to the score for adverse opinion (A).

Number of Weaknesses Findings of Internal Control System. The scoring formula uses mean of findings of internal control system weaknesses as a benchmark. From 542 LGFS for the fiscal year 2016, there are 6,116 findings of internal control system weaknesses (Badan Pemeriksa Keuangan Republik Indonesia (BPK RI), 2018; Badan Pemeriksa Keuangan Republik Indonesia, 2017) so that mean findings of internal control system weaknesses is 11.28 findings (i.e. 6,116/542). This number is rounded up to 12. If a local government has 12 or more findings, it will be scored 0, because it reflects a poor financial management. On the other hand, if a local government has less than 12 findings, the score will be somewhere between 0 to 25.

Number of Non-compliance Findings. The scoring formula uses mean of non-compliance findings as a benchmark. From 542 LGFS for the fiscal year 2016, there are 6,161 non-compliance findings (Badan Pemeriksa Keuangan Republik Indonesia (BPK RI), 2018; Badan Pemeriksa Keuangan Republik Indonesia, 2017). Therefore, the mean of non-compliance findings is 11.37 findings (i.e. 6,161/542) or rounded up to 12. The local government with 12 or more findings is given a score of 0, as it indicates a very poor financial management, while the local government with less than 12 findings is given score somewhere between 0 to 25.

Financial Impact on Non-compliance Findings. The financial impact of the non-compliance findings is measured by using a percentage of financial impact of non-compliance findings to the total expenditure. Total expenditure is one basis used by auditors of the SAB to determine audit materiality during the audit engagement on local government. The scoring uses 0.5% as a threshold, which is materiality level commonly used by auditors of the SAB (Badan Pemeriksa Keuangan Republik Indonesia (BPK RI), 2008b). Table 2 below shows scoring formula to measure LGFM quality. Score of LGFM quality is a total score from the four indicators, which is between 0 to 100. Higher score depicts better financial management.

Analyzing Relationship between LGIA Capability and LGFM Quality

To analyze relationship between LGIA capability and LGFM quality is conducted by following steps.

Ranking local governments. Local governments are ranked according to their LGFM quality score from the highest to the lowest. Local governments with LGIA capability at level 3 is expected to dominate the top ranks, while the local governments with LGIA capability at level 1 is expected to be at the bottom ranks.

Categorizing local governments. LGFM quality scores are categorized into four categories/levels of quality, which are very good with score of >75–100, good with score of >50–75, poor with score of >25–50, and very poor with score of 0–25. Number of LGIA at level 3 should be dominant in the very good category, and number of LGIA at level 1 dominating the poor category.

No	Indicators	Dimensions of LGFM Quality	Scoring Formula
1.	Audit opinion on LGFS	1. Orderly and obedient to laws and regulations 2. Transparent	Unqualified opinion = 25 Qualified opinion = 16.33 (2/3 of maximum score) Disclaimer opinion-auditor's limitations = 8.33 (1/3 of the maximum score). Disclaimer opinion-auditee's limitations = 0 Adverse opinion = 0
2.	Number of weaknesses findings of internal control system	Orderly and obedient to laws and regulations	$[(12 - \text{Number of findings of internal control system weakness})/12] \times 25$
3.	Number of non-compliance findings	1. Orderly and obedient to laws and regulations 2. Effective	$[(12 - \text{Number of Non-compliance findings})/12] \times 25$
4.	Financial impact of non-compliance findings	1. Orderly and obedient to laws and regulations 2. Economical 3. Efficient	$[(0.5\% - \text{Financial Impact of the Non-compliance Findings} (\%))/0.5\%] \times 25$

Table 2.
Table. 2
Scoring
Formula to
Measure
LGFM
Quality

Comparing mean and median of each level of LGIA capability. Mean acts as central value or representative for a data set. However if a data set contain an extremely large or extremely small values, mean might not be an appropriate representative. In such condition, median might be a better representative (Berenson, Levine, & Krehbiel, 2012; Lind, Marchal, & Wathen, 2015). In this study, both measures are used. Higher level of LGIA capability should have a higher mean or median of LGFM score.

