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INFLUENCE OF INTERNAL CONTROL IMPLEMENTATION ON PERFORMANCE WITH FINANCIAL REPORTING QUALITY AS THE INTERVENING VARIABLE

Suwarni Dyah Setyaningsih¹, Sri Mulyani², Bahrullah Akbar³, Ida Farida⁴, Achmad Djazuli⁵

^{1,2,3,4} Doctoral Program of Accounting Science, Faculty of Business and Economics, Padjadjaran

University, Dipatiukur Road No. 35 Bandung West Java, INDONESIA

⁵Tazkia Islamic Institute, Bogor West Java, INDONESIA

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ABSTRACT

The purpose of this study was to determine the influence of internal control implementation on performance with financial reporting quality as the intervening variable, in an examination of local governments in Indonesia over the period of 2010–2013. Research data of internal control implementation and financial reporting quality were obtained from the Supreme Audit Agency (BPK) and research data of performance were obtained from the Directorate General of Regional Autonomy, Ministry of Home Affairs. The study used a purposive sampling method to study 108 local governments that were analyzed by path analysis. The results of this study show that internal control implementation had a significant influence on the financial reporting quality, and thus on performance. This study shows that financial reporting quality also directly affects performance.

INTRODUCTION

Performance is an important factor in organizational life. Performance is an organizational effort to produce something. In public sector organizations, performance is very important to measure or evaluate (Simangunsong 2014). In Indonesia, the performance of local governments is assessed from the performance evaluation that is routinely carried out by the Ministry of Home Affairs every year and reported in the Performance Evaluation of Local Government Administrators (EKPPD) (Sutopo et al. 2017).

The legal basis for the EKPPD is Government Regulation Number 6 of 2008 concerning Guidelines for the Evaluation of Local Government Implementation Performance (EKPPD). EKPPD uses the Local Government Implementation Report (LPPD) as the main source of information. EKPPD also uses other information apart from the LPPD, such as the accountability report for the implementation of the APBD, regional financial information, and reports related to the implementation of regional government that come from independent institutions.

The form of accountability for regional financial information is reflected in the Regional Government Financial Report (LKPD) (Kewo 2017). The quality of local government financial reporting is reflected in the opinions provided by the Financial Report Audit Board (BPK) as the external auditor (Badan Pemeriksaan Keuangan [IHPS] 2014). Quality financial reports require the application of internal controls in local government. Internal control can help make financial reports better in accordance with applicable procedures (Doyle et al. 2007).

Regions that obtain WTP opinions do not necessarily have weaknesses in the internal control system (SPI), for example, the DKI Jakarta Provision, which in 2017 obtained WTP opinions from the BPK on LKPD. Even though it received a WTP opinion, in fact several problems were still found in his financial reporting. Among them is the problem of weakness in the SPI. The findings on SPI that are still found include the use of the asset information system for social facilities for public facilities and the collection of social facilities and public facilities which are not optimal, the administration of spending and cash on BOS funds, and inadequate educational operational assistance (CNN Indonesia 2018).

In 2014, Decree Number 120-476 of the Minister of Home Affairs of the Republic of Indonesia concerning Ranking and Performance Status of Local Government Implementation determined the 10 provinces with the highest performance scores and the 10 provinces with the lowest performance scores for 2013.

Tables 1 and 2 show that provinces with high performance status scores tended to get WTP opinions from the BPK. Provinces with a WTP opinion tended to have a few SPI weaknesses. For provinces with a moderate performance score, it can be said that their local government performance is low and tends to get a non-WTP audit opinion, but the findings on the weaknesses of SPI are not necessarily high. However, the findings on the weaknesses of SPI in regions with high

