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The Direct and Mediating Effects of An Auditor's Quality and the Legislative's Oversight on the Follow-up of Audit Recommendation and Audit Opinion

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Abstract: The purpose of this study is to analyze the direct and mediating effects of an auditor's quality and the legislative's oversight on the follow-up of audit recommendations and audit opinion. We use Indonesia's local governments' data from 2010-2012. Auditor's quality was measured by auditor's quality index; while the legislative's oversight was measured by the number of legislative member. The empirical test result shows that there is a direct effect between an auditor's quality and the legislative's oversight on the follow up audit recommendation and indirect effect to audit opinion. A high quality auditor is able to produce high quality recommendations that can be implemented by the audited entity. Strong legislative's oversight encourages a closer monitoring over the local government financial management so that the local governments can be more committed to follow-up the audit recommendation. The higher the audit recommendations are acted upon, the better the quality of the local government is, as shown by a better audit opinion.

BACKGROUND

Since the beginning of the regional autonomy and financial reform era in Indonesia, accountability and transparency have become important issues in public governance. As part of its financial accountability, the government is required to prepare financial statements functioning as a monitoring tool to reduce information asymmetry between the public/voters as a principal and the government as an agent (Streim, 1994). An agency problem arises not only because the public cannot directly observe the actions of the government but also because there are uncertainties related with honesty in managing public funds. An auditor's role is to mitigate the agency problem between the voters and the government and to provide an audit opinion on the fairness of the government's financial statements. In contrast with the private sector audit, the public sector audit is basically monopolistic in nature (Clark, *et al.,* 2007). The primary responsibility of the Supreme Audit Institution (SAI), including The Audit Board of the Republic of Indonesia[1] (BPK)

is to provide an audit and assurance service for the government, government agencies and other public sector entities. Due to the monopolistic nature, it is necessary to have quality assurance system to ensure that public sector audit has high audit quality.

A high audit quality should be followed by audit result utilization by the auditee. The results of BPK's financial statement audit are audit opinion, audit findings and audit recommendation that consists of corrective actions that must be performed by the auditee. Liu and Lin (2012) stated that detection of irregularities in government auditing is only the first step, but asking for responsibilities and making correction is more important. The recommendations prepared by an auditor would improve the government transparency and accountability. In Indonesia's local government context, the government official is required to provide an answer/explanation/actions plan to BPK regarding the follow-up of audit recommendation no later than 60 days after the audit report is received. The government official may also be subject to administrative sanctions if they disobey the obligation to conduct the rectification. Although the central government has the power to impose administrative sanctions and penalties to the responsible agencies, in fact, based on the summary of BPK's audit report during the period of 2005 to 2013, the average percentage of the number (nominal value) of the recommendations that were completely followed up was only 55.11% (27.34%). It is the responsibility of the local government to improve the public financial sector after following up the audit recommendation. Without follow-up, the audit results are useless in creating accountability in the government auditing process. Empirical research on the follow-up of audit recommendations is still very limited. In China, Liu and Lin (2012) found that an auditee's effort in following up the audit recommendation (audit rectification) is a very important factor for improving the government transparency and accountability. Liu and Lin (2012) suggest that the auditee's efforts to implement the audit recommendations can strengthen the audit effectiveness.

Government Accontability Office (GAO, 1993) stated that when a recommendation is made to an auditee, the management is basically responsible for implementing it, but auditors can do a great deal to improve the likelihood of implemented recommendation. An auditor can provide: (1) high quality recommendations to correct the basic cause of a deficiency, (2) commitment to perform and implement the action recommended and (3) aggressive monitoring and follow-up, because continued attention is required until results are achieved. A high quality auditor is needed in order to formulate appropriate recommendations that can correct the basic cause of a deficiency so it can be effectively implemented. Cheng *et al.*, (2013) measure an auditor's quality using auditor competencies in public accounting firm that consist of education, experience and training. An auditor's quality is an audit-specific firm attributes that affects the auditor monitoring strength. According to Watkins *et al.*, (2004), an auditor's monitoring strength represents auditor's ability to provide information that minimizes the difference between a clients reported economic circumstances and the 'true' unobservable economic circumstances of the client. The stronger the auditor's monitoring, the closer the financial statement reflects the true economic circumstances of the client and the higher the quality of the information.

An oversight function is required to monitor the activities of the local government. Ogul and Rockman (1990) define oversight as a formal or informal effort in order to direct an agent to comply with a particular law/regulation. Oversight is needed to ensure that the authorized parties are responsible with their tasks. In Indonesia, one of the duties of the House of Representatives at the Province/District/Municipalities (DPRD) level is to monitor the progress of an audit recommendation given by BPK. DPRD may request

an explanation from BPK while monitoring the follow-up of audit recommendation, and may conduct further investigation if necessary (Law No. 15/2004 art 21). Furthermore, DPRD has to supervise the implementation of recommendations by doing close coordination with the local government head. Refer to the above regulations, the legislative's oversight is expected to affect the follow-up of audit recommendation.

The first objective of this study is to examine the effects of an auditor's quality and the legislative's oversight to follow-up of audit recommendation. Auditors who have high competence are expected to provide appropriate recommendations that can be followed by the auditee, so the percentage of audit follow-up is increased. According to Asian Organization of Supreme Audit Institutions (ASOSAI, 2009), the greater the percentage of recommendations that are accepted and implemented by the auditee is one the indicators of high quality audit. Therefore, an auditor's quality is one of the main variables that are expected to affect the follow-up of audit recommendation. An auditor's quality measurement has not been widely explored in empirical research, as well as its effects on the follow-up on audit recommendation.

Audit opinion is one of the major concerns in determining how well local governments manage their financial management responsibilities. The central government in Indonesia has already taken an active role in encouraging the local governments to achieve better audit opinion. One of the indicators to measure the success of the bureaucratic reform in Indonesia is the target to achieve 100% unqualified audit opinion for the central government and ministries and government agencies and 60% for the local government in 2014 (Presidential Decree No.81/2010). Based on the summary of BPK's audit examination in 2012, only 23% of the local governments received unqualified audit opinion. This fact should have led to an attempt by the local government to improve audit opinion in order to achieve the bureaucratic reform target in 2014.

The second objective of this study is to examine the indirect effects of an auditor's quality and the legislative's oversight to audit opinion through the follow-up on audit recommendations. Auditors can generate high-quality recommendations that can solve the root causes of the auditee's financial management if the recommendations are implemented effectively. The higher the recommendations acted upon, the better of the audit opinion. Similarly, with strong legislative's oversight, it will encourage greater scrutiny over the financial management so that the local governments are more committed to follow-up the audit result. This will give impact on the better audit opinion for the next period.

This study provides two main contributions. First, the study is the first study that develops comprehensive auditor's quality in public sector. The auditor's quality measurement in this paper will be useful for future research and can be used as one of the audit quality proxies in public sector in which the literature is still limited. Second, we provide suggestions to stakeholders on how to both maximize the utilization of the audit results as well as to improve the audit opinion. The follow-up of audit recommendation serve as a mediating variable that connects an auditor's quality and the legislative's oversight to audit opinion. The improved accountability and transparency of the financial management can help the local governments in Indonesia to achieve 60% unqualified audit opinion targets of the bureaucratic reform in 2014.