Methods Identifying Factors Affecting the Presence or the Absence of Relationship between the Level of LGIA Capability and LGFM Quality

To identify factors affecting the presence or the absence of a relationship between LGIA capability and LGFM quality, researchers conducted in-depth interviews and focus group discussion (FGD). Transcripts of interviews and FGD are analyzed and interpreted using a textual data analysis which includes coding process to generate descriptions, categories, and themes, advancing how categories and themes will be represented in narrative or report, and making an interpretation of findings or results (Creswell, 2014).

Validity Test

To assure validity of data, validity test is conducted by increasing perseverance and triangulation (Creswell, 2014; Sugiyono, 2015). To increase perseverance, data are checked and rechecked to avoid errors. Furthermore, researchers triangulate among different sources of data to enhance accuracy of analysis.

RESULTS AND DISCUSSION

Measuring LGFM Quality

Group of LGIA Capability Level 1

In the group of LGIA capability level 1, from the content analysis of 14 LGFS, authors find that number of LGFS that have unqualified opinion is ten (71.43%). Number of internal control system (ICS) weakness findings is at least four findings, while the most is eleven findings. The average number of findings of ICS weakness is 7.07 findings.

The number of non-compliance findings is at least four findings, while the most is nineteen findings. The average number of non-compliance findings is eight and a half findings. The smallest percentage of financial impact of findings of non-compliance with total expenditure is 0.044%, while the largest is 0.675%.

From these data, then the quality of financial management is measured using the methods discussed in the previous section. The highest score is 76.96, while the lowest score is 6.25. The average score 1 is 55.22.

Group of LGIA Capability Level 2

In the group of LGIA Capability Level 2 authors identified thirteen LGFS that obtained unqualified opinion (92.86%). The number of findings of ICS weaknesses is at least 4 findings, while the most is 10 findings. The average number is 6.57 findings.

The number of non-compliance findings is at least three findings, while at most there are nineteen findings. The average number of non-compliance findings is 8.36 findings. The smallest percentage of financial impact of findings of non-compliance with total expenditure is 0.027%, while the biggest percentage is 0.286%.

No.	Local Government	LGIA Capabilit y Level	Audit Opinion on LGFS		Internal Control Weakness		Non- Compliance		Financial Impact		LGFM Qualit y Score
			Opinion	Score	N	Score	N	Score	%	Score	
1	City of Parepare	1	U	25.00	6	12.50	4	16.67	0.044%	22.79	76.96**
2	District of Nduga	1	D	0.00	11	2.08	10	4.17	0.675%	0.00	6.25*
3	District of Seruyan	1	U	25.00	6	12.50	8	8.33	0.069%	21.57	67.40
4	City of Palu	1	U	25.00	10	4.17	15	0.00	0.383%	5.86	35.03
5	Riau Province of	1	U	25.00	11	2.08	19	0.00	0.352%	7.41	34.49
6	District of Pakpak Bharat	1	U	25.00	4	16.67	5	14.58	0.499%	0.03	56.28
7	City of Banjar	1	U	25.00	4	16.67	10	4.17	0.095%	20.27	66.11
8	City of Tanjungbalai	1	Q	16.67	8	8.33	7	10.42	0.225%	13.76	49.18
9	District of Nunukan	1	U	25.00	4	16.67	6	12.50	0.069%	21.54	75.70
10	District of Ogan Komering Ulu Selatan	1	U	25.00	7	10.42	12	0.00	0.077%	21.15	56.56
11	District of Simalungun	1	Q	16.67	8	8.33	5	14.58	0.152%	17.38	56.96
12	District of Kepulauan Anambas	1	Q	16.67	6	12.50	7	10.42	0.123%	18.87	58.45
13	City of Batu	1	U	25.00	6	12.50	6	12.50	0.226%	13.72	63.72
14	District of Lebak	1	U	25.00	8	8.33	5	14.58	0.058%	22.11	70.03
		Mean			7.07		8.50		0.218%		55.22
		Median			6.50		7.00		0.138%		57.71
15	District of Bekasi	2	U	25.00	7	10.42	10	4.17	0.0657%	21.71	61.30
16	City of Padang Panjang	2	U	25.00	6	12.50	8	8.33	0.1101%	19.50	65.33
17	District of Jombang	2	U	25.00	6	12.50	3	18.75	0.0829%	20.86	77.11**
18	City of Samarinda	2	U	25.00	10	4.17	8	8.33	0.0600%	22.00	59.50
19	District of Karanganyar	2	U	25.00	6	12.50	9	6.25	0.2002%	14.99	58.74
20	City of Tomohon	2	U	25.00	9	6.25	19	0.00	0.2354%	13.23	44.48
21	District of Sidenreng Rappang	2	U	25.00	5	14.58	6	12.50	0.2096%	14.52	66.60
22	District of Malang	2	U	25.00	5	14.58	11	2.08	0.1037%	19.82	61.48
23	Province of Kalimantan Utara	2	U	25.00	5	14.58	7	10.42	0.0949%	20.25	70.25
24	City of Surabaya	2	U	25.00	8	8.33	6	12.50	0.0273%	23.63	69.47