Table 1. List of 10 Provinces with the Highest Ranking

		Status	Opinion	SPI	Status	Opinion	SPI	Status	Opinion	SPI	Status	Opinion	SPI
1.	East Java Province	High	WTP	377	Very high	WTP DPP	352	Very high	WTP DPP	312	Very high	WTP DPP	312
2.	Province of Central Java	High	WDP	284	High	WTP DPP	379	High	WTP	422	High	WTP DPP	390
3.	Special Region of Yogyakarta	High	WTP DPP	46	High	WTP DPP	80	High	WTP	87	High	WTP	67
4.	Riau Islands Province	Moderate	WTP	92	High	WTP	72	High	WTP	72	High	WTP	82
5.	West Java province	High	WDP	216	High	WTP	197	High	WTP	235	High	WTP	249
6.	South Sulawesi Province	High	WTP	143	High	WTP	205	High	WTP DPP	351	High	WTP DPP	376
7.	East Kalimantan Province	High	WDP	114	High	WDP	80	High	WTP	-	High	WDP	123
8.	DKI Jakarta Province	High	WDP	48	High	WTP DPP	56	High	WTP DPP	20	High	WDP	51
9.	West Nusa Tenggara Province	High	TMP	77	High	WTP	91	High	WTP	98	High	WTP	99
10.	Gorontalo Province	High	WDP	45	High	WDP	71	High	WDP	58	High	WTP	64

Table 2. List of 10 Provinces with the Lowest Ranking

No.	Local Government Name	2010			2011			2012			2013		
		Status	Opinion	SPI	Status	Opinion	SPI	Status	Opinion	SPI	Status	Opinion	SPI
1.	North Sulawesi Province	High	WTP	9	High	WDP	153	High	WTP DPP	186	High	WDP	149
2.	Central Sulawesi Province	Moderate	WDP	123	High	WDP	68	High	WTP DPP	57	High	WDP	81
3.	Bengkulu Province	Moderate	WDP	53	Moderate	WTP	93	High	WTP	83	High	WTP	132
4.	Central Kalimantan Province	High	WDP	74	High	WDP	110	High	TMP	57	High	WDP	138
5.	East Nusa Tenggara Province	Moderate	WDP	77	High	WDP	118	Moderate	WDP	147	High	WDP	158
6.	Riau Province	Moderate	WTP	60	High	WDP	144	Moderate	WTP DPP	125	High	WTP DP P	171
7.	West Papua Province	Moderate	TMP	11	Moderate	TMP	44	Moderate	TMP	17	High	WDP	12
8.	Bali province	Moderate	WDP	105	Moderate	WDP	116	Moderate	WDP	90	Moderate	WTP DPP	116
9.	Papua Province	Moderate	TMP	58	Moderate	TMP	130	Moderate	TMP	130	Moderate	WDP	224
10.	North Maluku Province	Moderate	TMP	32	Moderate	TMP	139	Moderate	TMP	45	Moderate	TMP	104

scores are not necessarily insignificant. On the other hand, provinces that received a performance appraisal with low scores tended to receive non-WTP opinions. However, regions with moderate scores did not necessarily have high SPI findings.

Local government performance and financial accountability can be improved with good internal control (Kewo 2017). However, if the internal control in the local government is weak, it will result in a scandal such as loss and organizational failure because internal control is important in assessing organizational risks that can threaten the achievement of organizational goals (Babalola 2013).

The research conceptual framework shows the effect of the implementation of internal control variables on performance variables through the variable of financial reporting quality. The conceptual framework in this study is presented in **Figure 1**.



Figure 1. Research Model

Government Regulation Number 60 of 2008 regulates the government internal control system, which is the adoption of COSO. This regulation states that the internal control system is an integral process of actions and activities carried out continuously by the leadership and all employees to provide adequate confidence in the achievement of organizational goals. Findings on the weaknesses of the internal control system can reveal state losses, decreased revenues, and administrative failures (Djanegara 2016). Local governments show that they have good financial reporting quality, namely that they get WTP opinions from BPK (Djanegara and Iriyadi 2017; Shabbir et al., 2019). Research conducted by Setiyawati (2016) stated that the weakness of the internal control system affects the BPK's opinion on local government financial reports. This is in line with research conducted by Afiah and Azwari (2015), which stated that internal control has an effect on the quality of financial reporting.

H1: Implementation of internal control affects the quality of financial reporting.

Quality financial reports are reports that present financial information to users in a complete, transparent, and not misleading manner and meet the quality criteria for financial reporting (Shabbir et al., 2019; Shariff et al., 2020; Tambingon et al. 2018). The LKPD contains a summary of the actual performance and financial

reports of local governments. The LKPD is submitted to the BPK for examination (Suwanda 2015). Local government performance can be evaluated not only on the quality of financial reporting, but can also be evaluated broadly from the local performance of government administration carried out by the central government through the Ministry of Home Affairs. Local governments with good audit opinions are expected to have good local government performance (Noorollahi, 2019; Shabbir et al., 2019; Sutopo et al. 2017). Research conducted by Wathani et al. (2017) stated that audit opinion affects local government performance. This is in line with research conducted by Sutopo et al. (2017) that audit opinion affects local government performance.