The empirical test result shows that there is a direct effect between an auditor's quality and the legislative's oversight on the follow up audit recommendation and indirect effect to audit opinion. A high quality auditor is able to produce high quality recommendations that can be implemented by the audited entity.

Strong the legislative's oversight encourages a closer monitoring over the local government financial management so that the local governments are more committed to follow-up the audit recommendation. The higher the audit recommendations are acted upon, the better the quality of local government financial statements as shown by a better audit opinion. The result implies that the central government should more consistently urge the local governments to follow-up the audit recommendation and seriously impose sanctions as necessary, if the local governments disobey the obligation. BPK's auditor and the legislative member should increase their competencies and monitoring role because it is proven to affect the follow-up of audit recommendation and audit opinion.

The remainder of this study proceeds as follows. Section 2 presents literature review and of hypotheses development. The research methodology is presented in section 3 followed by discussion of the empirical results in section 4. Section 5 discusses the conclusions, limitations and suggestions for further research.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

In several auditing literature, audit quality is defined as the probability of discovering the breach and to report it to the users of financial statements (De Angelo, 1981). In this original definition, auditor's competency is considered fixed and do not vary with each audit engagement. According to Watkins *et al.*, (2004), audit quality component consists of auditor monitoring strength and auditor reputation. Cheng *et al.*, (2013) relaxed this 'no variation in competence' assumption and measure audit quality by the quality of auditors of public accounting firm. Cheng *et al.*, (2013) show that an auditor's quality is positively related to the company's performance, where higher auditor's quality will result in superior performance. An auditor's quality in Cheng *et al.*, (2013) is extracted using principle component analysis and found three major components that form an auditor's quality which are education, experience and training. Those three components are derived from several factors that affect an auditor's quality as mentioned in auditing literature as follow: (1) tenure; (2) workload; (3) professional skills; (4) continuing professional education; (5) level of education; and (6) motivation.

There are two contradictory opinions between auditor tenure and audit quality. The first view says that there is a negative relationship between tenure and audit quality. The longer audit tenure results on the higher auditor competence (Johnson, *et al.*, 2002); and the more familiar their relationship with the client. This leads to client greater reporting flexibility and higher chance to compromise audit opinion (Davis *et al.*, 2002; Dopuch *et al.*, 2001; Chi *et al,* 2011). On the other hand, a short period of audit assignments related to low earnings quality (Johnson, *et al.*, 2002 and Myers *et al.*, 2003). This is might due to the shorter the period of assignment, auditor's knowledge of the business, operations, accounting policies and internal control system of the client are not yet comprehensive compared to the longer audit assignments. The existence of mixed evidence shows that there is a trade-off between independence and competence. However, increase in competence is not always accompanied by a decrease in independence. This is due to the loss of independency has greater impact than getting additional fees due to additional clients (Watts and Zimmerman, 1986). Because of this audit risk, several auditors can have high competence without losing its independence.

Workload can be seen from the number of clients handled by auditor in certain period of time and the limited time available to carry out all audit process. Jones *et al.*, (2010) and Agoglia, *et al.*, (2010) found the association between the busy season with stress and fatigue, and it reduces auditor commitment, job

satisfaction and individual performance. Lopez and Peters (2012); Hansen, *et al.*, (2008) and Van Linden and Willekens (2013) proved that the work pressure led to poor audit quality and improve management capabilities to manipulate reported earnings.

Professional skills are required according to the Indonesia's State Finance Auditing Standard (SPKN). Point 4.3 in SPKN (2007) stated that the staff assigned to carry out the audit must have sufficient professional skills required for the task. Choo and Trotman (2001) found that experienced auditors find more atypical findings compare with less experienced auditors. This is consistent with Tubbs (1992) who found that the more experience the auditors, the more errors they can found. Cheng *et al.*, (2013) measured professional skills using age and professional certification and concludes that auditors with age above 35 years with more 10 years working experience and hold certified public accountant (CPA) considered as more experienced than others.

Continuing professional education is intended to update auditors' knowledge with current developments in methodology and audit procedures. Through continuing education, auditor will obtain deeper understanding of accounting issue and increase motivation in conducting the audit. The American Institute of Certified Public Accountants (AICPA) task force reports that one of the factors that can improve the quality of the government auditor's work is training and the level of auditors' education.

Streim (1994) stated that motivation is other important aspect that affects audit quality especially in public sector. Private and public sector auditor's characteristics are very different. Public auditors usually civil servants who earn a fixed salary, small risk of being laid off, and do not suffer any loss of reputation (or could lose reputation without losing money). The lack of incentive to do a good job threatens audit quality. Therefore, motivation should be considered as determinant of audit quality. Efendy (2010) show positive relationship between motivation and audit quality. This is in line with Goleman (2001) who found that motivation drive the person to have high morale to achieve the goals and meet the existing standards. Efendy (2010) also noted that the recommendation on audit results should be followed up in order not to reduce auditor motivation. Increasing the effectiveness of the follow-up of audit recommendation is one of the strategic objectives outlined in the BPK's key performance indicators (KPI). Thus, the follow-up on audit recommendation could be one of the auditor's motivations to improve an auditor's quality.

An auditor's quality in this study is measured from the quality of the audit team leader. The audit team leader is in charge in conducting audit field duties to ensure all parties understand the audit process related to the overall planning and tasks assigned. According to European Organization of Supreme Audit Institutions (EUROSAI, 2004), the audit team leader should also ensure that the persons involved in the audit engagement have the skills needed to perform a given task, and no conflict of interest or other factors that would hinder any team member in carrying out the tasks assigned in competent and objective manner. Based on the above considerations, the quality of the audit team leader is considered reflects the quality of BPK's auditors.

The follow-up of audit recommendation is the local government responsibility to improve their public financial accountability. Without the follow-up, audit findings are useless in creating accountability in the government auditing process. In China, Huang and Wang (2010) argued that the correction or rectification effort made by the audit institutions and related parties after problems are recognized is the most important factor in determining the extent to which government auditing can perform its duties and

promote government transparency and accountability. However, not all recommendations proposed by the audit institution are fulfilled by the government. Empirical result shows that the auditee and other stakeholder efforts in following up the auditor recommendation can strengthen the effectiveness of government audit and help to reduce corruption in the future.

High quality auditors are expected to generate appropriate recommendations suitable with the auditee's conditions that can be implemented, so that the number of completely followed-up audit recommendations is higher. ASOSAI (2009) stated that the greater the percentage of recommendations accepted and implemented by the auditee is one of the indicators of high audit quality. BPK's performance management report (2012) stated that the BPK's auditor is encouraged to formulate recommendations that can be acted upon by the auditee and enable to enhance operational performance. The follow-up of audit recommendation in year (t) is the rectification process done by management during year (t) based on recommendation given by auditor in year (t-1); therefore the follow-up of audit recommendation in year (t) is affected by an auditor's quality in year (t-1). For example (as illustrated in figure 1), after the end of fiscal year 2011, auditor issues the audited financial statement that consists of opinions, findings and recommendations. Rectification efforts done by local government throughout 2012 are based on recommendation given by auditor in year 2011; therefore an auditor's quality used is an auditor's quality in 2011.

