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Control Environment Analysis at Government Internal Control System: Indonesia Case

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Abstract

The larger portions of local government as the presence of autonomy in Indonesia caused governance as major issue, particularly regarding more efficient, effective, transparent, and accountable of financial management. But in fact, many Indonesia local governments faced with hindrances to implement good financial management due to the weaknesses of internal control system. This more caused by lousy of control environment condition. The aim of this research is to determine control environment conditions in government internal control system (SPIP) based on roster test enclosed on Regulation of Indonesia Government Number 60 Year 2008 regarding SPIP.

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Keywords: internal control ;control environment ;SPIP ;local government

1. Introduction

1.1. Background of the Research

This paper is about how to use the analysis of Control Environment conditions to determine the course of public governance at the government agency. Good public governance at the local government level became one of the central issues in Indonesia after the autonomy that began with the issuance of Law No. 22 of 1999 as amended by Law No. 23 Year 2014 regarding *Local Government*. The autonomy affects the pattern of governance at the local level. Now, the portion of local government in Indonesia grew larger with the implementation of regional allocation

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of funds to villages regulated by Law No. 6 Year 2014 regarding *The Village*.

The growth of this local government capability always accompanied with greater responsibility for the region in order to achieve the goals of regional autonomy that is to improve people's welfare, improve public services, and increase the competitiveness of the region. To realize these goals, Indonesia introduced a system of intergovernmental transfers in order to ensure every region, especially the minus resources, can still carry out the operations of government. The main income comes largely from intergovernmental transfers by central. Unfortunately, the system of intergovernmental transfer's funds in Indonesia is known as one of the super-complexity system in the world that leads to a lack of transparency, inequity and uncertainty in allocation (Shah, 2012). System of transfer funding from central government to that region is more focused on a gap-filling approach to provincial-local finance in an objective manner to ensure revenue adequacy, without accountability to local residents for service delivery performance.

Good public governance requires the ability of financial management that is efficient, effective, transparent, and accountable that provides real benefits (Noor, 2014). Implementation of good accounting and financial statements reporting in local government is part of the accountability of financial management. Notwithstanding accounting is limited and ambiguous in its capabilities to fully represent a complex reality, yet accounting still needed to represent the result of past event as a form of accountability (Olson et al, 2001). Accounting alone is not enough and must be accompanied by more qualitative, informal means focused on behavior (Ouchi and Maguire, 1975). However, accountability is a more subtle and wider concept than responsibility of financial statement. Informal accountability refers to internal mechanisms, such as code of ethics, moral values, and professional norms (Klimonski and Frink, 1998)

Accountability is primarily a function of publicity rather than transparency. Publicity is a casual mechanism linking transparency and accountability (Naurin, 2006). In this perspective, the financial statement published by local government is a form of accountability. Accountability of financial management in local government can be rated from the opinion issued by the Supreme Audit Agency (BPK) to the local government's financial statements. Region that obtains unqualified opinion (WTP) from BPK will boost confidence of public and other stakeholders. The value of public confidence is the highest value in society, hence the regional government is expected to continue to achieve or maintain a WTP opinion on the financial management in their region (Martowardojo, 2010).

By this situation, WTP opinion becomes the primary concern by Local Government. Although WTP opinion is not the only one factor, however WTP opinion is basic requirement for achieving good public governance (Mardiasmo, 2010). WTP opinion given by BPK determined dominantly from evaluation of internal control system on the Local Government. The affect of internal control system to BPK opinion has been proved by researches conducted by Nora (2013), Tantriani and Puji (2012), Nugraha and Apriyanti (2010) and Indriasari and Ertambang (2008). In Indonesia, according to Government Regulation No. 60 Year 2008, a formal internal control system for local government is The Government Internal Control System (SPIP). This is confirmed by Binsar (2012) which states that if we want to improve the financial management of the local government then we must first fix the foundation that is SPIP. Implementations of SPIP become the key factor that determines the BPK opinion (Hasan, 2013). Yet, there are still many local governments face obstacles in their financial management. It was confirmed by the number of local governments examined by BPK which had not obtained WTP opinion showed 303 LKPD from 456 (BPK-RI, 2014).