H2: The quality of financial reporting affects the performance of local governments.

The public sector performance measurement system is a system that aims to help public managers assess strategy achievement through financial and nonfinancial measurement tools (Simangunsong 2014). Internal control is a very important part of supervision in the organization. Effective internal control is a prerequisite for creating better performance (Kewo 2017). Research conducted by Simangunsong (2014) stated that the weakness of the internal control system affects the performance of local governments. In addition, there is also research conducted by Wathani et al. (2017), which stated that audit opinion affects local government performance.

H3: Implementation of internal control affects the performance of local governments with the quality of financial reporting as an intervening variable.

RESEARCH METHODS

The data used in this research are secondary data. Data on the implementation of internal control variables and the quality of financial reporting were obtained from the results of the BPK RI audit in the Semester Audit Results Summary (www.bpk.go.id). Performance variable data were obtained from the EKPPD score from the Ministry of Home Affairs (www.kemendagri.go.id).

Our study sample comprises 108 local governments for Indonesian provinces in 2010–2013. We used a purposive sampling method, so that samples match specific objectives in accordance with predetermined criteria. This study uses path analysis, which is a method for examining the effect of intervening variables.

The dependent variable in this study is performance, which is an action or behavior carried out by individuals in an organization to achieve the goals of the organization itself. Local government performance in accordance with Permendagri No. 73/2009 is the achievement of the implementation of regional government affairs as measured by inputs, processes, outputs, results, benefits, and/or impacts. Performance helps in the decision making of an organization and can make the

organization better going forward. Sutopo et al. (2017) stated that local government performance is proxied by the EKPPD score. The performance rating is determined by grouping the performance of local government administration in the very high achievement (ST) group (score ≥ 3), high achievement (T) (≥ 2), moderate achievement (S) (≥ 1) and low achievement (R) (< 1).

The independent variable is the implementation of internal control, which is a control that is applied in an organization that regulates norms, rules, procedures, performance, and organizational structure to supervise and ensure the running of the organization to achieve its goals. In the governance aspect, the government internal control system becomes a supervisory activity for both regional and central government in carrying out activities aimed at creating an effective and efficient government. Setiyawati (2016) stated that internal control is proxied by the weakness of the internal control system (accounting and reporting), weaknesses of the control system for the implementation of the income and expenditure budget, and weaknesses of the internal control structure.

The intervening variable is the quality of financial reporting. Financial reporting quality is illustrated by a financial report that provides complete and transparent information in accordance with applicable accounting standards and is useful for users of financial reports such as the public. The quality of financial reporting is proxied by the audit opinion provided by the BPK on local government financial reports. Sutopo et al. (2017) stated that the quality of financial reporting is proxied by the BPK audit opinion. The WTP opinion was given a score of 5, WTP-DPP was given a score of 4, WDP was given a score of 3, TW was given a score of 2, and TMP was given a score of 1.

RESULTS AND DISCUSSION

Based on predetermined sample criteria, 27 provinces were analyzed and 108 data points were obtained.

Table 3.
Sample Determination Criteria

No.	Criteria	Total
1.	Provinces in Indonesia	34
2.	Province audited by BPK	34
3.	Provinces that have EKPPD	33
4.	Provinces identified as outliers	6
5.	Total provinces to be analyzed	27
Total sample data from 2010 to 2013		108

Source: Processed secondary data

The descriptive statistical test aims to provide an overview or description of data seen from the mean, standard deviation, maximum, and minimum values (Ghozali 2013, p. 19).

In Table 4, the results of descriptive statistics for the independent variable (implementation of internal control) show a minimum value of 1.00 and a maximum value of 3, with an average (mean) of 2.1667 and a standard deviation of 0.99061. The minimum value for the independent variable occurred in East Kalimantan Province in 2012, while the maximum value occurred in Central Java Province in 2012.