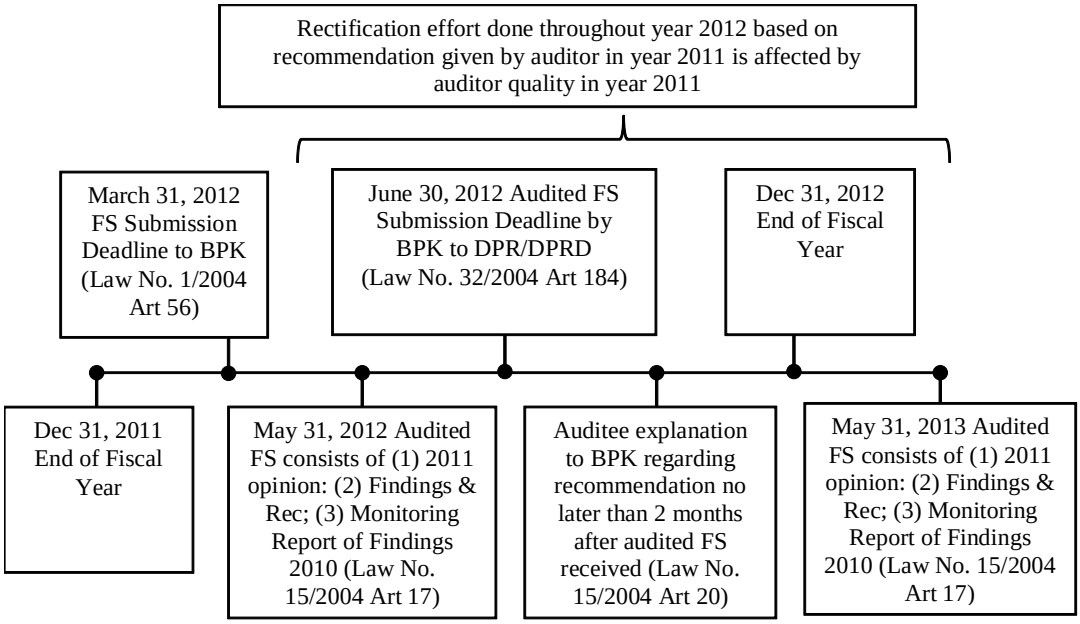

Figure 1: Illustration of Audit Opinion/Findings/Recommendations Progress

Based on the arguments presented above, the first hypothesis to be tested this study is:

H1 (Lag) An auditor's quality has direct and positive effects on the follow-up of audit recommendation

In Indonesia, the legislative member in the House of Representatives (DPRD) performs the legislative's oversight to monitor implementation of regulation/policies in province/district/municipalities. Indonesia's Ministry Decree No. 13/2010 provides further guidance on the oversight function of DPRD related with the follow-up of audit recommendation. DPRD discuss the BPK's audit result in special committee, asking for explanation in order to follow-up the audit results, may request to BPK to conduct further investigation

and monitor the implementation of the audit recommendation. Since this decree was established, DPRD in several province/district/municipalities in Indonesia was more actively discussed and monitored the follow-up of audit recommendation.

The oversight by DPRD is analogous to the monitoring function by the board of commissioners in private sector as one of the key factor of corporate governance mechanism. Hermawan (2011) found that the effectiveness of the board of commissioners implies better monitoring function over the financial reporting process; and it improves the informativeness of earnings. Gilligan and Matsusaka (2001) stated that the legislature size is one of the interests of decision maker. Legislature size must be large enough to possess knowledge of interest of the constituent but small enough to avoid absolute power. In private sector, the existing literature shows mixed evidence on the association of board size and board effectiveness. Yermack (1996) found a smaller board size is associated with high earnings quality, but Dalton *et al.*, (1999) suggest that the larger board size allow having more board expert to maintain comprehensive monitoring. The ideal board size is not too large that might slow decision making process, but not too small in order to obtain comprehensive competence to conduct effective monitoring.

The the legislative's oversight in this study is measured by the number of the legislative members. Indonesia's Law No. 8/2012 art 23 and 26 stated that the number of provincial legislative member is 35-100; while in district/municipalities the number of legislative member is 20-50 based on the number of population. If the legislature conducts their oversight function properly according to relevant law, the local governments will be more committed to follow-up the audit recommendation. The larger the number of legislative members will increase the likelihood of the legislature to have a collective capability in conducting thorough oversight; so the number of follow-up audit recommendation will be higher. Based on the arguments presented above, the second hypothesis to be tested in this study is:

H2 The legislative's oversight has direct and positive effects on the follow-up of audit recommendation

The output of financial statement audit are audit opinion, findings and recommendation of corrective actions that shall performed by the auditee. Liu and Lin (2012) stated that audit institutions are involved in the rectification process in several ways. They can: (1) impose sanctions and penalties directly; (2) transfer cases to the parties in charge and make suggestions on the sanctions and penalties that should be imposed; (3) make suggestions on how to repair deficiencies in government administration and (4) check on the implementation of audit decision and rectification result. In Indonesia, BPK do not have authority to impose sanction/penalties directly, but BPK has the responsibility to monitor follow-up by doing other three the rectification effort (Summary of BPK Audit Report, Semester II, 2012).

The greater percentage of implemented recommendations, probability of local government to achieve unqualified audit opinion is higher. Illustration in figure 1 above explains that follow-up of audit recommendation in year (t) is the correction done by management during year (t) based on recommendation given by auditor in year (t-1); therefore the higher the percentage of recommendations acted upon in the year (t-1); it is expected that the audit findings is lower and the higher probability for achieving unqualified opinion in year (t). Based on the arguments presented above, the third hypothesis to be tested is:

H3 Follow-up of audit recommendation has direct and positive effects on audit opinion

In our first hypothesis, it is states that auditors with high competence are expected to generate appropriate recommendations that can be easily followed by auditee. The higher number of the implemented

recommendations, it is expected that the quality of financial statements will be better which are indicated by the higher probability achieving unqualified audit opinion. Thus, the effect of an auditor's quality to audit opinion is not a direct effect, but indirect effect through the follow-up of audit recommendation. Based on the arguments presented above, the fourth hypothesis to be tested in this study is:

H4 An auditor's quality has positive and indirect effects on audit opinion through follow-up of audit recommendation

In accordance with the authority given by the law, DPRD is in charge of supervising the local government financial management by monitoring the implementation of the follow-up of audit recommendation as mentioned in second hypothesis. The stronger the the legislative's oversight, local governments will be more committed to follow-up audit recommendation. The higher number of the acted recommendations, it is expected that the quality of financial statements will be better which is indicated higher probability for achieving unqualified opinion. The follow-up of audit recommendation act as an intervening variable that mediates the relationship between the legislative's oversight and audit findings/opinions. Based on the arguments presented above, the fifth hypothesis to be tested in this study is:

H5 The legislative's oversight has positive and indirect effects on audit opinion through follow-up of audit recommendation

Conceptual framework of this study can be seen in Figure 2.