Obstacles encountered in the implementation of SPIP in Indonesia local government ever revealed by Zumriyatun (2010), in his research, the success of SPIP implementation mostly fazed by the commitment of Governors/Mayors/Regents. Another study by Ibnu (2009) stated that the effectiveness of SPIP is determined by the Control Environment which is a manifestation of leadership. Meanwhile Yudi (2010) stated that the environmental control where leadership, moral, ethics, honesty, and integrity are prerequisites of solid SPIP.

Based on the explanation above, research about control environment in Indonesia government is still limited. Therefore, this is study to fill that space. This research takes case study at the City of Padang Panjang, the cool highland City of West Sumatra, Indonesia. The area of this city is 23 km² beneath the volcanoes Mount Merapi, Mount Singgalang and Mount Tanditek and about 51.542 populations. The main road through Padang Panjang links coastal Padang and highland Bukittinggi. The traditional culinary well-known '*Sate Mak Syukur (SMS)*' is more famed by the traveller than the City itself.

1.2. Research Questions

This research suggests the following questions;

- How is the condition of Control Environment in Local Government of Padang Panjang?
- What are the most influential sub-elements that affect the design of Control Environment in Padang Panjang?
- What efforts need to take by Policy makers in Padang Panjang in order to create a positive and conducive Control Environment in Padang Panjang?

2. Literature Review

2.1. Control Environment

Control Environment is a set of standards, processes, and structures that provide the foundation for the continuity of internal control within the organization. The good Control Environment creates a positive atmosphere and set the tone for the implementation of effective internal control. In article 4 of Indonesia Government Regulation No.60 Year 2008 stated that the Head of Local Government shall create and maintain the Control Environment that evoke the positive and conducive behavior to the implementation of internal control systems in His/hers work environment.

Control Environment is the foundation of the whole system of internal control. Set up Control Environment means set the rhythm of the organization so that everyone in the organization are affected to have an awareness of the importance of control. The essence of an effective internal control is the soft control related to human being, and it is set up by top management. Top management plays the most crucial role for the creation of effective controls. If Top management believes that control is extremely important, then the other individuals in the organization will feel the same thing. Nonetheless the responsibility to carry out controls not only at the top management, it also involve all personnel in the organization as affirmed by INTOSAI (2001) that "Controls are everybody's business, this mean the entire organization, and every person who work there should be *tune in* to internal control".

The previous researches showed providing proper Control Environment on Local Government is essential to the operational effectiveness of the Local Government (Gadara and Said in, 2013). Meanwhile, Theophanous et al (2011) in his research found that Control Environment is the most important aspect in managing the organization as it reflects the management's policies and attitudes. In addition, Amado and Niangua (2009) stated that Control Environment guide the reduction of fraud activities in organization, the quality of the internal control system depends on the function and quality of the Control Environment. Tudor (2006) in his research in the Romania public sector organization revealed that managers are responsible for creating a positive Control Environment by regulating positive ethical tone, provide guidelines for better behavior, eliminating distractions for good behavior, discipline, setting up a written code of ethics, ensuring personnel have and develop the level of competence to perform his/her duties, as well as clearly define the key areas of authority and responsibility of each personnel. In addition, Ramos (2004) also evaluated internal control systems in the United States regarding to the issuance of the Sarbanes-Oxley Act and found that the Control Environment is a non-transaction-oriented and have a pervasive structure activity that affects many business processes, the most influential aspects are management integrity and organizational ethical values, operational philosophy, and commitment to competences.

Furthermore, Thomas and Metrejean (2013) revealed that the absence of Control Environment causing the opportunities for fraud behavior. Meanwhile, Rittenberg and Schwieger (2005) revealed that the Control Environmental starts from commissioners and management whom set the "tone" of the organization through the policy, behavior, and effective governance. Cohen et al (2000) emphasized the importance of Control Environmental based on his research by conducted a survey to auditors resulted *tone at the top* and its implications to apparatus behavior is important ingredients to the effectiveness of controls.