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No.	Local Government	LGIA Capabilit y Level	Audit Opinion on LGFS		Internal Control Weakness		Non- Compliance		Financial Impact		LGFM Qualit y Score
			Opinion	Score	N	Score	N	Score	%	Score	
25	District of Maluku Tenggara	2	U	25.00	4	16.67	8	8.33	0.2390%	13.05	63.05
26	District of Boalemo	2	Q	16.67	8	8.33	13	0.00	0.2862%	10.69	35.69*
27	District of Sleman	2	U	25.00	7	10.42	3	18.75	0.1092%	19.54	73.71
28	District of Kolaka	2	U	25.00	6	12.50	6	12.50	0.0773%	21.14	71.14
		Mean			6.57		8.36		0.136%		62.70
		Median			6.00		8.00		0.106%		64.19
29	District of Banyuasin	3	U	25.00	9	6.25	9	6.25	0.3030%	9.85	47.35
30	Province of Jawa Barat	3	U	25.00	6	12.50	13	0.00	0.0677%	21.61	59.11
31	City of Bandung	3	Q	16.67	10	4.17	12	0.00	0.3003%	9.98	30.82*
32	District of Bangka	3	U	25.00	8	8.33	9	6.25	0.0861%	20.69	60.28
33	District of Lahat	3	U	25.00	7	10.42	14	0.00	0.1431%	17.85	53.26
34	City of Surakarta	3	U	25.00	5	14.58	7	10.42	0.0610%	21.95	71.95
35	District of Bangka Tengah	3	U	25.00	5	14.58	7	10.42	0.1954%	15.23	65.23
36	District of Banjar	3	U	25.00	5	14.58	9	6.25	0.0310%	23.45	69.28
37	District of Lombok Barat	3	U	25.00	7	10.42	11	2.08	0.1660%	16.70	54.20
38	District of Kudus	3	U	25.00	8	8.33	8	8.33	0.0803%	20.99	62.65
39	City of Gorontalo	3	U	25.00	15	0.00	8	8.33	0.0651%	21.75	55.08
40	Province of Kepulauan Bangka Belitung	3	Q	16.67	10	4.17	11	2.08	0.0812%	20.94	43.86
41	City of Banjarmasin	3	U	25.00	7	10.42	2	20.83	0.0135%	24.32	80.57**
42	District of Sorong	3	U	25.00	4	16.67	7	10.42	0.0471%	22.64	74.73
		Mean			7.57		9.07		0.117%		59.17
		Median			7.00		9.00		0.081%		59.70

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Based on these data the quality of financial management can be measured; and the results are the highest score is 77.11 and the lowest score is 35.69. The average score on local government with the capability level of LGIA at level 2 is 62.70.