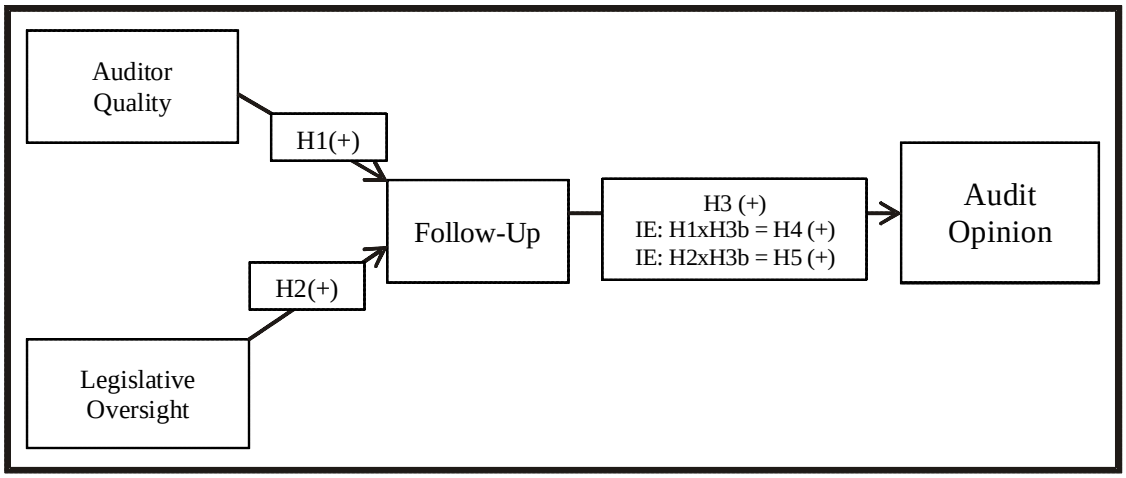

Figure 2: Conceptual Framework

METHODOLOGY

Data

Population in this study is all form of local governments (province/districts/ municipalities) in Indonesia for the period 2010-2012. Some variables (audit opinion and audit findings) use lag; so several data need to be collected from year 2009. The purposive sampling method is used to obtain complete data. Data sources of this study are obtained from BPK which consists of: (1) audited local government financial statement, (2) semiannual summary of audit report and (3) human resources data related to audit team leader competence. Other data are taken from Statistical Bureau and the official website of local government and DPRD.

Empirical Model

The first empirical model use to test the H1 and H2 are as follow:

$$TLHP\_NOM_{it} = a_0 + a_1AQ_{it-1} + a_2DPRD_{it} + a_3OPINI_{it-1} + a_4FINDING_{it-1} + a_5SIZE_{it} + a_6DEPEND_{it} + a_7AGES_{it} + a_8SUPP_{it} + €_{it} \quad (1)$$

Where:

TLHP_NOMit	=	Follow-Up of Audit Recommendation
AQit-1	=	(Lag) of Auditor's quality Index
OPINIit-1	=	(Lag) of Audit Opinion
FINDINGit-1	=	(Lag) of Audit Findings
SIZEit	=	Size of Local Government
DEPENDit	=	Intergovernmental Revenue Transfer
AGESit	=	Age of Local Government
SUPPit	=	Local Government Head Background
€it	=	Error term

Second empirical model use to test the H3, H4 and H5 are as follow:

$$OPINI_{it} = b_0 + b_1TLHP\_NOM_{it} + b_2AQ_{it} + b_3FINDINGS_{it} + b_4SIZE_{it} + b_5DEPEND_{it} + b_6AGES_{it} + b_7SUPP_{it} + b_8BPKP_{it} + b_9RE\_ELECTS_{it} + €_{it} \quad (2)$$

Where:

OPINIit	=	Audit Opinion
TLHP_NOMit	=	Follow-Up of Audit Recommendation
AQit	=	Auditor's quality Index
FINDINGit	=	Audit Findings
SIZEit	=	Size of Local Government
DEPENDit	=	Intergovernmental Revenue Transfer
AGESit	=	Age of Local Government
SUPPit	=	Local Government Head Background
BPKPit	=	BPKP's Assistance
RE_ELECTSit	=	Reelection
€it	=	Error term

Follow-up of audit recommendation variable (TLHP_NOM) is the dependent variable in the model (1) and become independent variables in the model (2). This condition is called simultaneity in which an explanatory variable value is determined through a system. Simultaneity is a violation of the assumptions and categorized the endogeneity problem. Because of the endogeneity, estimator generator will be biased and inconsistent; even by increasing the number of samples. One way to overcome endogeneity problem,

is putting the two equations as a single equation using Generalized Structural Equation Modeling (GSEM) for models (1) and (2) in STATA 13; because model (2) use ordinal dependent data which has a sequence (ordered logit). Kline and Klammer (2001) stated that the use SEM/GSEM is more recommended because SEM/GSEM can examine the relationship between the variables as a unit, unlike the multiple regressions that use piecemeal approach.

Variable Measurement

Table 1 present variable measurement for an auditor's quality component. Year end is the peak season for BPK's auditor, because auditor has an obligation to report the audit results six months after the fiscal year end. According to Van Linden and Willekens (2013) workload of staff /partner is negatively related audit quality. In this study, workload is measured by the number of auditees examined by the audit team leader in a year. There are no formal of auditor rotation in BPK. A common practice for auditor rotation is every 5 years or less (3 years) if auditor is placed in conflict/remote area. Measurement of tenure used in this study is the length of time (in years) audits the same auditee.

Table 1
An Auditor's Quality Component

No	*Variable*	*Measurement*
1.	Role (ROLE)	The role of the team leader at the time of audit; 4 = Senior Team Leader; 3 = Junior Team Leader; 2 = Team Member; 1 = Other
2.	Professionalism (PROF)	The length of time (in years) as audit team leader
3.	Experience (EXP)	The length of time (in years) as BPK-RI's auditor
4.	Number of Training (TRAIN_1)	Number of training followed during a year
5.	Training hours (TRAIN_1)	Number of training hours followed during a year
6.	Educational Background (EDUC_1)	Educational background of audit team leader, 1 =accounting background and 0 = others
7.	Level of Education (EDUC_2)	Level of education of audit team leader, 1 =post-graduate degree and 0 = others
8.	Motivation_1 (LTLRHP)	Lag of number of recommendations completely followed-up plus that cannot be followed-up divided by the total number of recommendations
9.	Motivation_2 (LTLRHP_NOM)	Lag of nominal value of recommendations completely followed-up plus that cannot be followed-up divided by the total nominal value of recommendations
10.	Workload (WORKLOAD)	Number of auditees assigned to audit team leader within a year
11.	Tenure (TENURE)	The length of time (in years) audit the same entities

BPK regulation 4/2010 art 19 states that every auditor has a role in carrying out their duty. The role classifications from the lowest to the highest are junior team members; senior team members; junior team leader; senior team leader; technical control and quality control. The differences between junior and senior team leader is associated with complexity of the task. The role in an auditor's quality components is measured by identifying whether the audit team leaders have a role as junior/senior team members as requested by the law.

As stated in general standard of State Finance Auditing Standard that the staff assigned to carry out the examination should collectively have sufficient professional skills required for the task. Setyaningrum (2011) measure professional skills using the length of time (in years) auditor became audit team leader. Measurement of professionalism variable in this study follows Setyaningrum (2011), with additional experience variable measure by the length of time (in years) as BPK auditors.

SPKN stated that in order to master the latest developments related to the role as auditor, BPK's auditor required to complete at least 80 hours of trainings every two years; whereas 24 hours of the 80 hours of trainings must be directly related to the audit tasks. Batubara (2008) found positive effects between continuing professional education with audit quality. To ensure that the auditor meets these requirements, BPK's education and training center provide education and training in accordance with the role of the auditor. Training variable measured by number of training hours and number of technical and functional training followed by audit team leader in a year.