In Indonesia case, Government Internal Control System (SPIP) also states that the Control Environment is a condition that is built and created in a government agency that affects the effectiveness of internal control. Control Environment is the dominant element affecting other elements in SPIP. Poor Control Environment provides a significant contribution to the ineffectiveness of implementation of other SPIP elements.

2.2. SPIP and Leadership

Based on previous literature, SPIP is strongly influenced by the effectiveness of leadership in Local Government. Leadership contingency theory explained that effective leadership is the result of two factors that is leadership style and situational favorableness (Donaldson, 2006). While the style of leader is determined separately, the situational favorableness can be created by three factors, 1) leader-member relations, 2) tasks structure, and 3) leader's position power. Leader member relations are the level of trust of team to their leader. The more credible leader will then create more favorable situation. Task structure is the type of task given by the leader. Clearly and structured tasks will create favorable situation than unstructured and vague tasks. Leader's position power is the amount of power or strength owned by the leader to steer the group, as well as the ability to provide reward and punishment. The stronger "power" he has, the more favorable situation he get. By this theory, believed leaders, giving clear and structured tasks, and they have a power to perform his instructions, are will be in more favorable situation to implement SPIP.

3. Method

This is a descriptive study, the research to know and to be able to explain the organizational characteristics that follow certain common practices (Saharan, 2006). This is case study type of research that includes in-depth analysis to the situation in an organization where its character and problem definition similar to other organizations.

3.1 Variables and Measurement

The variables of this research is the sub element of Control Environment which consist of seven items, (1) *Integrity and ethical values*, (2) *Commitment to competences*, (3) *Conducive Leadership*, (4) *Organizational structure*, (5) *Delegation of authority and responsibility*, (6) *The human resources policy and practice*, and (7) *The effective role of Government Internal Supervision Apparatus (APIP)*.

Control Environment variables measured by the roster test annexed on Indonesia Government Regulation No.60 Year 2008 regarding *SPIP*. Respondents' answer was measured by the criteria of Control Environment conditions in regulation Head of BPKP No.500 Year 2010 (BPKP, 2010). BPKP distinguish three categories they are red, yellow and green zones explain as follows:

- Red : If average of respondents' score is between 1.00 to 2.20.
- Yellow: If average of respondents' score is between 2.21 to 3.10.
- Green : If average of respondents' score is between 3.11 to 4.00.

Red and yellow zone indicate a weaknesses of SPIP implementation while the green zone indicates that sufficient SPIP implementation exist.

3.2. Population and Sample

Population of this research is the entire State Civilian Apparatus (ASN) at Government of Padang Penang. The sample was drawn from SKPD-the echelon unit in Government of Padang Penang- stipulated as pilot project of SPIP using purposive sampling technique. That technique was chosen due to obtain reliable data on the implementation of SPIP required minimal information from apparatus that had pursued a course of socialization or training about SPIP.

3.3 Data Collection and Analysis

The primary data of this research was obtained through observation, questionnaires, and in-depth interviews. The depth interview was conducted to explore respondents' questionnaire. Data from questionnaire processed using statistical software SPSS and analyzed with descriptive statistic.

3.3.1. Validity testing.

The purpose of validity testing is to know how far the instruments measured correctly and accurately. The item of questioner is valid if r statistic higher than critical value at 95% degree ($\alpha = 0.05$). Validity test techniques used in this study is content validity and not construct validity.

3.3.2. Reliability testing.

Reliability test was conducted to determine the consistency of respondents. The research instrument stated reliable if Cranach Alpha value greater than 0.6.

4. Finding and Discussion

Validity test results indicated there are some questions that are not valid because its value below of r table 0.2876 at alpha 5%. Hence the invalid questions cannot be used to measure the research variables. Meanwhile, reliability test for 7th variable-The effective role of Government Internal Supervision Apparatus (APIP)- showed Cranach alpha was 0.524 or below 0.6, means excluded from analysis.