Group of LGIA Level 3

In the regional government with APIP capability level 3, there are twelve LGFS (85.71%) with the unqualified opinion. The number of findings of ICS weaknesses is at least four findings, while the number of findings at the most is 15 findings. The average number of findings of ICS weakness is 7.57 findings.

The number of non-compliance findings is at least two findings, while the most is fourteen findings. The average number of non-compliance findings is 9.07 findings. The smallest percentage of the financial impact of the findings of non-compliance with total expenditure is 0.014%, while the largest is 0.303%.

By using these data the authors then measure the quality of financial management. The highest score is 79.94, while the lowest score is 20.92. The average score is 53.80. Table 3 shows results of LGFM quality score for all level of capability of LGIA.

Relationship between LGIA Capability and LGFM Quality

To indicate whether relationship exist between LGIA capability and LGFM quality, firstly, local governments are ranked based on their LGFM quality scores from highest to lowest. Then, authors separate local governments into top five ranks and bottom five ranks. Table 4 shows top five and bottom five of the local governments ranking. With good capability (i.e. level 3), LGIA should be able to perform its role more effectively so that quality of LGFM should also be better, and vice versa.

Local governments with LGIA capability level 3 should dominate the top five ranks. However, Table 4 shows that there are only two local governments with LGIA level 3 are in the top five (i.e. City of Banjarmasin and District of Sorong), and they are also two local governments with LGIA capability level 1 at top five ranks (i.e. City of Parepare and District of Nunukan). This fact indicates that there is no significant relationship between level of LGIA capability and LGFM quality.

Table 4.
Top Five
and Bottom
Five Ranks
of LGFM
Quality and
Their LGIA
Capability

Ranks	Local Governments	LGIA Capability	LGFM Quality	
Top Five	1	City of Banjarmasin	3	80.57
	2	District of Jombang	2	77.11
	3	City of Parepare	1	76.96
	4	District of Nunukan	1	75.70
	5	District of Sorong	3	74.73
Bottom Five	38	District of Boalemo	2	35.69
	39	City of Palu	1	35.03
	40	Province of Riau	1	34.49
	41	City of Bandung	3	30.82
	42	District of Nduga	1	6.25

Based on these data the quality of financial management can be measured; and the results are the highest score is 77.11 and the lowest score is 35.69. The average score on local government with the capability level of LGIA at level 2 is 62.70.

Group of LGIA Level 3

In the regional government with APIP capability level 3, there are twelve LGFS (85.71%) with the unqualified opinion. The number of findings of ICS weaknesses is at least four findings, while the number of findings at the most is 15 findings. The average number of findings of ICS weakness is 7.57 findings.

The number of non-compliance findings is at least two findings, while the most is fourteen findings. The average number of non-compliance findings is 9.07 findings. The smallest percentage of the financial impact of the findings of non-compliance with total expenditure is 0.014%, while the largest is 0.303%.

By using these data the authors then measure the quality of financial management. The highest score is 79.94, while the lowest score is 20.92. The average score is 53.80. Table 3 shows results of LGFM quality score for all level of capability of LGIA.

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Table 4 also shows that there are LGIA capability level 3 and level 2 at bottom five ranks (i.e. City of Bandung and District of Boalemo). Even, City of Bandung (LGIA level 3) is located at the second worst of LGFM quality score.