In order to understand the relevant accounting and auditing standards, auditor should have the academic and practical experience in the field of accounting. This study uses two variables to measure education, which are educational background and level of education. If audit team leader has accounting background, we give score of 1 and 0 if otherwise. Second variable is level of education, which is 1 if audit team leader has post-graduate degree and 0 if otherwise as used by Setyaningrum (2011).

Motivation is an important factor that should be considered as a determinant of audit quality, because in the public sector or risk dismissal for loss of reputation is very small considering the auditor is civil servants. Efendy (2010) measures motivation using auditors' perception, but none of the literature measured motivation using secondary data. This study proposes motivation measurement using percentage of the follow-up examination from previous period. As one of the BPK's key performance indicators, the auditor would be very concerned about the follow-up of audit recommendation.

Table 2 present variable measurements for the empirical model. Liu and Lin (2012) measure rectification effort using the amount of funds remitted to the state treasury and the amount of the budget cut after an audit. In Indonesia, BPK cannot impose sanctions and penalties directly as is done in China. This study measures follow-up of audit recommendation by adding nominal value of recommendations completely followed-up plus recommendation that cannot be followed-up divided by the total nominal value of recommendations. Based on summary of BPK's audit report from 2005 to 2013; local government are more focused on number (not nominal value) of recommendations. The average percentage of nominal value of recommendations were followed-up only 27.34%, which is lesser compare to percentage number of audit recommendation acted upon that reach 55.11%. Local government should give priority to recommendation that has high value since it shows the significance (importance) of the recommendation.

Audit opinion is measured using an ordinal scale that can be sorted by a ranking. In this study, the audit opinion is categorized from lowest to highest as follows: (1) Disclaimer Opinion, (2) Adverse Opinion, (3) Qualified Opinion, and (4) Unqualified Opinion. This measurement is used in Nuraeni (2011) and Wicaksono (2012). Audit findings were measured using nominal value of the audit findings. Nominal value of the findings reflects levels of findings materiality, thus reflecting the magnitude of the findings generated by the auditor. This proxy is used in Liestiani (2008) and Wicaksono (2012).

Table 2
Variable Measurement for Empirical Model

No	*Variable*	*Measurement*
1.	Follow-up of audit recommendation (TLHP_NOM)	Nominal value of recommendations completely followed-up plus recommendation that cannot be followed-up divided by the total nominal value of recommendations
2.	Audit Opinion (OPINION)	1: Disclaimer Opinion, 2: Adverse Opinion, 3: Qualified Opinion, 4: Unqualified Opinion
3.	Audit Finding (FINDINGS)	Number (nominal value) of audit findings
4.	An auditor's quality (AQ)	An auditor's quality Index
5.	The legislative's oversight (DPRD)	The number of parliament member
6.	Local government dependency (DEPEND)	Transfer revenue divided by total revenue
7.	Size of Local Government (SIZE)	Log of Total Asset
8.	Age of Local Government (AGES)	Age of local government since establishment act of district/city
9.	Local Government Head background (SUPP)	1 =Local government head has economics/accounting background, 0 =others
10.	BPKP Assistance (BPKP)	1 =Have BPKP's Assistance, 0 =Others
11.	Reelection (RE_ELECTS)	1 = If the Local Government Leaders is in the lead on the second period of 4 years , 0 =others

To measure the legislative's oversight, we use the number of legislative member. Hermawan (2011) classified board size into three groups: (1) good if the board of commissioners of the company consists of 5-10 persons; (2) fair if the board of commissioners consists of 11-15 persons; and (3) poor if the board of commissioners consist of more than 16 persons, or less than 5 persons. In sum, effective board size is not too large that might slow down the decision making process, but not too small in order to obtain comprehensive competence to conduct monitoring. The number of legislative member in the province is at least 35 persons; with an additional 5 persons for each multiple of 1,000,000 inhabitants and maximum of 100 persons if the population over 11 million persons. Number of legislature member for districts/ municipalities at least 20 persons with an additional 5 for each multiple of 100,000 persons and maximum of 50 persons if the population over 1 million persons (Law No. 8/2012 art 23 and 26).

EMPIRICAL RESULTS

Descriptive Statistic

Table 3 presents the descriptive statistic of an auditor's quality index. Number of complete local governments is 526 per year or 1,578 observations for 3 year. As shown in table 3, in average, team leader perform financial audit to 1-2 auditee during a year and team leader never audit the same auditee more than twice. The frequency distribution shows that 67% of auditor has a functional position role as team leader (junior and senior). However, it is also found that 31% of the samples still have a role as team member. This fact should become BPK's concern to ensure the adequacy of team leader competence as required by the law. In terms of educational background, 88% auditor has accounting background, but only 27% were completed post graduate degree. In average, team leader has nine years' experience as an auditor in BPK, and the

average experience of being a team leader is 7.2 months. To be a junior team leader, auditor must first pass through a role as a junior and senior team member where each role level increase requires at least 3 years, taking into account the adequacy of the number of credits and the assessment by human resources department. If the average experience as BPK's auditor is 9 years, the auditor should already reach early role as senior team leader, but in fact majority role of auditor in this sample is still as junior team member. It implies that auditors take more than 3 years to get promoted. Within a year, in average, team leader followed 2 training with total training hours of 65 hours. Training rules in the BPK mentioned that each year the auditor must follow minimum 40 hours in a year of training related with the functional roles as auditor and other technical trainings. The result shows that the training requirements for auditor have been met. The last variable is motivation measured by lag of follow-up of audit recommendation. The result shows that the number (nominal value) completed follow-up recommendation is 52.3 % (41.11%). This number is quite low, given the rule that following-up the recommendation is mandatory for local governments to improve the quality of financial statements. If percentage of follow-up on audit recommendation on the previous period is low, it could probably decrease auditor motivation to perform high quality audit for the next assignment; since auditee does not committed to make an improvement based on the recommendation given. Follow-up on audit recommendation is one measure of implementation success of the tasks, functions and role of BPK-RI in encouraging and managing the state's financial responsibility.

Table 3
Descriptive Statistics of an Auditor's Quality Component

Variable	*Mean*	*Std. Dev.*	*Min*	*Max*	*Obs*
workload	1,25	0,46	1	3	1496
tenure	1,05	0,21	1	3	1496
role	2,76	0,66	1	4	1449
educ_1	0,88	0,33	0	1	1449
educ_2	0,27	0,44	0	1	1449
exp	9,00	4,96	0	34	1449
prof	0,60	1,25	0	5	1449
train_1	2,06	1,75	0	12	1552
train_2	65,40	56,11	0	475	1552
LTLHP	0,52	0,29	0	1	1553
LTLHP_NOM	0,41	0,36	0	1	1522