4.1. Descriptive Statistic

In order to answer the first research question, results of descriptive statistics for each sub-element of Control Environment showed average value and its position on implementing SPIP zone present as follows:

Green

Yellow

Red

Fig 1. Control Environment Condition at Padang Penang Government

From the figure above shows the average (mean) of all variables are in the range of 2.21 to 3.10 or yellow zone. The weaknesses were contributed to this condition are as follows:

- Leader has not taken actions against unethical behavior
- Leader has not abolished the assignments or policies that encourage unethical behavior, such as; promotion has not been based on merit system
- The process for ensuring adequate level of people competencies for each position has not performed
- The assessment of apparatus performance was not based on objective factors.
- Leader has no managerial capacity and extensive technical experience in managing government institution

- Leader undertaken excessive rotations for Head of SKPD and have no patterned policies for the apparatus rotation
- Leader has not understood that internal control is a responsibility that must be carried out
- Mechanism for promotions, allowances and apparatus rotations have not based on performance assessment
- It has no guarantee that recruitment of new ASN was able to produce high quality ASN who has integrity and commitment.

The second research question showed that majority respondent chosen the variable enforcement of integrity and ethical values by forty percent (40%) of answer, followed by variable conductivity of leadership by thirty two percent (32%). This result elucidate that those two variables are the most influential sub element which affect the creation of positive and conducive Control Environment in Padang Panjang Government.

4.2. Interview

The interview explored respondents' conception about what kind of efforts should be done by policy maker in Padang Panjang in order to create positive and conducive Control Environment as follow:

- Commitment of the Leader. The majority of informants stated that the Control Environment can only be created when Head of Local Government have a high commitment in implementing all sub-elements of SPIP. The Commitment indicated by daily behavior that gives a message and impression to all subordinates that the Leader is really concern and consistent in enforcement of integrity and ethical values. The Leader's Integrity cannot be achieved by Leader's statement, but it can be sensed by the people around him. Integrity is a character of the leader in his daily life activities.
- Proper rotation patterns. Majority informants also stated that proper rotations affect apparatus's morale and productivity. The rotation should be based on real performance and not by illogical considerations.
- The solid SPIP team in each SKPD. Majority informants consider that the SPIP's Task Force in Padang Panjang does not work at all. Inadequate comprehension about SPIP and routine work overload are the mainly reason for that. Padang Panjang needs to upgrade the capacity of the task Force to provide a comprehensive understanding of SPIP so that they expected to become a pioneer and role model in the creation of a positive Control Environment in their SKPD.
- Strengthening APIP roles. The Informants consider that strengthening APIP roles by monitoring and evaluating so that SPIP could be internalized into daily organizational activities on Padang Panjang Government.

4.3. Discussion

From the results of statistical analysis and the results of in-depth interviews, with a cross analysis between the six sub-elements, Control Environment weaknesses in Padang Panjang local government look like dominantly by leadership factor and apparatus rotations policy. Leaders considered not having managerial capacity and extensive technical experience on managing Government Agency. Policies of apparatus rotation also considered not based on merit system and without performance objectivity. Placement of dignitary have not entirely based on the correct process in testing the knowledge, skills and abilities to fill the positions, this is proved by the excessive rotations of Head of SKPD in the Government of Padang Panjang.

The facts revealed by this study could be discussed to see governance pattern of local government in Indonesia. Many local governments in Indonesia are the result of direct election. The arousals of Head of Local Government to implement SPIP now are mostly politic motives than the nature of SPIP's intention itself.

5. Conclusion

The finding of this research gives us evidence that the conditions of Control Environment at Local Government is determined by the leadership factor of Head of Local Government, characterized by proper and transparent apparatus

rotations policies. The creation of positive and conducive Control Environment will then make large contribution to the successful implementation of SPIP in the local government.

The characteristics of SPIP that is special for each Local Government which adapts to the needs, size, complexity, nature and task functions of the Local Government make this study relevant only for Local Government Studied in Indonesia case. Future researches can add other variable such as another four SPIP elements or keep conducting similar studies but in other institutions.

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