Ranks	Local Governments	LGIA Capability	LGFM Quality
Top Five	1 City of Banjarmasin	3	80.57
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	3 City of Parepare	1	76.96
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	39 City of Palu	1	35.03
	40 Province of Riau	1	34.49
	41 City of Bandung	3	30.82
	42 District of Nduga	1	6.25

Table 4.
Top Five and Bottom Five Ranks of LGFM Quality and Their LGIA Capability

With higher LGIA capability, City of Bandung and District of Boalemo should have better financial management quality and have higher ranks. Again, this situation indicates that there is no relationship between level of LGIA capability and LGFM quality. To do further analysis of LGIA capability-LGFM quality relationship, then local governments are categorized into four levels of quality as shown in Table 5 below.

Table 5.
Categorization of the Local Governments Based-on Level of Quality

Level of Quality	LGFM Quality Score	LGIA Capability			Total
		Level 1	Level 2	Level 3	
Very Good	>75–100	2 (50%)	1 (25%)	1 (25%)	4 (100%)
Good	>50–75	8 (27.6%)	11 (38%)	10 (34.4%)	29 (100%)
Poor	>25–50	3 (37.5%)	2 (25%)	3 (37.5%)	8 (100%)
Very Poor	0–25	1 (100%)	0	0	1 (100%)

Table 5 shows that there are two (50%) local governments with LGIA capability level 1 in Very Good category, while there is only 1 local government from level 3 and level 2. There should be more local governments with higher level of capability especially level 3 in Very Good level. This fact indicates that there is no relationship between level of LGIA capability and LGFM quality.

Table 5 also shows that there is no significant difference in the number of local governments in the good category and poor category. There are eight (27.6%) local governments with LGIA capability level 1 in good level which is not much different with the number of local governments with LGIA capability level 2 (38%) and level 3 (34.4%) in the same level of quality. This similar pattern also exist in the poor category. Again, these situations shows that there is no relationship between level of LGIA capability and LGFM quality.

The relationship of LGIA capability-LGFM quality also analyzed by comparing mean and median of LGFM quality scores from each level of LGIA capability. Table 6 below shows that mean and median of LGFM quality scores of local governments with LGIA capability level 2 is the highest. Those scores are higher than mean and median of LGFM quality scores of local governments with LGIA capability level 3. Local governments with higher LGIA capability should have higher mean and median of LGFM quality scores. Local governments with LGIA capability level 3 should have the highest mean and median of LGFM quality scores, yet they are lower by 3.50 and 4.50 compared to mean and median of local governments with LGIA capability level 2. This fact indicates that there is no relationship between level of LGIA capability and LGFM quality.

From all comparison above, it can be concluded that there is no relationship between LGIA capability and LGFM quality. The findings of this study are in line with the conclusions of the research conducted by Wulandari & Bandi (2015), which concludes that LGIA capability does not have a significant effect on audit opinion on LGFS. Audit opinion on LGFS here represents the quality of LGFM. On the other hand, the results of this study weaken the conclusions of the Puslitbangwas BPKP Research (2016) which concluded that financial accountability could be improved moderately by improving the level of LGIA capability. Thus, the suspicion of the ineffectiveness of LGIA's role in improving the quality of local government financial management should be raised.

Factors Affecting the Absence of Relationship between Level of LGIA Capability and LGFM Quality

No.	LGIA Capability	LGFM Quality Scores	
		Mean	Median
1	Level 1	55,22	57,71
2	Level 2	62,70	64,19
3	Level 3	59,17	59,70

Table 6.
Mean and Median of LGFM Quality Scores

In-depth interviews were conducted to LGIA participants from the District Inspectorate of Sleman. The selection of Local Government of Sleman as sample is based on level of its LGIA capability and audit opinion of the SAB for the fiscal year 2011-2013. In 2011, when the level of LGIA capability was at level 1, there was an improvement on the audit opinion from qualified opinion to unqualified opinion with explanatory paragraph. In 2013, when the level of LGIA capability was still at level 1, audit opinion of the SAB increased from unqualified opinion with explanatory paragraph to unqualified opinion (Inspektorat Kabupaten Sleman, 2016, 2017). This fact shows that there is no relationship between level of LGIA capability and LGFM quality in the Local Government of Sleman. Therefore, interviews to participants from LGIA of Local Government of Sleman is considered suitable to explore factors affecting the absence of relationship between level of LGIA capability and LGFM quality. Interviews were conducted by face to face to three participants which consist of two senior auditors and one supervisor at Inspectorate Office of Sleman. Interviews were recorded into audio file and then transcribed into interview transcripts.