Description: WORKLOAD = Number of auditees assigned to audit team leader within a year; TENURE = The length of time (in years) audit the same entities; ROLE = The role of the team leader at the time of audit; 4 = Senior Team Leader; 3 = Junior Team Leader; 2 = Team Member; 1 = Other 4 = Senior Team Leader; 3 = Youth Team Leader; 2 = Team Members; 1 = Other; EDUC_1 = Educational background audit team leader, 1 if the accounting and 0 if other; EDUC_2 = Qualification audit team leader, Level of education of audit team leader, 1 = post-graduate degree and 0 = others; EXP = The length of time (in years) as BPK-RI's auditor; PROF =The length of time (in years) as audit team leader;TRAIN_1 = Number of training followed during a year; TRAIN_2 = Number of hours of training followed during a year; LTLRHP = Lag of number of recommendations completely followed-up plus that cannot be followed-up divided by the total number of recommendations; LTLRHP_NOM = Lag of

nominal value of recommendations completely followed-up plus that cannot be followed-up divided by the total nominal value of recommendations

The results of an auditor's quality variable reduction using principal component analysis methods yielded four components with eigenvalues more than one and explained 62% of the total variance. The next four component will be given the name accordance with the substance of each of component of the variables included, which are (1) EXPERIENCE which consist of ROLE, PROF, EXP, and EDUC_2; (2) TRAINING which consists of TRAIN_1 and TRAIN_2; (3) MOTIVATION which consist of TLRHP, TLRHP_NOM and WORKLOAD; (4) EDUCATION which consist of EDUC_1 and TENURE. Furthermore, all four components combine into single an auditor's quality index based on the percentage of variance explained by each component, as follows:

$$AQ = 0.3533\ (EXPERIENCE) + 0.2910\ (TRAINING) + 0.2040\ (MOTIVATION) + 0.1514\ (EDUCATION)$$

If the four components correlated with auditor's quality Index (AQ), all components has significant positively correlation (two-tailed test) with an auditor's quality. This suggests that an auditor's quality will be higher if the BPK-RI gives attention to all aspects of an auditor's quality.

Table 4 present the descriptive statistics for empirical model. The average percentage of nominal value of follow-up on audit recommendations during 2010-2012 is 32.23%. If we look further, there is a decline trend in the percentage of follow-up on audit recommendations examination results both in number and nominal. Central government and the BPK-RI as a regulator; should emphasize more on monitoring follow-up to improve the quality of local government financial statement. On average local governments achieve qualified audit opinion and there is a tendency of increase in unqualified opinion from 6.51% in 2010 to 22.90% in 2012. Meanwhile disclaimer and adverse opinion decreases over time. The improvement in the audit opinion deserves an appreciation because local governments have attempted to improve the audit opinion from year to year.

Table 4
Descriptive Statistics Empirical Model

Variable	*Obs*	*Mean*	*Std. Dev.*	*Min*	*Max*
$TLHP\_NOM_t$	1511	0.322	0.356	0	1
$OPINI_t$	1570	2.733	0.927	1	4
$OPINI_{t-1}$	1550	2.594	0.905	1	4
FINDINGt (Rp mio)	1433	15,725	69,211	0.12	1,334,660
FINDINGt-1 (Rp mio)	1578	19,903	170,655	29.04	6,431,585
$DPRD_t$	1500	35.486	12.926	19	100
AQ_{t-1}	902	0.034	0.505	-1.219	1.652
SIZEt (Rp mio)	1557	3,178	17,262	45,497	407,096
$DEPEND_t$	1557	0.881	0.123	0.223	2.078
$AGES_t$	1575	36.278	22.837	0	62
$SUPP_t$	1575	0.274	0.446	0	1
$BPKP_t$	1578	0.772	0.419	0	1
RE_ELECTS_t	1131	0.355	0.479	0	1

Description: $TLHP\_NOM_t$ = Nominal value of recommendations completely followed-up plus recommendation that cannot be followed-up divided by the total nominal value of recommendations; $OPINION_t$ = 1: Disclaimer Opinion, 2: Adverse Opinion, 3: Qualified Opinion, 4: Unqualified Opinion; $OPINI_{t-1}$ = Lag Opinion; $FINDINGS_t$ = log nominal value of audit findings; $FINDINGS_{t-1}$ = lag of the nominal value of the audit findings; DPRD = The number of parliament member ; AQ_t = An auditor's quality Index; AQ_{t-1} = lag An auditor's quality Index; $SIZE_t$ = Total Asset; $DEPEND_t$ = Transfer revenue divided by total revenue; $AGES_t$ = Age of Local Government Administrative Since There Establishment Act Local Government District/City; $SUPP_t$ = 1 if Local government head has economics/accounting background, 0 = others;$BPKP_t$ = 1 =Have BPKP's Assistance, 0 =Others; RE_ELECTS_t = 1 If the Local Government head is in the lead on the second period of 4 years , 0 = others Average nominal value of audit findings in a sample is Rp15.7 billion. There is a declining trend of nominal value of audit findings from Rp24.2 billion in 2009 to Rp11.8 billion in 2012. Average percentage number of DPRD is 35 person; with the minimum of 19 person[2] and maximum of 100 person. The highest percentage of number of legislature is 30 persons (15.80%); and the second highest is 45 persons (14.80%).

Hypothesis Testing Result

The empirical result for hypothesis testing is presented in table 5. Using GSEM; we combine equation (1) and (2) and see the result simultaneously.

Table 5
Empirical Testing Model 1 and Model 2

Generalized Structural Equation Model - Model 1

TLHP_NOMt <-		*Expected Sign*	*Coef.*	*P>z*	*Sig*
_CONS			0.940	0.068	
AQt-1	H1	(+)	0.125	0.000	***
$DPRD_t$	H2	(+)	0.003	0.005	**
$OPINI_{t-1}$		(+)	0.028	0.025	**
FINDINGSt-1		(+/-)	-0.087	0.000	***
SIZEt		(+)	-0.047	0.180	
$DEPEND_t$		(+)	-0.039	0.365	
$AGES_t$		(+)	0.002	0.004	***
$SUPP_t$		(+)	-0.016	0.254	

Generalized Structural Equation Model - Model 2

OPINIt <-		*Expected Sign*	*Coef.*	*P>z*	
$TLHP\_NOM_t$	H3	(+)	0.764	0.001	***
AQ_t		(+)	0.375	0.009	**
FINDINGSt		(-)	-0.676	0.000	***
SIZEt		(+)	1.653	0.000	***
$DEPEND_t$		(+)	-3.875	0.000	***

contd. table 5

OPINIt <-			*Expected Sign*	*Coef.*	*P>z*	
$AGES_t$			(+)	-0.007	0.037	**
$SUPP_t$			(+)	0.001	0.498	
$BPKP_t$			(+)	0.303	0.051	*
RE_ELECTS_t			(+)	0.321	0.021	**
Indirect Effects (AQt-1)		H4	(+)	0.096		***
Indirect Effects (DPRDt)		H5	(+)	0.003		***
Number of obs						1115
Opini	/cut1	12.684				
	/cut2	12.838				
	/cut3	16.810				

Description:

1. ***, **, * shows significance level 1%, 5%, 10% (one-tailed test)
2. $TLHP\_NOM_t$ = Nominal value of recommendations completely followed-up plus recommendation that cannot be followed-up divided by the total nominal value of recommendations; $OPINION_t$ = 1: Disclaimer Opinion, 2: Adverse Opinion, 3: Qualified Opinion, 4: Unqualified Opinion; $OPINI_{t-1}$ = Lag Opinion; $FINDINGS_t$ = log nominal value of audit findings; $FINDINGS_{t-1}$ = lag of the nominal value of the audit findings; DPRD = The number of parliament member ; AQ_t = An auditor's quality Index; AQ_{t-1} = lag An auditor's quality Index; $SIZE_t$ = Total Asset; $DEPEND_t$ = Transfer revenue divided by total revenue; $AGES_t$ = Age of Local Government Administrative Since There Establishment Act Local Government District/City; $SUPP_t$ = 1 if Local government head has economics/accounting background, 0 =others; $BPKP_t$ = 1 =Have BPKP's Assistance, 0 =Others; RE_ELECTS_t = 1 If the Local Government head is in the lead on the second period of 4 years , 0 = others

From table 5, we can see that (lag) of an auditor's quality has direct and positive effects on the follow-up of audit recommendation, so H1 is confirmed. These results indicate that high-quality auditors are able to produce appropriate recommendations that can be acted upon by the audited entity. This is in line with the recommendations mentioned in BPK's performance management report (2012) that the BPK are encouraged to formulate recommendations that can be acted upon by the audited entity so it reflects the effectiveness of the recommendations given.