Table 4.
Statistic Deskriptif Outputs

Descriptive statistics					
	N	Minimum	Maximum	Mean	Std. Deviation
Ic	108	1.00	3.00	2.1667	.99061
Kpk	108	1.00	5.00	3.3241	1.15870
Kpd	108	1.35	3.15	2.2929	.35474
Valid n (listwise)	108				

Source: Output SPSS

The descriptive statistical results of the intervening variable, namely the quality of financial reporting, show a minimum value of 1.00 and a maximum value of 5.00 with an average (mean) value of 3.324 and a standard deviation value of 1.12. Minimum values occur in Maluku Province (2010, 2011, 2012), North Maluku Province (2010, 2011, 2012, 2013), Central Kalimantan Province (2012), West Papua Province (2012), and Banten Province (2013). The maximum value occurs in 13 provinces, including East Java Province (2010), North Sulawesi Province (2010), and South Sulawesi Province (2010, 2012).

The results of the descriptive statistics for the dependent variable (performance) shows a minimum value of 1.35 and a maximum value of 3.15, with an average (mean) of 2.29 and a standard deviation of 0.35. The minimum value in the dependent variable occurred in North Maluku Province in 2013. The maximum value in this variable occurred in East Java Province in 201

Table 5.
Normality Test Results

One-Sample Kolmogorov-Smirnov Test		
		Unstandardized Residual
N		108
Normal Parameters ^{a, b}	Mean	.0000000
	Std. Deviation	.13228344
Most Extreme Differences	Absolute	.085
	Positive	.046
	Negative	-.085
Statistical Test		.085
Asymp. Sig. (2-tailed)		.055 ^c

Source: Output SPSS

Table 5 shows that the Asymp. Sig. (2-tailed) value in the one-sample Kolmogorov-Smirnov test is 0.055. This shows that the research data are normally distributed or the residual values of the path analysis model are normally distributed.

Table 6.
Multicollinearity Test Results

Model		Collinearity Statistics	
		Tolerance	VIF
1	(Constant)		
	LN_IC	.958	1,044
	LN_KPK	.958	1,044

Source: Processed SPSS output

Based on the results of the multicollinearity test, the independent variable (implementation of internal control) and the intervening variable (quality of financial reporting) has a tolerance value of 0.958, which means that the value is greater than 0.10. The VIF calculation shows a value of 1.044, which does not exceed 10. So it can be concluded that the path analysis model is free from multicollinearity.

Table 7.
Autocorrelation Test Results with Test Runs

Runs Test	
	Unstandardized Residual
Test Value ^a	.01454
Cases < Test Value	54
Cases >= Test Value	54
Total Cases	108
Number of Runs	50
Z	-.967
Asymp. Sig. (2-tailed)	.334

Source: Processed SPSS output

The results of the runs test are shown in Table 7. The test value is 0.02104, and the Asymp. Sig. (2-tailed) is 0.335. The Asymp. Sig. (2-tailed) value is 0.334, above the significance value of 0.05, which means that the residual is random or there is no autocorrelation between residual values.

Table 8.
Heteroscedasticity Test Results Correlations

		LN_KP K	LN_I C	Unstandardized Residual		
Spearman's rho	LN_KPK	Correlation Coefficient	1.000	-.172	.072	
		Sig. (2-tailed)	.	.074	.456	
		N	108	108	108	
	LN_IC	Correlation Coefficient	-.172	1.000	-.007	
		Sig. (2-tailed)	.074	.	.943	
		N	108	108	108	
	Unstandardized Residual	Correlation Coefficient	.072	-.007	1.000	
		Sig. (2-tailed)	.456	.943	.	
		N	108	108	108	

Source: Processed SPSS output

Table 8 shows that the significant value of the internal control variable has a significant value of 0.943, and the financial reporting quality variable has a

significant value of 0.456. This indicates that there is no symptom of heteroscedasticity, so this model is suitable for predicting performance variables based on the implementation of internal control variables and the quality of financial reporting.

Table 9
Recapitulation of Hypothesis Testing Results

No.	Hypothesis	Statistic test	Ha's decision	Conclusion
1	Implementation of internal control affects the quality of financial reporting	H0: $p_z \leq 0.05$ H1: $p_z < 0.05$	H1 accepted	Take effect
2	Quality of financial reporting affects performance	H0: $p_y \leq 0.05$ H1: $p_y < 0.05$	H2 accepted	Take effect
3.	Implementation of internal control affects performance through the quality of financial reporting			Take effect

The effect of internal control implementation is proxied by the weakness of the internal control system based on Table 4. It has a t-value of -2.150 with a significance level of 0.034. This shows significance because it is less than 0.05. The standardized beta coefficient value is -0.204. Thus, H1 is accepted, which means that the internal control implementation variable affects the quality of financial reporting.