In addition to conducting interviews with participants from the Sleman Inspectorate, researchers also conducted FGDs. FGD is conducted with six participants who are Heads of Accounting and Reporting in the Financial and Assets Management Office from several local governments by using Whatsapp. Interview transcripts, FGD transcripts, and others collected documents (such as local regulations, regent regulations, local regulations, regent regulations, regional government work plans, performance reports of government agencies performance) are then analyzed to identify factors affecting the absence of relationship between level of LGIA capability and LGFM quality.

Dominant role of LGWUs. Participants revealed that there are two parties contributing to LGFM quality, which are LGWUs and district inspectorate. Inspectorate contributes to the LGFM quality by performing consultation and inspection activities. These roles are explicitly stated in 2011-2015 Strategic Plan (Inspektorat Kabupaten Sleman, 2016). The LGWUs contribute to the LGFM quality by organizing, monitoring, and controlling their work plans and budget execution (Republik Indonesia, 2003). This is as stated by participants as follows:

"... especially we, together with Office of Regional Finance, are always trying to improve the soft infrastructure of financial management ... For example, what number is PSAP or which number is the technical bulletin, we adjust the accounting policy ..." (IR-8)

"Of course these LGWUs also play a role, yes. Controlling the implementation of the budget in the LGWU is getting better, respectively." (AM2-8)

The participants also claimed that LGWUs have more dominant role to LGFM quality. Participants stated that the implementation of good internal control is indicated by high

level of internal control system maturity and low frequency of consultation to Inspectorate. Statements from Participants IR and AM1 supporting this claim.

“I think the factor that has a more dominant role is the implementation of good internal control system by the LGWUs. It is shown by its maturity level. In Province of D.I. Yogyakarta (including Local Government of Sleman), in general, the maturity level is good (high) so that the results of audit of the SAB are also good.” (IR)

“... the LGWUs has a dominant role. They are doing their jobs well enough so that the consultation to the inspectorate is pretty rare.”(AM1)

Although participants claimed that LGWUs have implemented good internal control system, based on audit reports on Sleman’s LGFS for the fiscal year of 2015-2016, researchers found two recurring findings which are inadequate administration of local owned goods and inventories. This fact shows that there is still weaknesses in internal control systems in LGWUs that inspectorate can provide assistance. Inspectorate can initiate consulting activities on these problems to improve its contribution to good LGFM quality.

No significant improvement on roles and services provided by LGIA. When asked about benefit of improvement of LGIA capability, participants revealed that improvement of LGIA capability bring betterment to the audit documentation.

"... the performance of my staff or our auditors is relatively more systematic and more organized ... now the assignment documentation is more organized and structured." (IR-14)

"What I feel the most is that the KKA documentation is now more orderly." (AM1-12)

However, no participant revealed the benefit on improvement on roles and services of LGIA. In level 2, LGIA are expected to be able to perform compliance audit, while in level 3, LGIA are expected to be able to perform advisory/consulting activities and performance audit. However, participants claimed that inspectorate has performed consulting activities before achieving level 3 in 2017. The problem was that there was no proper documentation on the implementation on the consulting activities. Comments supporting this claim include:

“I think when we were still at the level 1 and 2, we have performed consulting activities, but those activities were still not documented. All of the activities now must be documented.” (IR-16)

“For consulting activities, they have been implemented since before achieving level 3, but the documentation was still not orderly.”(AM1-14)

The claim is also supported by 2015-2016 District Inspectorate of Sleman’s Performance Accountability Report. In 2015-2016, when the LGIA capability was at level 2, there had already been an implementation of consulting activities such as facilitation to the LGWUs and village authorities.