Government Accontability Office (GAO, 1991) stated that when a recommendation is made to an auditee, management is basically responsible for implementing it. But auditors can do a great deal to improve the likelihood that a recommendation will be appropriately implemented by giving: (1) high quality recommendations: recommendation that does correct the basic cause of a deficiency, (2) commitment: committed to the need for action on a recommendation and do what needs to be done to get it implemented and (3) aggressive monitoring and follow-up: acceptance of a recommendation does not ensure results; continued attention is required until results are achieved. This regression result confirms all important point that highlighted by GAO (1991). High auditor competence reflects high an auditor's quality that can generate correct and appropriate recommendations that can correct basic cause of deficiency, so it could be effectively implemented by the auditee. Auditor should also have to monitor the follow-up because the more recommendations are acted upon, the better the quality of local government financial statements.

Further analysis about an auditor's quality component that affects follow-up of audit recommendation is presented in table 6.

Table 6
Additional Test on an Auditor's Quality Component

$TLHP\_NOM_t$	*Expected Sign*	*Coef.*	*P>t*	*Sig*
EXPERIENCEt-1	(+)	0.018	0.064	*
TRAININGt-1	(+)	0.005	0.318	
MOTIVATIONt-1	(+)	0.141	0.000	***
EDUCATIONt-1	(+)	0.010	0.208	
Number of Observation				809
R-squared				25.97%

Description:

1. ***, **, * shows significance level 1%, 5%, 10% (one-tailed test)
2. $TLHP\_NOM_t$ = Nominal value of recommendations completely followed-up plus recommendation that cannot be followed-up divided by the total nominal value of recommendations; $EXPERIENCE_t$ consists of role, experience as auditor, experience as team leader and level of education; $TRAINING_t$ consist of number of training and number of training hours; $MOTIVATION_t$ consist of lag of follow-up of audit recommendation in number and nominal value and workload; $EDUCATION_t$ consist of educational background and tenure

Table 6 shows that an auditor's quality components that affect the follow-up of auditor recommendation are experience and motivation. Experience is measured by the audit team leader's role, experience as an auditor and as audit team leader and level of education. Experience variables indicate the competence of auditors in conducting audit, meaning that the higher the competence, the higher the quality of audit recommendations given and appropriate with auditee's condition, so it will be easily followed. The second component affecting the follow-up of audit recommendation is motivation. It could be argued that the greater the percentage of follow-up implemented from previous periods, will motivate auditors to improve quality of the recommendations and have an impact on the higher follow-up for the next period[3].This result support Efendy (2010) which stated that motivation is one of the important factors that affect the quality of the audit results, especially in public sector.

Table 5 shows that the legislative's oversight has direct and positive effects on the follow-up of audit recommendations, so H2 is confirmed. In the special committee, DPRD discuss the audit result from BPK no later than two weeks after receiving the audited financial statements, and the report from discussion should be completed within a week. The report can consist of request to BPK to provide an explanation if found ambiguity on certain aspects; and/or request to BPK to conduct further examination to elaborate certain findings. Awareness of the importance of oversight function over the follow-up of audit recommendation has been carried out by many province/districts/municipalities since the establishment of Ministry Decree 13/2010. DPRD involves in active discussion with reporting entities or other relevant parties to ensure the extent to which the recommendations have been acted upon. The positive effectss between legislative sizes with follow-up of audit recommendation also shows that number of legislative member currently is in ideal condition; whom collective capability to conduct effective oversight is achieved.

There is a direct and positive effects between the follow-up of audit recommendation and audit opinion as can be seen from table 5, so that H3 is accepted. As illustrated in figure 1, follow-up of audit recommendation in 2012 contains corrective action done by management during the year 2012 based on the auditor's findings and or recommendations in 2011. So, the greater the percentage of recommendations were acted upon, the greater the opportunity for local governments to obtain unqualified audit opinion. In accordance with Liu and Lin (2012), audit institutions play a role in rectification process by impose sanctions directly, turning the case over to responsible party, and give suggestions to improve the weaknesses found and monitored the results of the audit recommendation. In Indonesia, although the BPK does not have the authority to impose sanctions directly, but the BPK continue to monitor previous year recommendations by preparing monitoring report of previous auditor recommendations as integral part of audited financial statement. If the auditee implements recommendation properly, the violation/errors/irregularities found should not be repeated for the next period, so the better the audit opinion. The better the audit opinion reflects better transparency and accountability in the managing public funds.

Result from table 5 confirms indirect positive effects between auditors quality to the audit opinions, through the follow-up of audit recommendation. The calculation of indirect effects is the multiplication of coefficient (a1) in models 1 and (c1) in model 3 and the result is significantly positive. We interpret this positive and indirect effects is that high-quality auditors can produce high quality recommendations that can be effectively implemented by auditee so the follow-up of audit recommendation is higher (positive effects), and it will impact on higher probabilities to obtain an unqualified audit opinion (positive effects) for the next period. This result implies on the importance of auditor role for improving local government financial management by increasing their competencies.

From table 5, we also confirm positive and indirect effects between the legislative's oversights and audit opinion. Ministry Decree 13/2010 mentioned that there are four actions done by the legislature in order to improve the audit opinion are: (1) legislature may encourage local governments to maintain an unqualified opinion; (2) legislature may conduct supervision and monitoring to correct the findings/recommendations to local governments that received a qualified opinion; (3) when adverse opinion received; legislature may propose to the local government head give sanction, advice and guidance to motivate reporting entities depends on the level and nature of audit findings; and (4) legislature may request information/clarification from BPK regarding disclaimer opinion given to local government. Strong legislative's oversight will result on higher follow-up of the audit recommendation, thus it increase higher probabilities for local governments to obtain an unqualified opinion.

Control Variable

In the first model, we show the positive effects of lag of audit opinion on follow-up of audit recommendation. These results are consistent with the signaling theory in which local government will maintain good audit opinion from previous year, by increasing the percentage of follow-up of audit recommendation this period. This is done to give the signal to the public that local government performed proper financial management. Lag of audit findings show negative effects on follow-up of audit recommendation. It implies that local government need more time to finish all recommendation given by BPK. These results are in line with Liu and Lin (2012) who also found that local government with

large audit findings, the audit rectification effort is lower, result on the higher the level of corruption. Local government characteristic that positively affect follow-up of audit recommendation is administrative age. Lesmana (2010) states that the longer the administrative age, the local government become more experienced in running the administrative system, including financial reporting process. Local government will report higher quality financial statement by implementing more audit recommendations.