A local government is said to have good internal control, which can be seen from the number of findings of weaknesses in its internal control system. The fewer findings on the weaknesses of SPI show that internal control in a local government is good. The weaknesses of SPI in question are in the form of records that have not been or are not carried out or are inaccurate, the report preparation process is not in accordance with applicable regulations, or it is late.

In submitting reports, there is no adequate accounting and reporting information system, and accounting and reporting information systems are not supported by adequate human resources. Good internal control in local government shows that a local government has been able to produce reliable, relevant, and timely financial reports in accordance with applicable standards. Good local government financial reports reflect the quality of their financial reports. Local governments with quality LKPD will be able to obtain WTP opinion from BPK. From this explanation, the

implementation of internal control of a local government affects the quality of local government financial reporting.

The effect of financial reporting quality is proxied by the audit opinion based on Table 4. It has a t-count value of 6,554 with a significance level of 0.00. This shows that it is significant because it is less than 0.05. The standardized beta coefficient value is 0.528. Thus, H2 is accepted, which means that the variable of financial reporting quality has an effect on the performance variable.

Regional government financial reports are prepared by regional apparatuses. Quality financial reports are produced from regional apparatuses that already understand the preparation of LKPD in accordance with applicable standards. Quality financial reports indicate good performance by regional officials. By doing so, it can be concluded that local governments that have quality financial reports reflect good local government performance. Based on the phenomenon, LKPDs that get WTP opinion tend to get high performance scores. There are also LKPDs that get TMP opinion tend to get low performance scores.

Based on the test results using path analysis, internal control variables have an effect on local government performance through the quality of financial reporting as an intervening variable. The variable of financial reporting quality has an indirect effect on local government performance, which can be seen from the total influence, which shows a value of -0.282.

The implementation of internal control relies on strengthening the system that has been built and implemented by all actors in the organization, starting from the existence of policies; formation of organizations; preparation of budgets, facilities, and infrastructure; assigning personnel to implement; and establishing procedures and reviews at all stages of development. If an entity has implemented an effective internal control, this will affect its performance (Badara and Saidin 2013). Effective implementation of internal control can affect local government performance. The implementation of budget evaluation and the feedback obtained is expected to be used as assessment material for the effectiveness of internal controls, so that as internal controls are more effective, the performance will increase (Simangunsong 2017). With good internal control implementation, local government financial reports will have high quality. Quality local government financial reports can be seen from the acquisition of audit opinions. The WTP opinion reflects the quality of the financial reports that the local government has.

Every local government naturally wants to get a WTP opinion from BPK on its financial statements. In preparing quality financial reports, of course, local government performance is needed. To obtain the WTP opinion, the local government will improve its performance. The better the implementation of internal control, the better the quality of financial reporting that will be produced. If the quality of local government financial reporting is improving, it will have a positive impact on the subsequent performance.

The development of performance measurement in local government provides opportunities for regions to prove themselves as the best regions in Indonesia. The existence of EKPPD has made local governments continue to strive to improve their performance. Better performance will produce reports that comply with standards such as local government financial reports. Quality LKPD is reflected in the opinion obtained from BPK. The results of BPK's examination of LKPD contain a number of findings.

CONCLUSION

This study attempted to provide empirical evidence regarding the effect of implementing internal control on performance with financial reporting quality as an intervening variable. The findings indicate that the implementation of internal control affects the quality of financial reporting variables. The quality of financial reporting has an influence on performance variables, and the implementation of internal control has an indirect effect on local government performance through financial reporting quality.

The implication of these results can contribute to local governments in Indonesia, as local governments that have EKPPD with high performance scores should be able to have better internal control. In this study, it was found that many areas had high performance scores, but the findings on the weaknesses of the SPI were still very high. This of course reflects that there are still irregularities and fraud in the area. Local governments in Indonesia are expected to be able to properly implement internal controls in order to develop their regions and create trust from the community.

In this study, data were available only until 2013. Future researchers should use more recent data and increase the research period to 5 years to evaluate trends.

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