Authors then made comparison between inspectorate’s planned and/or implemented programs during the fiscal year 2015-2018 based on the 2015-2018 Local Government Sleman’s Work Plans and the 2015-2017 District Inspectorate of Sleman’s Performance Accountability Reports. The 2015-2018 planned and/or implemented programs include regular internal supervision, review on the LGFS, supervision on the village authorities,

monitoring and evaluation on the acceleration of corruption eradication program, and facilitation to the LGWUs and village authorities. There is no performance audit program in the 2017-2018 planned and/or implemented programs even though the Inspectorate have achieved capability at level 3 in 2017. During 2015-2018, the planned and/or implemented programs are practically similar. Though the level of LGIA capability increased to level 3 in 2017, there is no significant improvement on the roles and services provided by LGIA.

Potential weakness in the assessment process of LGIA capability. Participants revealed that there is potential weakness during assurance process of LGIA capability. The participant stated:

“I feel that the quality assurance by the FDSA focused more on the validation of formal documents provided by LGIA. To fulfill the requirement to the next level, we prepared the documents as requested in the requirement, although those do not depict the real condition.” (IR-36)

Besides documents validation, the FDSA must conduct interviews to internal and external parties during quality assurance (BPKP, 2015). Failure to identify document that do not depict real condition might be caused by assessment are not conducted according to guidelines. This could result in a wrong conclusion on level of LGIA capability.

CONCLUSION

To analyze relationship between LGIA capability and LGFM quality, this study develops a method to measure LGFM quality by using four indicators generated from audit reports of the SAB on LGFS. The indicators used are audit opinion on LGFS, number of weaknesses findings of internal control system, number of non-compliance findings, and financial impact of the non-compliance findings. Information of LGIA capability are gathered from the Report of LGIA Capability Improvement Program for the year 2016 from the FDSA. Results of analysis show that there is no relationship between LGIA capability and LGFM quality.

This study also identifies factors affecting the absence of relationship between LGIA capability and the LGFM quality by conducting in-depth interviews and FGD. It can be concluded that the absence of relationship between level of LGIA capability and LGFM quality is caused by the more dominant role of LGWUs compare to LGIA in the process of financial management, the improvement of LGIA capability which is not followed by the significant improvement on the roles and services provided by LGIA, and potential weakness in the assessment process of the LGIA capability.

This research is expected to provide academic and practical contributions. The academic contribution provided by this study is to provide new ideas about the LGFM quality measurement method. The practical contribution of this study to the central government and local governments is to improve policies related to enhancing the capability of the LGIA. In addition, this study has following practical implications, which are (1) findings of this study will assist both central government and local governments to evaluate “what went wrong” with their Improvement of LGIA Capability Program, (2) findings of this study suggest that there is a weak coordination between head of local government, LGWUs, and LGIA. This findings will help central government to formulate a better policy on the relationship and coordination of among the three parties.

Based on conclusions above, authors suggest that (1) district inspectorate to initiate consulting activities based on the needs of LGWUs and to include performance audit program on its planing program, (2) the FDSA should ensure that assessment of LGIA capability to be conducted according to guidelines, (3) central and local governments should evaluate their improvement LGIA capability programs by identifying factors avoiding LGIA to contribute to good LGFM quality and providing solutions to factors identified.

This study has limitations, which is each indicator composing LGFM quality is given similar weight (i.e. 25 for each indicator). Authors realized that weight of each indicator should be different because each indicator has different importance. Another limitation is that authors use mean as threshold for indicators number of weaknesses findings of internal control system and number of non-compliance findings without testing normality of data. This condition happened because authors have limited access to all audit reports on LGFS for the fiscal year 2016. Based on limitations above, authors suggest future researches to conduct a preliminary research in order to determine weight of each indicator of LGFM quality to improve accuracy the measure.

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