In the second model, an auditor's quality (without lag) indicates positive and direct effects on audit opinion. High an auditor's quality in year (t) will provide appropriate proposed adjustments and if all the adjustments accepted by the auditee, the opinion in year (t) would be better. Nominal value of audit findings indicate direct and negative effects on audit opinion; means the higher the findings, the probability to obtain unqualified opinion is smaller. Size of local governments has positive and direct effects on the audit opinion, meaning that the larger the local government assets, the higher opportunity to obtain unqualified opinion. Local governments with high assets usually have lots of resources, including human resources who are competent to prepare financial statements, as well as follow-up audit findings or recommendations given by the auditor. This will give positive effects on the audit opinion. The next control variable is the degree of dependence of local governments show direct and negative effects on audit opinion. According to Wicaksono (2012), this happen because monitoring provided by the central government regarding transfer of revenue are still low, so there is less support to present better financial statements. Indonesia's State Comptroller Agency (BPKP)'s assistance in preparation of financial statements has direct and positive effects on audit opinion as well as re-elected local government head. Cohen and Leventis (2012) said the local government head ruling for the second period has had a lot of experience managing the financial area so better chance of getting unqualified opinion.

Additional Test

The first additional analysis performed to test whether there is direct effect between an auditor's quality and the legislative's oversight on audit opinion. The result of additional test shows positive effects of an auditor's quality to audit opinion. The higher the an auditor's quality urge auditee to be more concern with quality of financial statement, because local government are fully aware that high quality auditor can discover more finding including atypical finding that can affect audit opinion (Tubbs, 1992). Meanwhile, the legislative's oversight has no direct effects to audit opinion. This result support argument from main hypothesis and confirm that the the legislative's oversight only affect audit opinion through their monitoring effects on the follow-up of audit recommendation.

The next additional test performs to find out ideal number of legislature to conduct effective monitoring. We divided sample into province and districts/municipalities as the have different allocation of legislative member (Law No. 8/2012). Because of data insufficiency, we can only perform this test for districts/municipalities and made 5 different set of subsample which is: (1) 20-30 persons; (2) 31-40 persons; (3) 41-50 persons; (4) 20-35 persons; and (5) 36-50 persons[4]. The result of additional tests show that the the legislative's oversight has direct effects to follow-up of audit recommendation, as well as indirect effects to audit findings/opinion if the number of legislative member is 41-50 persons and 36-50 persons. This result implies that larger legislative size allow legislature to have complete expertise needed to perform effective monitoring role.

Sensitivity Analysis

We performed three sensitivity analysis to make sure the result from main model robust with different variable measurement, which are: (1) exclude provincial data since province has several different characteristics with districts/municipalities and (2) replace dependent variable of model 3 into binary logit, 1 if audit opinion in unqualified or qualified and 0 if audit opinion is adverse or disclaimer without give a ranking. The result from sensitivity analysis is robust for all hypothesis tested as explained in main analysis.

CONCLUSIONS, IMPLICATION AND LIMITATIONS

The purpose of this study is to analyze the direct and mediating effects of an auditor's quality and the legislative's oversight on the follow-up of audit recommendation and audit opinion. Sample for this study is Indonesia's local governments' (province/districts/municipalities) financial statement from 2010-2012. This study develop BPK's auditor's quality index from 11 auditor's quality variables. Using principle component analysis, we extract four components extracted that form an auditor's quality which is experience, training, motivation, and education which then combined into single an auditor's quality index that represent a comprehensive measure an auditor's quality.

The empirical test result shows that there is a direct effect between an auditor's quality and the legislative's oversight on the follow-up of audit recommendations, and indirect effects on audit opinion. High quality auditor is able to produce high quality recommendations that can be easily followed by the audited entity. Strong legislative's oversight encourages closer monitoring over the local government financial management so that local governments more committed to following up the audit recommendation. The higher the audit recommendations are acted upon, the better the quality of local government financial statements is, as shown by higher probability to achieve unqualified audit opinion.

The general implication of this study is to give empirical evidence that the responsibility to follow-up audit recommendation not only become single responsibility of local government. Auditor can take an active role by continually strive to improve the competencies and legislative member can perform oversight function properly according to the law in order to increase follow-up audit recommendations. This role will in turn can improve the quality of financial statements as shown better audit opinion. Specifically, this is the first study uses auditor's quality to measure audit quality in public sector. An auditor's quality index developed in this study is useful for the next research to measure an auditor's quality as well as audit quality that as far as our concern the research is limited.

This study is presenting comprehensive picture of auditor competence of BPK especially audit team leader competence. It is found that not all field work auditor in charge has a role as audit team leader, some of the auditors do not engage in compulsory training and less of them has post graduate degree. This is valuable input for BPK in quality assurance process to ensure all audit team leader has high competence as in this research shows positive effects on high quality of financial statements.

This study explores the factors that should be given an attention in order to achieve bureaucratic reform target in Indonesia. Central government can start to focus on local government that has high budget and high audit findings. Central government can design law/presidential decree as technical guidance in order to avoid repeated findings/violation/irregularities. Above all, central government has to impose sanctions/penalties seriously to local government that disobey the obligation to fully implement audit

recommendation as part of their commitment to increase transparency and accountability to support good public governance.

Finally, this study shows empirical evidence that oversight function by DPRD has direct and indirect effects on follow-up of audit recommendation and audit findings/opinion. This implies that legislative member should more intensively monitor the follow-up of audit recommendation, according to the authority given by the law. Ideal number of legislative member that has positive effects is 35-50 persons. This is one of the valuable input for central government together with legislative member to set the allocation of DPRD member, and not only based of number of inhabitants.

There are several limitations of this study. First, motivation as one of an auditor's quality component is measured using lag of previous year follow-up on audit recommendation. This measure cannot directly observe auditor motivation in conducting audit. Further research can complement this study by using more direct measures such as auditor perception on follow-up of audit recommendation. Second, numbers of audit findings use in this study do not classify findings according to type of audit finding and progress of audit findings. Further research can extend this research by focusing on type and progress of audit findings to see whether our main variable robust with different audit findings measurement. Finally, the legislative's oversights in this research are measured using legislature size only. Hermawan (2011) measures effective monitoring role of the board using size, activity and independence of the board. Further research can develop the legislative's oversight index that represents not only size but also activity and legislature competence.

ENDNOTES

1. According to the Law No. 15/2006; Badan Pemeriksa Keuangan (BPK) is the only governmental institution in Indonesia that is given authorities to conduct audit for all government entities.
2. Minimum legislative member of Districts/Municipalities is 20 persons; but data from Statistical Bureau shows that Tidore Kepulauan district has only 19 legislative members.
3. To further investigate the correlation between motivation and an auditor's quality, we made sub-sample data where the audit team leader perform audit for the same entities more than once, to ensure that the same team leader monitor follow-up previous their previous recommendation. The results of the correlation test shows a significant positive correlation, meaning the completion of the auditor's recommendations given in the previous period can increase the motivation of auditors to do a better job on the next audit.
4. We cannot performed sub sample data with 5 persons (ie 20-25; 26-30 etc) interval due to data insufficiency.

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